



KPMG
International
Annual Review
2006

Chairman's foreword

KPMG INTERNATIONAL

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2006 was a good year for KPMG and our profession. But at a time of rapid change, the need for bold reform and leadership remains.

USD **16.9** billion

Combined revenue of member firms

This represents growth of 9.6 percent in local currency and 7.6 percent in U.S. dollars.

42%

Average growth in BRIC (Brazil, Russia, India and China) countries

Our decision to invest early and heavily in important new markets in Asia, Europe and Latin America is reaping strong returns.

113,000

Number of people worldwide

KPMG member firms headcount increased by 9,000 people last year.

Last year proved to be a positive year for business despite a testing environment in which companies and our profession continued to face intense public scrutiny and regulatory change. The year was very much about learning to respond to rapid change while delivering quality services, growth and opportunity.

The six largest accountancy networks published a vision statement to inspire and invite dialogue between all stakeholders involved in the global economy and capital markets. We feel open communication and engagement is needed if—collectively—we are to keep enhancing audit quality and increasing the relevance and usefulness of financial reporting for investors. KPMG sees this as an excellent opportunity to reexamine the role and responsibilities of auditors and to discuss the best way forward for auditing and reporting, with all concerned sharing their perspectives. I will discuss my own perspectives on some of the issues later in this foreword. Over the next year, the debate will be pursued through roundtable talks and consultations working with investors, regulators and companies.

KPMG's performance

KPMG member firms achieved excellent progress in 2006. We saw the benefits of our early investments in the fastest-developing economies, including China, India, Russia and key markets in Latin America. We also achieved healthy growth in a number of other European and Asian markets. As a result, combined revenue was up 9.6 percent in local currency to USD16.9 billion. Our fastest-growing business was Advisory with 12.9 percent local growth to USD5.28 billion. In the U.S. KPMG, like many professional firms, faces difficult trading conditions but the prospects for this market remain positive for the long term and we aim to continue to provide the highest quality Audit, Tax and Advisory services to our clients.

Ultimately, our success is due to the truly exceptional people who work for KPMG firms the world over and the distinctive culture we have created. I thank everyone for their tremendous work last year.

The quality and commitment of the people within KPMG is critical to our long-term success and I am delighted that member firms are succeeding in



Mike Rake
Chairman—KPMG International

attracting and developing high caliber individuals at all levels. People see KPMG as a great place to develop a career, which reflects well on our efforts to create career opportunities and to make our profession a respected and vibrant part of the business community. This is vital to our reputation.

The success of this employer of choice strategy was recognised in independent research carried out for us in 2006. It showed that the quality and professionalism of KPMG people stands out, wherever we operate. In many countries we also received widespread external recognition during the year. In the U.K., for example, we were voted best big company to work for by *The Sunday Times*—an award based on a detailed survey completed by KPMG people; in the Netherlands we were ranked third in the 2006 top 50 best workplaces by *Intermediar* magazine; in Canada we were listed as one of Canada's 2007 top 100 employers by *Maclean's* magazine; and in the U.S., *Fortune* magazine placed us among the 2007 best 100 companies to work for.

I am also pleased that so many people within the KPMG network share my belief in the value of corporate responsibility, and are supporting individuals, organizations and award-

winning projects that can make a tangible difference to society. As the "Supporting sustainable communities" pages in this Review demonstrate, corporate responsibility is now a very important part of what makes KPMG special and how we contribute to the world.

Adapting to the new world

At the end of our financial year we moved to take advantage of the changes in the European Union 8th Company Law Directive when we announced plans to merge the U.K. and German member firms. The new entity continues an evolution we began in 1999 when we established our regional structure.

The new entity will take effect in October 2007 and looks set to become Europe's largest accountancy practice. Other European KPMG member firms may join this organization in due course. The move, welcomed by many commentators, should enable us to serve global clients even more effectively and provide exciting international opportunities for KPMG people.

Progress on reform

Enhanced standards, regulation and oversight all have an important role to play in helping to assure the public

that the capital markets can operate efficiently and ethically.

While the quality and integrity of reporting must be strengthened even further, this should be done without imposing such a burden that companies are prevented from fulfilling their most important role of creating wealth and employment.

I believe it is important that new standards and regulatory regimes reflect the international nature of business with consistency around the world and reciprocal arrangements across borders.

Our profession worked hard to meet demands for reform in 2006 and practical progress has been achieved. The successful application of International Financial Reporting Standards (IFRS) in nearly 100 countries was a huge achievement. The debate around the future convergence of standards—notably IFRS and U.S. Generally Accepted Accounting Principles (GAAP)—remains lively, however. There is a broad consensus



KPMG International Management Committee

Mike Rake *Chairman—KPMG International*

Shown from left to right, top to bottom:

Timothy P. Flynn *Chairman—Americas*

John Harrison *Chairman—Asia Pacific*

Rolf Nonnenmacher *Head of KPMG's member firm in Germany*

Ben van der Veer *Chairman—Europe, Middle East, Africa*

Mike Wareing *Chief Executive Officer—KPMG International*



in favor of equivalence between standards and removal of the reconciliation requirement, but many believe a period of stability in IFRS and extensive consultation is required before we move toward full harmonization. Our hope is that any future global auditing and accounting standards are principles-based and avoid unnecessary duplication, complexity and cost.

We welcomed the full introduction of the 8th Directive in 2006 in Europe. This has far-reaching consequences for business and our profession, including setting out a principles-based approach and mandating statutory audit committees. We also welcomed the launch of the International Forum of Independent Audit Regulators, a confederation of independent national oversight bodies, and we hope to see increasing equivalence of standards and mutuality between national regulators. KPMG has played a strong and constructive role in helping shape this new regulatory environment.

Independence, choice and competition

Some believe auditors should be able to detect all fraud, including any accounting misdemeanors. The alternative view is that the role of the auditor is one of stewardship, and value lies in providing an

independent and expert challenge to management; but to expect the audit to uncover all wrongdoing is unrealistic. This "expectation gap" must be addressed. The profession should do a better job of explaining its role in the detection of fraud and outlining the inherent limitations of the traditional audit. I believe we must work together with business to develop new approaches to detecting high-level fraud.

Published in 2006, London Economics' report on "Liability Reform for the E.U." confirmed that the likelihood of a catastrophic claim against a major audit firm remains high. Such a collapse would further reduce choice in the audit market and harm confidence in financial reporting.

Liability should be limited to a proportionate share or cap of any loss actually caused by an auditor's negligence, and we welcome the progress on reform achieved in several jurisdictions in 2006, including Spain, Italy, the U.K., Canada and Australia. At a global level, however, inconsistency remains and should be addressed urgently. Reform would reduce the risk of a Big Four collapse and remove the prohibitive risks for mid-tier networks, encouraging them to compete for international assignments. KPMG supports such a move, which would certainly be in the public interest.

Taking a long-term view

When I speak to people, one of the recurring themes I hear about business and the capital markets is the increasing importance of a long-term view.

In addition to the issue of climate change and the environment is the implementation of economic strategy. Different economies must have an appetite to compete, but in most cases removing artificial barriers and embracing choice, competition and opportunity is likely to benefit the national interest. By contrast, narrow economic nationalism can cost jobs, investment and prosperity at home and abroad.

Politicians have the opportunity to lead on this issue. We must hope that—after last year's breakdown in the Doha Development Trade round—there will be real progress in future World Trade Organization talks.

Free, open markets and genuine global competition are the best ways to generate prosperity long-term for all. This was the conclusion of a far-reaching paper prepared for the E.U.—U.S. summit in June by the Trans-Atlantic Business Dialogue, of which KPMG International is a member. In it we argued for greater cooperation on regulation, the liberalization of capital markets, tougher measures to protect intellectual

People want to see governments, companies and those of us who support businesses thinking about tomorrow's consequences when we make today's decisions.



property and security systems that would enhance both safety and trade. But we warned that all of these necessary aims would be seriously compromised, and the global trading system stifled, if economic protectionism were once again to reassert itself.

Looking ahead

It is likely we will see slower economic growth in 2007 and we face a number of risks, including volatility in oil prices and other commodities, concerns about key housing markets and fluctuating interest rates. Despite these anxieties, the broad consensus is that the general environment for business looks healthy. Certainly, at KPMG we are looking forward to the next 12 months.

So we enter 2007 with confidence. I am delighted to be serving as Chairman, working with an outstanding group of people at an exciting and demanding time for KPMG, for member firm clients and for our many stakeholders.

Mike Rake
Chairman—KPMG International

INDIA MEETING NEW EXPECTATIONS

KPMG International Chairman Mike Rake co-chaired the World Economic Forum's India Economic Summit in November 2006. The summit examined the Indian economy and business environment in terms of competitiveness, growth, infrastructure development and risk management. More than 500 business and government leaders from around the world met to learn, debate and help shape the country's growth agenda.

"India is an important market," comments Mike. "This summit addressed many topics including infrastructure, education, healthcare, energy and water conservation, from both domestic consumption and foreign investment perspective."

KPMG in India opened in 1993, and has established offices in Mumbai, Delhi, Bangalore, Chennai, Kolkata and Hyderabad. In 2006, KPMG in India opened its seventh office—in Pune, western India. The new office provides the entire portfolio of Audit, Tax and Advisory services.

Mike Rake is pictured above with: (left) Kamal Nath—*Minister of Commerce and Industry of India* and (right) Nandan M. Nilekani—*CEO and MD, Infosys Technologies, India*

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