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U.S. BUSINESS NEWS

KPMG Apologizes for Tax Shelters

Firm Takes Responsibility For Improper Tax Shelters; U.S. Debates Indictment

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Staff Reporter of THE WALL STREET JOURNAL
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• Tax Shelter Litigation (U.S v. KPMG, LLP)[3]
Provided by FindLaw (www.findlaw.com[4])

Seeking to stave off possible federal criminal charges that it promoted improper tax shelters and obstructed probes into them, KPMG LLP acknowledged that former partners had acted illegally and apologized.

"KPMG takes full responsibility for the unlawful conduct by former KPMG partners during that period, and we deeply regret that it occurred," the firm said in a statement issued yesterday.

The public contrition has been common with other firms and companies under legal pressure, but it hasn't been with KPMG. It came after The Wall Street Journal reported[1] that Justice Department officials were debating whether to indict the firm, and it marks a reversal. The firm for years used aggressive litigation tactics that set it apart from the three other Big Four accounting firms, which moved more quickly to resolve allegations that they peddled improper tax shelters. KPMG's past uncompromising stance is at the heart of a possible obstruction charge, a person familiar with the matter said.

The new tack reflects a broader change in attitude among corporations facing regulatory scrutiny, with many racing to cooperate by turning over damaging information and jettisoning culpable employees. That change was prompted by the 2002 indictment and conviction of Arthur Andersen for obstruction, which devastated the storied accounting firm as clients fled. The Supreme Court recently reversed that conviction, but the damage was already done.

"After Andersen, everybody knows they have to comply or face devastation," said Evan Barr, a former federal prosecutor who now is at law firm Steptoe & Johnson LLP. "The consequences of resistance are too great."

Other companies have suffered the wrath of authorities angered by tough legal tactics in recent months. A Florida judge issued a default judgment against **Morgan Stanley** after finding that the Wall Street firm "deliberately" violated court orders to turn over documents related to allegations in a civil suit by financier Ronald Perelman.

Marsh & McLennan Cos. was forced to undergo a management shakeup after New York state investigators said its top executives weren't being forthcoming enough in a probe of its insurance brokerage firm.

KPMG's tough tactics were on full display in January 2003, after the Securities and Exchange Commission accused it in a suit of "knowingly or recklessly misleading" investors by allowing **Xerox** Corp. to file four years of false financial statements. Rather than settling quickly, KPMG girded for a drawn-out battle, issuing a 2,500-word rebuttal that called some SEC claims "absurd" and predicted "vindication." In April, the firm agreed to pay $22.5 million to settle the charges. The SEC says the payment, consisting of disgorgement of audit fees as well as penalties, is the largest ever made to it by an audit firm. KPMG didn't admit or deny the charges, but it agreed to several reforms, including the establishment of an internal whistle-blower procedure.

KPMG's tax shelters have been under scrutiny for years as part of a broader probe of the industry. KPMG initially defended the shelters as proper and stood by the partners involved in them, sending some to testify before a congressional panel. The Internal Revenue Service in 2002 demanded documents relating to several shelters, but KPMG resisted on the grounds that many were protected by attorney-client privilege.

Washington federal Judge Thomas Hogan later rejected most of KPMG's arguments and ordered the firm to give investigators what they wanted. (See the court's opinion.[2]) He said he had come to the "inescapable conclusion that KPMG has taken steps since the IRS investigation began that have been designed to hide its tax-shelter activities." He cited more than 30 instances of documents the firm had improperly claimed were privileged, said KPMG stalled in turning over other documents and had misled investigators about its role in promoting the tax shelters, and called a KPMG document log "inaccurate, incomplete and even misleading."

After a contentious congressional hearing into the shelters in the fall of 2003, KPMG replaced the lawyers who had been handling the matter with Robert S. Bennett of Skadden, Arps, Meagher & Flom and began adopting a more conciliatory approach. The firm successfully pressed then-Deputy Chairman Jeffrey Stein, who had overseen the shelters, to retire, and other partners were put on leave or reassigned. At an April 2004 court hearing, KPMG agreed to waive attorney-client privilege for shelter-related documents.

In yesterday's statement, KPMG said it would "continue to cooperate fully" with investigators and pointed to measures it had taken to prevent future misconduct, including parting ways with "those responsible for wrongdoing," ending its promotion of the improper tax shelters and instituting "firm-wide structural, cultural and governance reforms."

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