



KPMG LLP
757 Third Avenue
New York, NY 10017

Telephone 212 909 5600
Fax 212 909 5699
Internet www.us.kpmg.com

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D. C. 20006-2803

PCAOB Rulemaking Docket Matter No. 035
Proposed Standards for Attestation Engagements Related to Broker Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards

Dear Mr. Secretary:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's (the "PCAOB" or the "Board") Release No. 2011-004, *Proposed Standards for Attestation Engagements Related to Broker Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards* (the "Proposed Standards"). We support the Board's efforts to align its attestation standards more closely with the auditor's responsibilities under Securities and Exchange Commission's (the "SEC" or "Commission") Proposed Rule 17a-5 (the "Proposed Rule") relative to audits of broker-dealers. In general, we support the Board's Proposed Standards. However, we believe that certain elements of the Proposed Standards require further clarification and guidance, and we have summarized our observations and recommendations for your consideration below. Our comments and observations relate to the following areas:

- Audit Scalability
- Material Non-Compliance
- Engagement Quality Reviews
- Examination and Review Reports
- Exemption Report
- Timing and Extent of Certain Compliance Tests
- Inquiries of Regulatory Agencies
- KPMG Comments on Commission's Proposed Rule

We have also commented on the Commission's Proposed Rule in our letter dated August 25, 2011 that covers many of the topical areas discussed below. We encourage the PCAOB to also review that letter in conjunction with our observations herein.



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Audit Scalability

The Proposed Standards require that procedures to be performed as part of an examination or review engagement be designed to be “scalable based on the broker’s or dealer’s size and complexity.”¹ We believe that auditors would benefit from additional guidance in this regard, including where possible, specific examples of the application of scalability to both compliance examination and exemption review engagements. We believe that without such guidance, application of the audit scalability concept could vary greatly across the audit profession and may inhibit the Board’s intent of striking an appropriate balance between increasing investor protection and minimizing audit costs.

Material Non-Compliance

The Proposed Standards require auditors to plan and perform examination procedures to detect instances that, individually or in combination, would result in “material non-compliance”. The Proposed Standards also indicate that the auditor should consider “relevant quantitative and qualitative factors”² and “devote more attention to the matters that are most significant to compliance with the specified Financial Responsibility Rules”³ in planning and performing procedures for a compliance examination engagement.

As the scope of the proposed examination is a compliance attestation engagement, we suggest that the definition of “material non-compliance” as used in AT §601.64-67 of the PCAOB Standards and Related Rules also be used for purposes of the Proposed Standards, *i.e.*, “noncompliance with the applicable requirements that the practitioner believes have a material effect on the entity’s compliance.”⁴ In addition, we believe that the Board should provide guidance with respect to qualitative and quantitative factors that may impact the determination of “materiality” consistent with the objectives of a compliance attestation engagement.⁵

Finally, consistent with our response to the SEC on the Proposed Rule, we suggest that the Board and Commission collaborate to provide further guidance and clarification related to the interaction between (i) material errors discovered during the audit of the financial statements and/or material weaknesses in internal control over financial reporting (“ICFR”) identified, and (ii) the determination of instances of “material non-compliance” and/or material weaknesses in internal control over compliance with the Financial Responsibility Rules.

¹ See PCAOB Release 2011-004, Section III. A.

² See PCAOB Release 2011-004, Appendix 4, Section I.C.3.

³ See PCAOB Release 2011-004, Appendix 4, Section I.C.5.

⁴ See AT §601.64 of the PCAOB Standards and Related Rules.

⁵ See AT §601.36 of the PCAOB Standards and Related Rules.



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Engagement Quality Reviews

The Proposed Standards include certain amendments to PCAOB Auditing Standard No. 7, *Engagement Quality Review* (“AS 7”) that would require “an engagement quality review and concurring approval of issuance for attestation examination engagements and review engagements of broker-dealers.”⁶ This requirement would apply to both carrying broker-dealers that file a Compliance Report and non-carrying broker-dealers that are exempt from the Compliance Report requirement, and file an Exemption Report. In addition, we note that the application of AS 7 to broker-dealers will also require an Engagement Quality Review (“EQR”) as part of the financial statement audit.

Non-Carrying Broker-Dealers

Under the Proposed Rule, broker-dealers that do not maintain customer funds or securities would file an Exemption Report and therefore would not be subject to the compliance examination requirement. Non-carrying broker-dealers are typically smaller entities that pose less risk to investors. As a result, the proposed review standard mandates fewer and less burdensome procedures when compared to the proposed examination standard.

We believe that requiring an EQR under AS 7 for non-carrying broker-dealers may present additional costs in excess of any related benefits. The Board should evaluate whether the application of AS 7 is necessary and cost-justified for the financial statement audit and review of the Exemption Report of non-carrying broker-dealers.

EQR Procedures

AS 7 includes specific guidance regarding the EQR process for audit engagements⁷ as well as reviews of interim financial information.⁸ However, AS 7 does not include guidance for attestation examination or review engagements, nor do the Proposed Standards provide for any amendments to AS 7 to include such guidance. We suggest that the PCAOB evaluate how AS 7 applies to an attestation engagement, and whether any amendments to AS 7 are appropriate.

Examination and Review Reports

Explanatory Language

Broker-dealers’ assertions are principally based upon regulatory requirements (e.g., net capital computations pursuant to Rule 15c3-1 and, reserve requirements pursuant to Rule 15c3-3) that may be subject to legal interpretation. As a result, we believe that the scope paragraph of examination and review reports should be modified to include language indicating that the auditor’s examination or review did not provide for a legal determination of a broker-dealer’s compliance with specific requirements, similar to established guidance within the PCAOB’s Standards and Related Rules.⁹

⁶ See PCAOB Release 2011-004, Section V. A.

⁷ See AS 7, paragraphs 9 – 13.

⁸ See AS 7, paragraphs 14 – 18.

⁹ See AT §601.56 of the PCAOB Standards and Related Rules.



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Similarly, evaluating a broker-dealer's compliance with regulatory requirements may be based upon interpretations of laws, regulations, or rules established by the Commission and/or Designated Examining Authorities ("DEA"). Therefore, we believe the Proposed Standards should permit the inclusion of a paragraph within the examination and review reports stating the description and the source of interpretations made by the broker-dealer's management, similar to established guidance within the PCAOB's Standards and Related Rules.¹⁰

Restriction of Use

Audit firms previously have restricted the use of internal control reports required by Rule 17a-5 to the board of directors, management, the Commission, and other regulatory agencies that rely on Rule 17a-5(g) under the Securities Exchange Act of 1934.¹¹ However, the Proposed Standards do not include provisions that allow auditors to restrict the use of examination and review reports to specified parties.¹²

We believe that a restriction on the use of an auditor's examination or review report is appropriate, given that general users of these reports may not have a sufficient understanding of the subject matter to which they relate, such as the Financial Responsibility Rules or the exemptive provisions of Rule 15c3-3. As such, we request that the PCAOB include a provision allowing auditors to restrict the use of examination and review reports, as deemed appropriate by the auditors.

Modifications of Standardized Reports

The Proposed Standards include examples of standardized examination and review reports, and indicate that these reports should be modified if certain conditions exist.¹³ However, the Proposed Standards do not provide examples of modified reports. We believe audit firms would benefit from specific examples of report modifications, similar to the standard reports included within the Proposed Standards.

Exemption Report

Under the Proposed Rule, the Exemption Report would require broker-dealers to assert that they are exempt from Rule 15c3-3 and identify the provision of that Rule that they are relying on to qualify for the exemption. However, the Proposed Rule does not indicate whether broker-dealers should make these assertions for an annual period (e.g. for the year ending December 31) or an "as of date" (e.g. as of December 31). In our comment letter on the Proposed Rule, we stated that the Commission's final rule should clarify this matter. We believe the PCAOB's Proposed Standards should also indicate, consistent with the Commission's final rule, whether the auditor's review of the Exemption Report is for an annual period or an "as of date."

¹⁰ See AT §601.59 of the PCAOB Standards and Related Rules which provides the following as an example of such a paragraph, which should be placed directly following the scope paragraph: "We have been informed that, under [name of entity]'s interpretation of [identify the compliance requirement], [explain the source and nature of the relevant interpretation]."

¹¹ See AICPA Audit and Accounting Guide: *Brokers and Dealers in Securities*, Appendix C.

¹² See PCAOB Release 2011-004, Appendix 4, page 32 and page 50.

¹³ See PCAOB Release 2011-004, Appendix A, paragraphs A1 and Appendix 2, paragraphs 20 - 21.



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Timing and Extent of Certain Compliance Tests

The Proposed Standards provide examples of certain procedures that auditors are required to perform to obtain evidence about the existence of customer funds or securities.¹⁴ We believe that the Board should provide clarification regarding the extent and timing of these procedures. If the Board believes that these procedures can be performed at an interim date, auditors would benefit from additional guidance, including, where possible, specific examples of roll-forward procedures.

Inquiries of Regulatory Agencies

The Proposed Standards indicate that “if the broker or dealer has sent or received correspondence with the SEC or the broker’s or dealer’s DEA that is relevant to compliance with the exemption conditions, the auditor should read such correspondence and, when necessary in the circumstances, make inquiries of the regulatory agencies.”¹⁵ We suggest that the Board provide guidance related to the interaction between auditors and examiners consistent with the American Institute of Certified Public Accountants *Audit and Accounting Guide for Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies*, Chapter 5 section on “Auditor and Examiner Relationship.”

KPMG Comments on Commission’s Proposed Rule

We have commented on the Commission’s Proposed Rule related to topics on internal control over compliance with the Financial Responsibility Rules and transition timelines and effective dates. We provide these comments due to their interaction with the Board’s Proposed Standards, and to stress the need for further coordination between the Board and the Commission.

Internal Control over Compliance with the Financial Responsibility Rules

Pursuant to the Commission’s Proposed Rule, “a broker-dealer could not assert that its internal control over compliance with the Financial Responsibility Rules during the fiscal year was effective if one or more material weaknesses exist with respect to internal control over compliance.”¹⁶ Consistent with our comment letter to the Commission on the Proposed Rule, we believe that a broker-dealer should be allowed to assert compliance with the Financial Responsibility Rules if it can identify deficiencies, implement effective controls, and test their operating effectiveness prior to year-end, and if the auditor also can adequately test the operating effectiveness of the remediated controls. Such a revision would both allow for the opportunity of remediation and align the Commission’s Proposed Rule and the Board’s Proposed Standards with the requirements in Section 404 of the Sarbanes-Oxley Act of 2002 related to an issuer’s report on ICFR.

¹⁴ See PCAOB Release 2011-004, Appendix A, paragraph 26

¹⁵ See PCAOB Release 2011-004, Appendix 2, paragraph 10 (2).

¹⁶ See SEC Release No. 34-64676, *Broker-Dealer Reports*, Section II, B. 1.



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Transition Timelines and Effective Dates

The Proposed Standards have an effective date for fiscal years ending on or after September 15, 2012, which is consistent with the end of the transition period for carrying broker-dealers under the Proposed Rule, but does not coincide with the Proposed Rule's effective date of fiscal years ending on or after December 15, 2011. We believe the PCAOB's proposed effective date is reasonable. In our comment letter on the Proposed Rule, we had expressed concerns to the Commission about its proposed effective date, a summary of which follows.

With the Commission's effective date approximately four months after the end of the comment period for the Proposed Rule (August 26, 2011), we have concerns about the time available for broker-dealers to prepare the additional reports and documentation needed to support their assertions to facilitate an auditor's examination or review, as applicable. Additionally, this schedule would leave minimal time for auditors to review, assess and comply with the new attestation and reporting requirements.

As detailed in our response to the Proposed Rule, we believe that by the end of the comment period, planning and interim procedures for December 31, 2011 audit engagements may have already begun. A change in the rules and procedures at that point in time would require the revision of already-established audit plans thereby creating both inefficiencies and unnecessary costs.

As communicated in our comment letter on the Proposed Rule, we believe a transition to the Commission's final rule could be accomplished more effectively and efficiently if that final rule were to become effective consistent with the Board's proposed effective date of September 15, 2012.

* * * * *

In closing, we would like to reiterate our support of the Board's efforts to redefine the professional standards applicable to broker-dealer audits. We trust that our comments and observations will assist the Board to that end.

If you have any questions regarding our comments or other information included in this letter, please do not hesitate to contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com, or Karl E. Ruhry, (212) 872-3133, kruhry@kpmg.com.

Very truly yours,

KPMG LLP



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cc:

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