

STATEMENT OF KPMG LLP
BEFORE THE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
NOVEMBER 18, 2003

Representatives of KPMG are here today at the Subcommittee's invitation to discuss the tax services offered to KPMG clients in the past. Our representatives are prepared to provide the Subcommittee information regarding these complex tax strategies.

KPMG would like to take the opportunity to place this issue into an appropriately broader context.

There are four main points the firm would like to call to your attention:

1. The tax strategies being discussed today represent an earlier time at KPMG and a far different regulatory and marketplace environment. None of the strategies — nor anything like these tax strategies — is currently being presented by KPMG.
2. The strategies presented to our clients in the past were complex and technical, but were also consistent with the laws in place at the time, which were also extremely complicated.
3. The strategies did undergo intensive and thorough review at KPMG — a review process that resulted in vigorous, sometimes even heated, debate internally.
4. KPMG understands that the regulatory environment and marketplace conditions have changed. This understanding has led to significant changes within KPMG over the past three years from a policy, procedural, operational and structural perspective, and we are anxious to continue to demonstrate our commitment to improved clarity and fairness in the tax laws.

We would like to elaborate on each of these points.

First, the tax strategies that the Subcommittee will review were all presented by KPMG under regulatory and marketplace conditions that now do not exist. None of the strategies are currently being presented by KPMG — nor do we today present any aggressive tax strategies specifically designed to be sold to multiple clients, like FLIP, BLIPS, OPIS and SC2.

The tax strategies under examination by the Subcommittee were presented offered at a time when the U.S. economic boom was creating unprecedented individual wealth. That wealth generated demand for tax advice aimed at achieving tax savings. All major accounting firms, including KPMG, as well as prominent law firms, investment advisors and financial institutions offered tax advice, including these types of tax strategies, to clients.

KPMG responded to this highly competitive environment by presenting clients with strategies that could provide tax and non-tax benefits, and helping them implement those strategies. As you will hear at the hearings today and on Thursday, other firms often provided investment advisory and other non-tax services in connection with these transactions. All of these relationships were consistent with legal and professional requirements.

Second, it is true that these strategies were complicated and that the tax consequences turned on careful and detailed analyses of highly technical tax laws, regulations, rulings, and court opinions. But all of these tax strategies were consistent with the laws in place at the time and still applicable today.

It is important to note that no court has found them to be inconsistent with the tax laws and, in some cases, the IRS has agreed that taxpayers should be allowed to retain a portion of the tax benefits they claimed as a result of implementing a strategy.

For all of the strategies being reviewed by the Subcommittee, KPMG provided our clients with a “more likely than not” opinion as to their tax consequences. In other words, we informed our clients that based on the facts and actions they took, they would have a “more likely than not” — or a greater than 50 percent — chance of prevailing if the IRS challenged the transaction.

The tax laws are complicated and often times ambiguous and unsettled. As a result, KPMG’s opinions regarding these tax strategies were long, detailed and technical. Our clients were advised about how the timing of a transaction might affect their tax situation in any given year. They were also told that, in addition to a possible tax benefit, the law required a transaction to have a business purpose, profit, charitable or other non-tax motive. They were required to provide us with representations to that effect.

All of our clients were sophisticated and typically had their own attorneys, accountants and investment advisors. In each step of the process, KPMG made it very clear to the clients that they were undertaking complex transactions on which the law was ambiguous and often had not been clarified by either the IRS or the courts.

Our third point is that, because we understood that these tax strategies might be subject to an IRS challenge, KPMG put them through a rigorous review process before they were approved and offered to clients. That process was thorough, detailed and independent. After mid-1997, both KPMG’s Washington National Tax (“WNT”) and Department of Professional Practice — Tax (“DPP”) groups were involved in reviewing whether KPMG could provide a “more likely than not” opinion on these strategies before they were presented to multiple clients. The tax strategies also underwent very careful analysis of the IRS requirements for registering tax shelters in effect at the time.

Many tax partners with different areas of expertise participated in the review process. That, combined with the fact that we were dealing with a “more likely than not” opinion, is the reason there was a lively debate among partners over the interpretation and application of tax laws, regulations, rulings and opinions. It is also why it sometimes took many months for KPMG to review and approve or reject a strategy. Many of the materials provided to the Subcommittee document this lively internal debate.

Lastly, we understand that the regulatory environment and marketplace conditions have changed, and that we have had to change too. The manner in which we marketed some tax strategies, like SC2, to multiple clients is not something we do or would do today.

In recent comments, Senator Levin has pointed to telemarketing of aggressive tax strategies as a prime example of questionable practices. KPMG did make “cold calls” to potential clients in connection with the SC2 strategy. While these calls were intended only to pre-screen S-corporations to determine if they were suitable for an SC2 presentation, we agree in retrospect that they reflected poor judgment.

We want the Subcommittee to know that KPMG has also carefully, thoroughly and painfully examined — and reexamined — the past tax practices and policies of our firm. This introspective review has led to a number of substantial and meaningful changes over the past several years at KPMG.

We have learned important lessons from the past practices of our firm and the tax services profession. First and foremost is that we must hold the conduct of everyone in KPMG to the highest and most rigorous standard. Today, the standard by which we judge that conduct is whether any actions could in any way risk the reputation of the firm or our clients. If it could, we will not do it. Our reputation, our integrity and our credibility are simply too important to put at risk.

Some of the more significant changes and new procedures in place at KPMG include:

1. We have substantially changed KPMG’s tax services and offerings. Today, KPMG offers our clients tax services that are tailored to address their distinct business objectives and tax planning needs. We no longer present or implement aggressive tax strategies specifically designed to be sold to multiple clients, like FLIP, BLIPS, OPIS, and SC2. The look-alike tax strategies provided on a large scale to clients in the past have all been discontinued. Additionally, KPMG does not and will not accept any new engagements for advice and opinions on tax shelters that have been listed and deemed abusive by the IRS.

2. Over the past three years, KPMG has developed an increasingly more rigorous and formal review and oversight procedure within our tax practice. All tax strategies must undergo three levels of review and approval.

First, we have created the new position of Partner in Charge of Tax Risk and Regulatory Affairs. This partner analyzes each tax strategy proposed by the firm to determine if it could in any way put KPMG and our clients at risk.

The Partner in Charge of our Washington National Tax practice must sign off on the technical merits of all significant tax strategies.

Finally, the Department of Professional Practice - Tax reviews all tax strategies to ensure that they are in compliance with the firm’s policies and procedures.

Each of these partners has veto power over any tax strategy proposed. If any tax strategy puts KPMG or our clients at risk, is not technically correct and defensible or is inconsistent with

KPMG's policies or procedures, it will not be approved. All of these partners also operate independently from our tax operations and business development functions.

3. We have also revised our procedures with respect to list maintenance and registration obligations under the Internal Revenue Code. In early 2000, KPMG established the Practice Procedure and Administration group in Washington National Tax as the contact point for analysis of disclosure, list maintenance and registration issues. KPMG's procedures and training programs have been updated continuously since that time, tracking developments in the law and fine tuning our compliance processes.

4. Many of the practices and positions responsible for developing past tax strategies are no longer part of the firm. In 2002, two practices in particular, Stratecon and Innovative Solutions, were eliminated. These practices were responsible for developing tax strategies specifically designed to be presented to multiple clients. Many of the partners who were part of these practices are no longer with the firm. We have also abolished positions such as National Deployment Champions and Area Deployment Champions, which were charged with marketing these tax strategies to our clients. We also eliminated the Tax Innovation Center, which was responsible for marketing look-alike tax strategies designed to be sold to multiple clients.

5. Our tax training program now focuses on technical developments rather than marketing strategies. We have discontinued weekly tax partner calls, training programs and other activities that focused on marketing tax services. Tax partner calls and training now concentrate on changes in the law and technical tax developments.

6. In 2002, KPMG implemented a firmwide Compliance and Ethics Hotline. This hotline is designed to encourage anyone within KPMG to report their concerns about any potentially unethical, improper, or illegal conduct within the firm. In addition to the confidential hotline, longstanding channels of communication are available to our employees, including our network of professional practice partners, Area Risk Management partners, the Office of General Counsel, and the Department of Professional Practice.

7. We have put in place more stringent rules about offering tax services to executives at our SEC-audit clients. As you know, consistent with the Sarbanes-Oxley Act, the Audit Committees of our SEC-audit clients must pre-approve all services provided by KPMG to the company, including tax services. We have also applied this discipline to tax advice offered to executives of SEC-audit clients. We disclose to the Audit Committees of these clients the names of the executives who receive personal tax services from KPMG, regardless of whether the company or the executive is paying for them, and require Audit Committee approval for certain types of transactions and services to executives. Where our audit client has a more restrictive policy, we scrupulously abide by it.

8. We are constantly looking at additional steps we can take to improve and enforce compliance with these policies and practices. We encourage anyone at KPMG — partners or staff — to bring to our attention immediately any practices or policies that are inconsistent with these guiding principles and procedures. We also encourage everyone at KPMG to provide suggestions to us on any additional policies or procedures that would help ensure that we are providing the highest quality tax services and advice to our clients.

We believe that our tax advice was sound. But we realize that it is not enough for KPMG to come before the Subcommittee and say we stand behind the technical compliance of the tax services we provided. With these policies and procedures in place, KPMG is confident that the past practices involving tax strategies would not happen at the firm today.

KPMG takes seriously our responsibility to restore confidence and trust in the accounting profession. We want to work with Congress — as well as the IRS and other policymakers — as you consider sound and responsible approaches to better define what tax strategies are allowable under the law and to further strengthen the enforcement of the tax code, including increased resources for the IRS and improved coordination among regulatory agencies.

Thank you.