



280 Park Avenue
New York, N.Y. 10017
8th Floor

Telephone 212-909-5600
Fax 212-909-5699

November 6, 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

PCAOB Rulemaking Docket Matter No. 009
Proposed Rule Regarding Certain Terms Used in
Auditing and Related Professional Practice Standards

Dear Mr. Secretary:

KPMG appreciates this opportunity to comment on the Public Company Accounting Oversight Board's (Board) Proposed Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* (Proposed Rule). KPMG fully supports the Board's efforts to improve financial reporting, corporate governance and audit quality in the interest of furthering the public interest and restoring confidence in our capital markets system.

In general, we agree with the definitions in the Proposed Rule for terms representing unconditional obligations, obligations that are presumptively mandatory and subsidiary obligations. In addition, we agree with the Board that the Interim Standards adopted by the Board in April 2003 contain few unconditional imperatives and support the Board's expressed intention to use sparingly those terms that represent unconditional obligations on the part of the registered public accounting firms and associated personnel. Our comments outlined below represent matters for consideration by the Board as it deliberates a final rule on this subject.

Impact on Interim Standards

As indicated in the Proposed Rule, the Board would use the proposed definitions when interpreting obligations of registered public accounting firms and associated personnel pursuant to the provisions of Interim Standards. The Proposed Rule points out (i) the terminology is "generally consistent with the manner in which the profession currently interprets existing auditing literature" and (ii) the Public Oversight Board's Panel on Audit Effectiveness raised concerns about the clarity and consistency in existing standards of the various levels of imperatives. However, we believe a comprehensive analysis of how and in what context the defined terms are used in the Interim Standards is necessary in order to determine whether current practice is consistent with the proposed

definitions. We encourage the Board to undertake such an analysis and carefully evaluate whether, and to what extent, use of the defined terms in the Interim Standards is consistent with the Board's expectations relative to professional obligations of registered public accounting firms and their associated personnel.

As an example, consider paragraph 80 of AU Section 319, *Consideration of Internal Control in a Financial Statement Audit*. This paragraph includes the terms, 'should consider,' 'generally' and 'must provide' (see below).

.80 The conclusion reached as a result of assessing control risk is referred to as the assessed level of control risk. In determining the evidential matter necessary to support an assessed level of control risk below the maximum level, the auditor should consider the characteristics of evidential matter about control risk discussed in paragraphs 90 through 104. Generally, however, the lower the assessed level of control risk, the greater the assurance the evidential matter must provide that the controls relevant to an assertion are designed and operating effectively.

Applying the proposed definitions, we interpret the last sentence of paragraph 80 of AU Section 319 to reflect an obligation that is presumptively mandatory (generally), not an obligation that is unconditional (must). This is but one instance where terms defined in the Proposed Rule and appearing in the Interim Standards may require further consideration to ensure consistent interpretation by all interested parties.

The Board indicated in Release 2003-006, *Establishment of Interim Professional Auditing Standards*, that the Interim Standards will be reviewed on a standard-by-standard basis to determine if they should be modified, repealed, replaced or adopted permanently. As the review of each interim standard is completed, appropriate actions will be taken before a standard becomes a permanent standard. As an alternative to the comprehensive analysis noted above, the Board may consider use of the defined terms as each Interim Standard is reviewed and propose changes as deemed appropriate to reflect the intended professional obligation.

Conduct Prior to the Effective Date of a Final Rule

Footnote 6 of the release indicates, "...the principles in Rule 3101(a) will usually also apply to the interpretation of the interim standards with respect to conduct occurring prior to the effective date of Rule 3101(b). However, in the case of conduct prior to the effective date of the rule, the Board will consider, on a case-by-case basis, in light of all of the circumstances, the proper interpretation of imperatives in the existing standards." Footnote 6 applies to a sentence in the release that refers to prospective application of the defined terms in Rule 3101(a) to the Interim Standards. Further, in Appendix 2 to the release, the Board notes that "[r]ule 3101(b) will apply to conduct occurring after the effective date of the rule." It is unclear to us how footnote 6 to the release affects the prospective application of Rule 3101.

Because of the potential inconsistencies in the interpretation of defined terms used in the Interim Standards, one example of which we note above, and consistent with the language included in Appendix 2 to the release, we do not believe it is appropriate for the Board to retroactively impose provisions of the Proposed Rule to work performed prior to the effective date of Rule 3101. In addition, we believe it would be premature for the provisions of Rule 3101 to become effective relative to the Interim Standards until such time as the Board has completed one of the analyses of the Interim Standards suggested in the immediately preceding section of our letter.

Application of “Should Consider”

Footnote 2 to the release clarifies that for an action or procedure the auditor “should consider,” only consideration of the action or procedure is presumptively mandatory, not the action or procedure itself. We recommend that this clarification also be included in the text of Rule 3101(a)(2).

* * * * *

If you have questions regarding the information included in this letter, please contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com or Craig W. Crawford, (212) 909-5536, ccrawford@kpmg.com.

Yours sincerely,

KPMG LLP

