

EXHIBIT P

.....

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

MEMORANDUM

June 27, 2005

TO: KPMG File

FROM: **Joseph L. Barloon**

Re: June 27, 2005 Meeting with U.S. Attorney

On June 27, 2005, Robert S. Bennett, Armando Gomez, and **Joseph L. Barloon of Skadden, Arps, Slate, Meagher & Flom LLP** and Judge Sven Erik Holmes and Joseph I. Loonan of KPMG LLP ("KPMG" or "the Firm") met with United States Attorney David Kelley, Celeste Koeleveld, and prosecutors Shirah Neiman, Stan Okula, and Justin Weddle of the Southern District. Treasury agent Rich Kando also attended the meeting, which began at approximately 9:30 a.m. and lasted until approximately 10:30 a.m.¹

This memorandum serves to reflect my thoughts, recollections, impressions, conclusions and opinions concerning this meeting, in connection with a grand jury investigation of KPMG LLP. It is not a verbatim recitation of the meeting. This memorandum also serves to communicate **certain** facts and mental impressions to KPMG in connection with the provision of legal advice. Accordingly, this memorandum and its contents are protected from

(continued ...)

•

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

Agreement Terms Outlined by Kelley

Kelley opened the meeting by telling us that the Deputy Attorney General, in consultation with the Attorney General, had determined that he would like the Southern District to try to work out a deferred prosecution agreement with KPMG, but had not ruled out filing charges against KPMG.

Kelley emphasized however, that the Deputy Attorney General had not ruled out filing charges against

KPMG. He added that he was assuming that we wanted to take this step forward and that he wanted the negotiations to move forward quickly.

With regard to specific terms of any deferred prosecution agreement, Kelley related the following:

- *Duration:* Kelley told us that the term of any deferred prosecution agreement should be five years, with a statute of limitations waiver of six years.
- *Admissions:* Kelley told us that he envisioned that KPMG would agree to a statement "along the lines of what we have been pushing." Kelley told us that his Office had drafted a statement of facts, but indicated that it required some

(...continued)

discovery by virtue of the attorney-client and work product privileges. In addition, as this meeting was a settlement discussion, this memorandum and all statements included herein are inadmissible pursuant to Federal Rule of Criminal Procedure 11(f) and Federal Rule of Evidence 410.

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

"tinkering" before he could share that document with us. He indicated that there would be very little flexibility for revision once he provided the statement to us and that he did not want to get "bogged down" with wordsmithing the statement

- *Monetary Payments:* In terms of fines and restitution, Kelley envisioned a lump sum payment with additional amounts paid over the duration of the agreement. He did not want to get into specifics regarding financial payments, and told us that **he wanted to review the Firm's financial statements at a separate meeting so that he could "figure out what is fair and appropriate" for KPMG to pay.** He told us that his determination as to an appropriate monetary amount would not be made with reference to settlement amounts in other matters. He **identified four components of the payment: (i) the amount of fees received by KPMG for FL:IP, OPIS; BIJPS, and SOS transactions, including the Greenberg transactions; (ii) gross unrecoverable tax that would have been recovered "but for KPMG's obstruction"; (iii) interest on taxes due and owing to the government as a result of the shelter losses, less any interest collected by the IRS; and (iv) the promoter penalty applicable to KPMG.**

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

- *Tax Practice Restrictions:* With regard to limitations on KPMG's tax practice, Kelley told us that a resolution "along the lines of my proposal" would be acceptable. He said that he knew we "wanted a broader tax practice," and indicated that **he would allow KPMG to retain "what's essential to the audit function."**
- *Monitor:* Kelley told us that he wanted a monitor for the five-year term of the agreement. He said that it was not his role to determine who "needed to go" at the Finn, and **he wanted to structure the monitor's duties and authority to allow him to effect personnel actions in some fashion.**
- *Cooperation:* K.PMG would have to agree to continue to cooperate with the investigation as part of any resolution.
- *SEC/PCAOB:* Kelley affirmed that **any settlement would be conditioned on an agreement from the Securities and Exchange Commission ("SEC") and the Public Company Oversight Board ("PCAOB") to take no disciplinary action against KPMG and he said that we could try to "get some type of language" from those regulators that would support KPMG.**

Discussion of Proposed Terms

Bennett began his response by telling Kelley that **we had read his position as indicating that he "didn't want to put KPMG under," which we appreciated.** Nevertheless, Bennett told Kelley, the terms and conditions of any agreement with the government would be crucial to the Firm's survival: KPMG "can die by indictment or we can die by deferred prosecution." Bennett added that **KPMG understood that it would have to pay "a lot" and that there would be "a lot of pain."** He stated that KPMG was hopeful that it could reach an agreement but **KPMG would not agree to any resolution that would "put it under."**

Bennett noted that he perceived **the Deputy Attorney General as wanting to vindicate the interests of justice with regard to tax fraud and obstruction.** He said, though, that such an outcome has to be done in a way that would not destroy KPMG. At this point, Neiman asked for an example. **Bennett said that, based on our discussion, we would not have a problem with "obstruction-type language" in the statement of facts, but that K.PMG would not want an obstruction component in the charge itself. Such a charge "would kill us."** Bennett stated that we would like the U.S. Attorney's Office to consider not filing a charge at all. Instead, the charge could be attached to the agreement and "held in abeyance." "If we're not successful at

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

convincing you to do that," he said, then we would need to discuss what the exact charge would be. **Obstruction was a problem because "it's the kind of charge that could kill us."** Bennett also stated that the amount of money to be paid by K.PMG was another example where a term of the deferred prosecution agreement could destroy the Firm.

Bennett said that he did not want the statement that KPMG could not agree to certain terms in an agreement to be perceived as a threat.

Rather, he simply wanted to make sure that Kelley could not assume that "any deferred prosecution agreement would be preferable to an indictment" The benefit of an indictment is that it "at least gives you time to unwind." Depending on the terms, however, a deferred prosecution agreement could cause the immediate destruction of the Firm.

Kelley asked Bennett to **address the impact of filing a charge based on tax fraud versus filing a charge based on obstruction. Bennett responded that KPMG "could probably survive" a tax fraud charge but that an obstruction charge "would kill us."** He noted that the charge filed in the *AmSouth* deferred prosecution agreement did not include an obstruction component although the statement of facts in that agreement set forth the necessary factual predicate for an obstruction charge.

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

Kelley asked whether the AmSouth agreement had included a statute of limitations waiver on obstruction charges. Bennett replied that it had not but suggested that such a provision could be included in an agreement

At this point, **Judge Holmes spoke about his recent discussions with audit committees and lawyers advising audit committees of KPMG clients. He noted that clients have **been** consulting whether continuing to retain KPMG would be in violation of committee members' standard of care. He said that KPMG was "*in extremis*."** The Firm was forecasting that it would suffer a significant drop in revenue with the filing of charges relating to the "evasion of taxes." He said that he told audit committees that there were elements of obstruction in the case. He told them that there was an "intentional failure to produce documents." **The clients understood that fact but they made it clear that "if you have capital '0' Obstruction" in the charge then they may not be able to continue to retain KPMG. Neiman asked why they viewed an obstruction charge as so much worse than the tax fraud charges. Holmes responded that clients viewed an obstruction charge as involving something "at the heart of the system."**

Holmes indicated that it was **important that this problem be viewed as a tax problem.** He said that KPMG's proposal to restrict its tax practice would entail

lost annual profits of \$62 million, but that shedding those businesses "makes it clear that this was a tax problem." **He said that the inclusion of an obstruction charge in the agreement would cause audit committees to view the entire firm as a "criminal enterprise."**¹¹

Neiman asked why the obstruction charge would have such an impact given that the underlying facts would in any event be described in the statement of facts. **Bennett responded that "some obstruction-type language could be part of [an allocation] if it can be focused on people who are gone."** Bennett stated that if there is language in the statement relating to obstruction but no obstruction charge, then KPMG would at least have a chance at convincing the audit committees to stay with KPMG. Holmes added that, **if both sides had a mutual goal of permitting the survival of KPMG**, then they would need to put themselves in the position of audit committees, who had an obligation to consider whether continuing to retain KPMG was in violation of the standard of care for a committee member. At this point Kelley cut off further discussion, stating, "I get the gist."¹¹

Discussion of Changes to the Tax Practice and the Remaining Audit Function

We then provided an overview of the ways in which KPMG proposed to restructure its tax practice. We noted that KPMG had given a lot of thought to the

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

different ways to "shrink the tax practice." **Kelley said that he thought that he was probably thinking of more expansive changes than we had in mind.** We responded that KPMG was "willing to give up lucrative, profitable business" in an effort to shed everything that was not necessary to maintain the audit practice. The businesses that we felt we had to keep did not necessarily make money but they were necessary in order for KPMG to continue to be able to perform the services for audit clients. For example, Loonan noted that partners in federal tax are involved deeply in the review of client financial statements. He added that the SEC and PCAOB have reminded audit firms that they need to work with client tax professionals throughout the year in order to ensure a quality audit

We added that we had engaged in a great deal of internal and external consultation in determining which parts of the tax practice were necessary to the audit practice. The Firm had asked audit clients, such as Pfizer, what capabilities KPMG needed to retain in the tax area to be able to conduct sophisticated audits. **We had been informed that certain practices, such as mergers and acquisitions, federal tax, valuations, and international taxation, were necessary to support the audit function.**

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

Neiman said that she was still confused as to what tax service KPMG would continue to offer. Kelley cut off further discussion on this issue and asked for a presentation within the next day or two regarding the tax segments that KPMG proposed to retain.

Holmes reiterated that KPMG's proposed restrictions on its tax practice would have a significant financial impact on KPMG because **the restrictions would cause KPMG to lose \$62 million annually in lost profit.** Accordingly, the tax practice restrictions had to be viewed as a "penalty component." He asked Kelley to keep that in mind when considering the other components of a resolution.

Homes added that he had asked Ellen Zimiles, who was a former prosecutor and who headed up KPMG's anti-money laundering practice, to work with him and KPMG's financial personnel over the weekend in order to determine KPMG's ability to pay. He said that he would like her to participate in any follow-up discussions relating to KPMG's financial statements. He said that he wanted to make sure that we were completely open with the government and that the government believed that it could trust KPMG.

Discussion Relating to Suspension & Debarment

Bennett said that KPMG would like the Department of Justice ("DOJ") as part of the resolution to issue a statement affirming that it would continue to use the Firm as its auditor. Kelley responded by saying that he did not think DOJ had much of a choice but to continue with its contract with KPMG. He added that, if DOJ says nothing to the contrary, then KPMG's continued role as DOJ auditor would be a signal to the marketplace. Loonan said that KPMG wanted to get an agreement from General Services Administration ("GSA" that the fact the Firm had entered into a deferred prosecution agreement would not prevent it from being deemed "presently responsible" for purposes of federal contracting. Kelley responded that there were so many agencies that he did not think KPMG could get all of the assurances it was seeking prior to entering into an agreement. Loonan said that the key was having GSA on board. He suggested expediting GSA's time frame for consideration of the issue. Kelley indicated that he would "hear it out as it unfolds." Holmes added, "We just want to front-run it a little bit." Kelley replied by saying that he would let us know if we could go ahead and have discussions with GSA.

Length of Agreement

Holmes raised concerns about the proposed length of the agreement. Holmes noted that all previous deferred prosecution agreements were three years in duration or less and stated that a five-year agreement would be unprecedented. Holmes stated that **audit committees wanted KPMG to get this investigation behind it**, and that such a long agreement, during which time KPMG would be subject to a monitor, would make it more difficult to view the problem as a "past problem" and not a present problem.

Holmes reiterated that previous deferred prosecution agreements were much shorter than five years. **Kelley responded, half-jokingly, that "you guys are really bad," and asked what term we had in mind.** Holmes said that an appropriate term would be two years from the end of the fiscal year. **Kelley responded, "Two years is not going to happen." Holmes responded that, if KPMG couldn't get things into shape by the end of two years, then, "We should be indicted."** Neiman said that it "takes a long time to change culture," adding that, in the case of Consolidated Edison, it took nearly seven years to change the culture. Holmes said that he viewed his own charge as including changing KPMG's culture. Neiman responded that the issue was not Holmes; rather, the issue was that there were 20,000 employees at

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

KPMG and it was necessary to have a long-term agreement with a monitor to ensure that the culture among the 20,000 employees changed.

Kelley stated "Let's say I cut it [the duration] back. What about having a clause [in the deferred prosecution agreement] that would make it extend-able?" We indicated that such an arrangement might be acceptable .

IRS Settlement

Loonan told Kelley that he wanted to ensure that the resolution would be "global" in that it would resolve the IRS audit as well as the government investigation. **Nieman disagreed and stated that we would have to work out any promoter penalty with the IRS.** We said that we had always understood that this was to be a global resolution. We added that the **IRS told us that it had given the SDNY the information needed to determine the promoter penalty and that we had not yet received that information.** Kelly seemed impatient with this discussion and said that he would get back to us on the issues of the "obstruction language" and the "term of the agreement" He asked us to provide him with more detail on the tax practice proposal and scheduled a meeting for the following day to discuss KPMG's financial statements. He made it clear that **he planned to participate in the discussion of KPMG's financial condition.**

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

Civil Litigation

After scheduling a follow-up meeting we briefly discussed a proposed settlement of civil litigation. Bennett noted that the total amount of payments KPMG would be making to resolve the tax shelter issues had to include civil litigation payments. **Bennett added that KPMG's insurance companies have informed the Firm that payments for civil shelter claims would not be covered under the terms of its policies.**

Holmes also addressed the Firm's attempt to settle the civil suits as part of a class action. He noted that KPMG and Milberg Weiss were working with two retired judges to try to reach a settlement. He said he understood that Kelley's office had expressed concern about a proposed resolution of the civil litigation. He said he did not think that there was anything wrong with attempting to negotiate such a settlement, and that any objections to the settlement could be adequately addressed during a fairness hearing. He added that the government could participate in the fairness hearing in order to ensure that the plaintiffs will have met all of their obligations to the government. **Neiman asserted that "the IRS needs to be made whole before the people [plaintiffs] need to be made whole."** Holmes indicated that KPMG could not simply ignore the civil litigation: "This is like rent. We have to pay

*Attorney Work Product
Privileged & Confidential
Settlement Discussion*

it." Weddle added that KPMG's obligation to pay the government should take precedence over any payment to civil claimants who were "co-conspirators."

Neiman said, "The bottom line is that the government needs to be paid back. If you have to move out of your posh headquarters, then so be it." Holmes ended discussion of this topic by noting that any payment to civil plaintiffs would not occur until 2006.

