International Headquarters

KPMG Building
Burg. Rijnderslaan 20
1185 MC Amstelveen
The Netherlands

Mail address:
PO Box 74111
1070 BC Amsterdam
The Netherlands

Tel +31 (20) 656 6700
Fax +31 (20) 656 6777
BTW no. NL 0067 82 310 B 01
www.kpmg.com

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

Our ref njl/am/lj

28 March 2003

Dear Mr Secretary

Rulemaking Docket Matter No. 001

KPMG greatly appreciates the opportunity to comment on both the Public Company Accounting Oversight Board's (Board) proposed rule, *Proposal of Registration System for Public Accounting Firms*, (Proposed Rule) issued 7 March 2003 pursuant to Section 102 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), and the issues to be discussed at the roundtable on the registration of non-US auditors to be held on 31 March 2003.

The overarching objective, we believe, of the provisions of Sarbanes-Oxley, including Section 102, is one of furthering the public interest through improving financial reporting, governance, and audit quality. KPMG wholeheartedly supports the efforts of the Board in helping to achieve this objective.

KPMG International is a Swiss non-operating association which functions as an umbrella organisation to approximately 100 KPMG member firms in countries around the world, to whom it licenses the KPMG name. Each KPMG member firm is autonomous, with its own separate ownership and governance structure. The KPMG member firms do not share profits amongst themselves, and they are not subject to control by any other member firm or by KPMG International.

The observations set forth in this letter reflect the assessment by KPMG LLP (the US member firm of KPMG International) and other member firms of KPMG International (collectively, KPMG) of the Proposed Rule's potential effect on US as well as non-US firms. Many of the KPMG member firms outside the United States have a direct interest in the new rules because of the number of issuers and affiliates of issuers domiciled outside the United States that they audit. Adoption in final form of all the provisions in the Proposed Rule without consideration of the

matters discussed in this letter, will in our view result in significant cost and other inefficiencies, conflicts with overseas requirements and potential delays in registration and therefore delays in issuers' financial reporting processes.

We set out for your consideration in the attached memorandum our comments on the Proposed Rule, including suggestions that we believe will improve the overall quality and effectiveness of the final rule in a cost-effective manner, consistent with the objectives of Sarbanes-Oxley. Our principal comments are summarised below.

General comments on the Proposed Rules

- The Board's registration process should be complete and fair and comport to the standards of constitutional due process. We have provided suggestions to improve the transparency of the application process, including: clarification of acceptance criteria; institution of procedures governing disapproval of an application, including a hearing and appeals process; establishment of procedures for the withdrawal of an application; provisional registration and acceleration of review of re-submissions in response to requests for additional information; and, designation of "as-of" dates for information provided by the applicant.

- The proposals require applicants to provide fee information relative to their issuer audit clients and the applicant's entire practice. Fees to clients for professional services are not consistently defined in the Proposed Rule, and are not consistent with fee information that is required to be provided to other regulatory bodies, in particular, the Securities and Exchange Commission (Commission or SEC). We believe this will create confusion to the public and require unnecessary duplication of costs and efforts in reporting fee information. Fee information should be based on the fees disclosed in public filings by the issuers. Provision should be made for such data to conform to the Commission's fee disclosure rules utilised by issuers.

- Certain terms as defined in the Proposed Rules are overly broad, resulting in unintended consequences. Our observations and recommendations relate to *accountant, associated entity, person associated with a public accounting firm (and related terms),* and *play a substantial role in the preparation or furnishing of an audit report.*

- The proposals that the applicant agree to "secure and enforce" from each associated person a consent to "cooperate in and comply with any request for testimony or the production of documents made by the [Board]" raise concern. The legal ability of the applicant to force existing employees to waive any rights that they may have in this

regard as a condition of their continued employment is a matter of local law and could represent an unlawful material change in conditions of employment.

- The Proposed Rules in Part V require reporting of legal and administrative proceedings in five categories covering a prior period of one to ten years. The Board should balance the considerable burden on the applicant of assembling this material, in the form requested (which could potentially involve the manual review of many hundreds of case files) with the limited value of such material to the Board. We believe the information required in Part V should be limited to pending matters as provided for in Sarbanes-Oxley.

- Overall the Proposed Rules require applicants to provide a large amount of information all of which will require the Board to establish a complex and costly infrastructure to collect, maintain and analyse. We question both the need for the Board to obtain certain specific information, and whether Sarbanes-Oxley provides a basis to request such information. We believe that the Board should provide an analysis of the costs and benefits of its proposals, and specifically address and provide its rationale for requesting information that is not explicitly contemplated by Sarbanes-Oxley.

Issues unique to foreign firms

- The inspection of foreign public accounting firms should be exercised by a competent regulatory authority, either national (such as exists in Canada or the United Kingdom) or supranational (such as the European Union) where one exists, otherwise there will be dual oversight for audit firms operating in major countries outside of the US. Such dual oversight is undesirable as it will be inefficient, costly, will potentially lead to conflicts with national regulators and finally in some instances will be illegal where it breaches national sovereignty. In relation to disciplinary matters, the Board should work together with national regulators to ascertain how the disciplinary process could operate without creating conflict.

- The registration process is complicated for foreign public accounting firms by the existence of local laws. Certain obligations associated with the proposed registration requirements conflict with domestic legislation in a number of countries (including in Germany, Japan, Switzerland Israel and UK) in particular around the issue of client and third party confidentiality, data protection and employment law. All of these conflicts must be resolved before foreign public accounting firms can register with the Board since foreign firms cannot register if it means breaching local laws.

- To obtain the requested information for the very large number of individual practices that will need to register, most public accounting firms will need to develop new systems and processes, all of which will take time. The registration process will be further complicated by the need to 'translate' certain parts of Form 1 into non-US equivalents (especially for determining local equivalent legislation). Consequently, we believe that an extension of at least one year should be granted to foreign public accounting firms before registration is required.

Finally, we would emphasise that we believe that all of our suggestions can be implemented in a manner which would improve the functioning of the Board whilst remaining faithful to the overall objectives of Sarbanes-Oxley.

If you wish to clarify any comments you find unclear or answer any questions our comments raise, then please call or write to Neil Lerner + (44) 207 311 8620, neil.lerner@kpmg.co.uk. with regard to the matters affecting non-U.S. firms, and Michael A. Conway, (212) 909-5555, mconway@kpmg.com, with regard to matters affecting the U.S. firm.

Yours faithfully,

KPMG

Contents

Page locations for our detailed comments are given in the abbreviated table of contents below.

PART 1 – GENERAL COMMENTS

The constitutional requirements of administrative due process

The Board is domiciled in the United States of America. US constitutional privileges and due process protections, including Fourth, Fifth, and Fourteenth Amendment rights, provide protection against governmental action. To be sure, Sarbanes-Oxley explicitly states that the Board is not a government agency. Section 101(a) of Sarbanes-Oxley states that the Board is a non-profit corporation, and Sec. 101(b) states that "[t]he Board shall not be an agency or establishment of the United States Government." However, these statements are not determinative of whether the Board is subject to constitutional restraints. Courts have held that a statutory pronouncement that an entity is a private corporation and not a government actor will not prevent that entity from being deemed to be a government actor if it is otherwise sufficiently governmental in character. See Lebron v. National R.R. Passenger Corp., 513 U.S. 374, 392-93, 397 (1995)[1]. The factors set forth in Lugar v. Edmondson Oil Co., 457 U.S. 922, 937 (1982), demonstrate that the actions of the Board are "fairly attributable" to the government.[2]

Factors that are determinative here include: (1) the establishment of a Board is required by Congress (see Sec. 101(a)); (2) Board members will be appointed by government officials (see Sec. 101(e)(4)); (3) Board members can be removed by the Commission (see Sec. 101(e)(6)); (4) the Board will enforce the federal securities laws relating to the preparation and issuance of audit reports (see Sec. 101(c)(6)); (5) Board members will enjoy immunity from civil liability "in the same manner and to the same extent as an employee of the Federal Government in similar circumstances" (Sec. 105(b)(6)); and (6) the Board is given the government-like power to levy fees on issuers (see Sec. 109(b)).

Consequently, KPMG believes that it is in the best interests of the Board and the public to ensure that the Board's rules and conduct comport with the standards of constitutional due process, including its procedures governing the registration process. We believe that result will ultimately enhance the effectiveness and integrity of the Board and its processes. Portions of

[1] In Lebron, for example, the Court held that Amtrak was a government actor for First Amendment purposes despite the fact that Amtrak's authorisation statute stated that it was not an agency or establishment of the federal government. The Court stated that the federal government "is not able to evade the most solemn obligations imposed in the Constitution by simply resorting to the corporate form" (id. at 397), and held that "where the Government creates a corporation by special law, for the furtherance of governmental objectives, and retains for itself permanent authority to appoint a majority of the directors of that corporation, the corporation is part of the Government for purposes of the First Amendment." Id. at 400.

[2] In *Lugar*, the Supreme Court concluded that otherwise private conduct may constitute state action where: (i) the state has exercised its coercive power on a private actor, or provided significant encouragement, either overt or covert, to a private actor; (ii) the private actor has been delegated a public function of the state; (iii) the private actor is controlled by an "agency of the state," or when the private actor is entwined with governmental policies or when government is entwined in the private actor's management or control.

this letter will comment on the specific features of the proposed rules that appear not to comport with the minimum due process requirements.

The Registration Application Process

The Board's registration process should be complete and fair. However, we believe that some elements of such a process may be missing and one element in particular should be modified.

Application process and acceptance criteria

Proposed Rule 2105 provides little indication of the process the Board will follow when taking action on an application, and provides no criteria to be considered when deciding whether to approve or disapprove an application. Indeed, proposed Rule 2105(a) provides essentially complete discretion to the Board in both of these matters. We believe that it is in the interests of the public, the Board, issuers, and the applicants that the Proposed Rule describe the Board's process and identify the criteria to be applied when making a decision on an application. It will help all interested parties better understand the conditions necessary for approval. It will provide the Board with a standard against which to measure its performance relative to this important responsibility. It will provide applicants with an understanding of the Board's expectations, which will facilitate an effective and efficient application process. Moreover, it will help ensure that the process is fair and is conducted uniformly for all applicants.

Absence of a procedure governing disapproval of registration

KPMG has concerns arising from the failure to provide an applicant the opportunity to be heard in the event that the Board disapproves or delays approval of the application for registration under proposed Rule 2105(b)(2)(ii), and the failure to include procedures permitting review of an adverse decision following such a hearing. We believe that the Board should acknowledge that administrative due process requires these procedures at a minimum when the Board seeks to take ultimate action. There can be no doubt of the significance of an adverse application decision, which would represent the death knell for many firms. The lack of protective procedures for application disapproval is placed in even starker contrast by Section 102(c)(2) of Sarbanes-Oxley, which provides that disapproval results in an automatic disciplinary sanction; while the Board observes (at footnote 19 of its proposing release) that the disciplinary sanction is subject to SEC review, no such review is provided for the disapproval decision itself.

Accordingly, KPMG recommends that the Board provide by rule for procedures permitting a hearing on a determination of disapproval of an application, and permitting meaningful review of a final disapproval decision.

Amendment or withdrawal of application

Proposed Rule 2105 does not provide rules and forms governing the amendment or withdrawal of pending registration applications and withdrawal from registration after approval of a registration application. Footnote 20 of the Board's proposing release indicates that the Board may consider such rules and forms. We believe such elements of the registration application process are essential and should be implemented concurrent with the registration process.

Requests for additional information and provisional registration

Under proposed Rule 2105(c), if the Board requests more information from an applicant, the application, as supplemented with the additional information, is treated as if it is a new application. This has the effect of re-starting the 45-day period the Board is allowed to take action on an application. Although the proposed rule may be within the statutory authority permitted by Section 102(c)(1) of Sarbanes-Oxley, we do not believe that this approach is reasonable, particularly as it relates to an application prepared and filed with the Board in good faith, as it may result in the unnecessary delay of an otherwise timely-filed application beyond the date registration is required by law.

In recognition of the vast amount of information that is required to be filed with the application, much of which accounting firms have not previously been required to accumulate and report, the Board should adopt a different approach to the receipt and amendment of applications. Provided that the applicant demonstrates a good faith effort to comply with the proposed Rules, the Board should recognise receipt of the application and allow for subsequent amendment to address additional information requests by the Board without re-starting the 45-day period. The Board also should provide for a provisional registration for a reasonable period after the required registration date during which the applicant may accumulate and submit any remaining information necessary for a complete application. In making a decision on whether to provide such a provisional registration, we recognise that the Board may need to exercise judgment regarding the significance of any missing information. One could analogise to the Commission's procedures pertaining to SEC staff comments provided to an issuer with respect to its regulatory filings. In such situations, the Commission has the authority to halt public trading of the issuer's stock, but generally would not do so simply because the SEC staff had requested some additional information, even though the comment process may extend over several months. To the extent the Board does not provide for a provisional registration, the response time after providing additional information pursuant to the Board's request should be limited to 10 days or less.

Other registration matters

The Board should acknowledge that individual accountants are not required to register even though certain jurisdictions may require individual accountants to sign the auditor's report in their name rather than or in addition to the name of the firm.

A number of items in the application, such as in Part II, relating to issuers and fees, Part V relating to proceedings, Part VI relating to accounting disagreements, and Part VII, relating to the roster of accountants, require substantial data accumulation. The form should make it clear that the applicant may designate an "as of" date for purposes of accumulating this data. The "as of" date should be allowed within 180 days of the registration date. A shorter time frame could result in the need to re-accumulate data should an applicant be required to file an amended application or, worse, the inability to accumulate the data in time to file an initial application.

Definitions of Terms Employed in Rules

Accountant

Proposed Rule 1001(a) defines the term "accountant." We recognise that the Board's definition of accountant applies to a natural person rather than a legal entity. However, as currently defined, the term "accountant" is too broad and could cause unnecessary reporting of certain individuals. As defined in proposed Rule 1001(a), accountants include those who possess either an undergraduate or higher degree in accounting or a license or certification authorizing them to engage in the business of auditing or accounting. For example, a literal interpretation of the definition requires an applicant to include in its registration form (Roster of Associated Accountants) any firm employee who holds an accounting degree, regardless of whether the individual participates in or contributes to the preparation of audit reports for an issuer. For instance, many KPMG member firms employ individuals with undergraduate degrees in accounting who perform only administrative or ministerial functions for the firm and are not associated with providing audit or other professional services to issuers. However, as the term "accountant" is currently defined, these individuals would be included as part of the registration process.

We do not believe the foregoing interpretation is the intention of the Board. As such, we recommend that the Board revise the definition of accountant to include certified public accountants who hold current valid licenses, and natural persons who hold an undergraduate or higher degree in either accounting or another field and who participate in audits of issuer audit clients. Only these persons should be recognised as associated with a registered public accounting firm included in the applicant's Roster of Associated Accountants.

Similar revisions also would be required for Appendices 2 and 3 – Part VII – Roster of Associated Accountants.

Additionally, there may be some confusion in trying to apply one definition of accountant to both U.S. domestic and foreign natural persons because of differences in local country licensing and educational requirements. The Board may wish to consider including a separate definition of accountant as it applies to foreign natural persons.

Associated entity

Proposed Rule 1001(c) defines the term "associated entity," and goes on to indicate in 1001(c)(2) that associated entities include any "associated entity," as used in Rule 2-01(f)(2) of Regulation S-X that would be considered part of that firm for purposes of the Commission's auditor independence rules. In the Section-by-Section Analysis, the Board indicates that the definition of associated entity is meant to give the term the same meaning as in the Commission's auditor independence rules. However, the term "associated entity" is not defined in either Regulation S-X or the Commission's independence rules.

In addition, the Board cites footnotes 490 and 491 contained in the Final Rule: Revision of the Commission's Auditor Independence Rules (Release Number 33-7949) as a guiding factor in determining whether an entity is an associated entity with respect to a public accounting firm. We caution the Board that this rule adopted by the Commission did not provide accounting firms with the certainty of the definition and thus is open to individual interpretation, which may cause inconsistencies in the application of the rule.

Because of the lack of a precise definition of associated entity, we recommend that the Board define associated entity without reference to the Commission's rules or other similar rules. We suggest that the Board consider defining the term "associated entity" as: an entity domiciled inside or outside of the United States and its territories that is a member of or similarly connected with an international firm or association of firms with which the applicant holds itself out as being associated.

Person associated with a public accounting firm (and related terms)

Proposed Rule 1001(m) defines the terms "person associated with a public accounting firm" and "associated person of a public accounting firm." We believe that the proposed definition is too broad and ambiguous. Rather, we recommend that the Board clearly define the terms "professional employee," "independent contractor," and "agent." We do not believe the Board intended to include within this definition third-party specialists (for example, a specialist engaged by the auditor who provides chemical analysis of inventory samples of petroleum products to an audit engagement team). The Board also may wish to consider whether a materiality concept should be applied to compensation paid to independent contractors or agents and thus allow a firm to exclude such individuals, not having a substantial role in the audit, from the registration reporting requirements. Finally, we believe that the Board should exclude the words "or otherwise" from the phrase "participates as agent or otherwise" from its definition, as it either is meaningless or impermissibly vague. We believe that this amendment will provide helpful clarification to the language contained in Section 2(a)(9) of Sarbanes-Oxley, consistent with the Board's amendment in the proposed definition removing the "any other" phrase from this statutory definition.

Play a substantial role in the preparation or furnishing of an audit report

Proposed Rule 1001(n) defines the term "play a substantial role in the preparation or furnishing of an audit report." The Board has proposed several tests to determine if an entity has met the substantial role in preparing or furnishing an audit report. We believe that the Board should reconsider whether the proposed rule will result in meaningful data or results, and whether the rule is applicable in all situations. For instance, in a particular country, personnel costs may be low and relatively more hours are incurred on the engagement (for example, in early career training of professionals), thus causing a situation where the audit firm may be construed to have played a substantial role in the audit although the subsidiary entity is immaterial to the issuer. In addition, in circumstances where the principal auditor and the auditor of a subsidiary company are not with the same international network of firms, the information necessary to make the measurement may not be available to the auditor of the subsidiary.

Situations may exist where the scope of the audit changes (due to the issuer acquiring companies, etc.) whereby the firm auditing the subsidiary may not previously have met the criteria to cause it to be registered. In these circumstances, we have concerns with respect to the Board's processes for registering such a firm or whether the issuer's subsidiary will be forced to change auditors to meet the proposed rule pertaining to "playing a substantial role". We recommend that the Board adopt a simpler and more meaningful test for determining whether an entity or individual played a substantial role. We believe a consistent criterion is to measure the role based on the factor contained in proposed Rule 1001(n)(2), which is whether the assets or revenues of the subsidiary or component constitute more than 20 percent of the consolidated assets or revenues of the issuer. As noted by the Board, this definition would be consistent with the standard used in the independence rules for partner rotation.

Additionally, the determination should be performed at a fixed point in time. We believe application of the rule to the issuer's prior fiscal year revenues and total assets as of the end of the prior fiscal year would provide a reasonable measure of substantial role.

In the event the Board concludes that the proposed multiple tests are preferable, we believe the Board should consider a protocol for determining when and how the test will be applied. For instance, some significance items, such as the hours and fees, may not initially be considered to have been met, but the criteria may be met upon issuance of the audit report. The Board should consider safe-harbour provisions in these types of events to avoid encountering the possibility for last-minute re-audits by another firm. In addition, including hours and fees as criteria could cause some firms to register and de-register if these factors change annually.

Fees for Professional Services

The proposed Form 1 requires applicants to provide fee information relative to their issuer audit clients for the year the audit report is prepared or issued and the applicant's entire practice. Fees to clients for professional services are not consistently defined in the Proposed Rule, and are not consistent with fee information that is required to be provided to other regulatory bodies, in particular, the Commission. We believe this will create confusion to the public and require

unnecessary duplication and cost of efforts in reporting fee information. Accordingly, we recommend that the Board define the fee information required consistently among the various proposed Rules (or explain why the basis for the fee calculation is different), and conform the fee disclosure to the fee disclosure requirements of the Commission. Additionally, we question what interest of the Board or investors would be served by requiring applicants to provide fee information relative to their non-issuer clients. We will discuss each of these matters in more detail.

Definition of fee information is inconsistent

Items 2.1 and 2.2 of proposed Form 1 require that fees be accumulated based on fees billed to the issuer. Item 3.1 of proposed Form 1 requires that aggregate fees of the applicant for its fiscal year be aggregated based on fees received. It is unclear why the fee information is being requested on an inconsistent basis. Accordingly, we recommend that the Board define the required fee information uniformly among the various proposed Rules, consistent with the Commission's fee disclosure rules, or explain why the basis for the fee calculation and disclosure is different. Such reporting would provide the investing public with more uniform data with respect to fees. Further elaboration pertaining to uniformity with the Commission's fee disclosure rules is delineated in the next section.

Conform requirements to Commission's fee disclosure rules

Items 2.1, 2.2, and 3.1 require that fees be reported in accordance with four categories, as follows: (a) audit services, (b) other accounting services, (c) tax services, and (d) services provided to the issuer other than those in (a), (b) or (c). These categories, as defined by the proposed rule, are not consistent with the fee disclosures required either by the Commission's existing proxy rules or the new fee disclosure rules in the Commission's *Final Rule: Strengthening the Commission's Requirements Regarding Auditor Independence*, released January 28, 2003 (Commission's Final Rule). We cannot envision a justification for requiring an aggregation of fees different from those required by the Commission.

If the Board requires use of a different aggregation method, the data likely will not be reconcilable to or consistent with the data reported publicly by each issuer. Indeed, no issuer has nor will be required to report primary fee data consistent with the Proposed Rule. We believe it is inappropriate to report this information on an inconsistent basis, because users of the information will not understand that it is not comparable, or that it cannot be reconciled. In addition, the inconsistencies in the definition of required fee data likely will result in additional data accumulation outside the normal operating systems of the applicant, and quite possibly outside of the normal internal control processes of the applicant. This will increase the risk of inadvertent errors and create significant costs and inefficiencies by requiring the aggregation of the same data in two different ways. Many applicants will not have common systems with member firms around the world and will use a substantially manual process for this data accumulation.

Accordingly, we recommend that the categories of fees used in the final rule be modified to conform to the Commission's fee disclosure rules used by the issuers in filing their applicable fee information with the Commission.

Obtain information directly from the Commission

The uniform reporting of fee data would be further enhanced if the Board were to obtain the data directly from the proxy or information statements already filed with the Commission. Applicants would then be required to provide fee information only for its issuer audit clients that are not required to comply with the Commission's proxy rules. Such a process would provide data that is more current, eliminate a significant duplication of efforts, and reduce the possibility of errors in reporting. Thus, we recommend that the Board work with the Commission's staff to develop a mechanism to obtain this information directly from the Commission. In the interim, audit firms could gather the fee data, albeit in an efficient manner, and supply it to the Board.

Board lacks a basis to require certain applicant information

We are particularly concerned with Part III of proposed Form 1. It requires the applicant to provide fee information with regard to all services provided to all of the applicant's issuer, non-issuer, audit and non-audit clients. Firstly, many applicants do not account for fee information related to their non-issuer and non-audit clients in a manner to be able to aggregate the fees in accordance with the proposed Form 1. If the Board proceeds with this requirement, we recommend that firms be able to provide such fee information in a manner consistent with the way the applicant manages its business. This would be similar to the way in which issuers report segment information pursuant to *Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information*. We believe that a prudent action for the Board would be to allow similar reporting by an applicant.

Secondly, we question the need for the Board to require applicants, most of which are non-public entities, to provide information relative to their non-issuer clients, and relative to the results of the operations of their businesses. We recognise that Sarbanes-Oxley Section 102(b)(2)(C) provides that, in addition to disclosing fees received from issuers, the applicant shall submit "such other current financial information for the most recently completed fiscal year of the firm as the Board may reasonably request, and Section 102(b)(2)(H) permits "such other information . . . as necessary or appropriate." However, the Board has not provided an analysis of the public interest objectives that would be served by this disclosure. We also recognise that some of this information is reported in a summarised manner in the media in the US; however, it is not reported in the same level of detail as is proposed by the Board and it generally is not reported by firms around the world (particularly for firms who do not have large public company audit practices). Therefore, at a minimum, we recommend that the Board reconsider its need of this information, and in the alternative afford automatic confidential treatment of this information if required by the final rule.

Other fee reporting matters

We believe that the Board intended that the fee information required by Items 2.1.and 2.2 of proposed Form 1 discussed above be presented including fees of associated entities on a basis consistent with the fee disclosure requirements of the Commissions. Such fee data would represent gross fees not only of the applicant, but also of other member firms of the same global network. The Board should clarify this requirement in the final rule. We reiterate our position that the Board should conform its reporting requirement with the Commission's fee disclosure rules.

The application of Items 2.1.and 2.2 of proposed Form 1 to investment company issuers requires clarification. It is not uncommon for a single trust, comprised of multiple series of portfolios with varying fiscal year ends, each of which is audited, to be registered as an issuer. A firm may audit some or all of the series of portfolios in the trust. We believe Items 2.1 and 2.2 of proposed Form 1 should require trusts to be listed as a single issuer with (1) disclosure of aggregate fee data for the series and (2) the date of the audit report listed as "various" where series of portfolios have multiple fiscal year ends. Listing each series of portfolio in a trust on the application provides no meaningful additional information and results in significant duplication of data, as generally the fee data for the investment advisor and its affiliates that provide ongoing services to the issuer will be the same for each series of portfolios.

Finally, we request clarification of certain registration issues for those issuers who are required by local law or custom to have joint audits. For example, the final rule should indicate whether one or all of the firms involved in a joint audit must register, and indicate the portion of the audit fee that must be reported by each firm (for example, if all firms in a joint audit are required to register, each firm should report the amount of fees it billed, not the fee for the entire audit).

Consents of Employees

Proposed rule 8.1(b) requires that the applicant agree to "secure and enforce" from each associated person a consent to "cooperate in and comply with any request for testimony or the production of documents made by the [Board]." The proposed rule presents three significant issues concerning the interests of individual employees and partners of the applicant.

As the Board does not have the legal authority to compel the production of information or testimony, we appreciate the need for cooperation by applicants to permit the Board to perform its oversight functions effectively. At the same time, individuals have a substantial personal interest to not waive for the future their right to refuse voluntarily to provide information or especially testimony that could be used against them in collateral proceedings, pursuant to Section 105(c) of Sarbanes-Oxley. The legal ability of the applicant to force existing employees to waive these rights as a condition of continued

employment is a matter of the law in various jurisdictions around the world, and as discussed later in this letter in several jurisdictions could represent an unlawful material change in conditions of employment.

A second concern is whether the Board can impose this condition on professionals as, effectively, a condition of the continuation of their careers as auditors of public companies. Legal standards require that actions with significant impact on individuals' liberty interests cannot be imposed by governmental bodies without procedures permitting a meaningful opportunity for comment and review. In addition, procedural concerns are implicated by the potential collateral effects discussed later in this letter, such as legal or professional liability, that are certain to follow the waiver of rights imposed by the proposed rule.

Finally, the applicant's ability to compel consents from an "independent contractor or entity" as currently included in the definition of "associated persons" is even more limited, and to the extent that the term incorporates individuals or entities with only a tangential relationship to the audit would appear to be of marginal utility to the Board's investigative responsibilities.

For these reasons, we suggest that proposed Rule 8(1)(b) be rewritten to require that the applicant "use its best efforts to secure and enforce" the consents of cooperation from its associated persons.

We also suggest that proposed Rule 2104 be changed to permit applicants the option to gather the consents of their partners and employees through an electronically generated response, similar to the method of certain firms for confirming individuals' compliance with independence rules, as opposed to requiring the gathering of manual signatures of many thousands of partners and employees.

Objections to Reporting of Prior Criminal, Civil and Administrative Proceedings

Part V Exceeds the Statutory Authority of the Board

The proposed rules in Part V require reporting of legal and administrative proceedings in five categories covering a prior period of one to ten years. It is conceded by the Board in the Section-by-Section Analysis discussion of Part V that to the extent that these items cover proceedings that are no longer pending, or that do not relate to audit reports, they are broader than permitted by Sarbanes-Oxley. While Section 102(b)(2)(H) of Sarbanes-Oxley permits the Board to gather "other information" in addition to that specifically identified in Section 102, we do not believe that it is legally sound construction of Sarbanes-Oxley to rely on the provision as permitting the Board to ignore the express restriction included in Section 102(B)(2)(F): "Information relating to . . . proceedings pending against the firm . . .." We submit that any attempt of the Board to gather information or regulate behaviour beyond that expressly permitted by Sarbanes-Oxley, to which the Board owes its existence and which both provides and limits its powers, is

ultra vires. Consequently, the proposed rules in Part V must be redrawn to conform to the limited powers of the Board.

The Information Requested is Overbroad and Will be Unduly Burdensome on the Applicants

In addition to and apart from the legal defects of Part V, we request the Board reconsider the breadth of these rules on several grounds.

Firstly, we do not believe that the Board has balanced the considerable burden on the applicant of assembling this material, in the form requested, with the limited value of such material to the Board. KPMG member firms have not organised their information systems in a manner that permits retrieval of much of the material requested, and for certain categories and for earlier years the only way to identify responsive information is a manual review of many hundreds of case files.

To take one example, Item 5.4 of proposed Form 1 calls for records of all administrative and disciplinary actions against the applicant or associated persons "in which a violation was rendered, or a sanction entered" in the previous ten years. While we believe such matters were relatively few, our record keeping systems do not allow us to identify them without reviewing the records of many hundreds of investigations and inquiries over this time period, retrieving tremendous amounts of material from storage, and performing detailed legal reviews to determine which of those matters meet the Board's criteria. That burden is exacerbated by the ten year time frame, by the fact that information is sought even with respect to personnel no longer with the firm, and for matters related to reports for non-issuer clients.

Item 5.5 also presents practical problems insofar as it requires the reporting of felony or misdemeanour convictions of individuals unrelated to their activities as employees. A firm, in most cases, would not have had direct involvement in the matters, which might in fact have taken place before the individual's association with a firm. Institutional memory may be a source for some such information, but will not be complete or reliable.

Similar difficulties are presented to a lesser degree concerning the other categories of prior proceedings. We accordingly request the Board to consider the relative need for the information about older proceedings in light of the probable thousands of hours of personnel time required for applicants to review materials in order to generate required responses, and suggest that three years coverage of prior proceedings under Items 5.2, 5.4 and 5.5 would appropriately balance the burden associated with this element of the applications.

A different problem presented by Item 5.4 is the requirement that concluded proceedings that remain confidential by their terms or by law nevertheless require disclosure to the Board. Any individuals involved in these proceedings are entitled to continued confidentiality, and the applicant is not in a position to waive that right on their behalf, especially with respect to

individuals who are not currently employees or partners of the applicant. There may be similar circumstances pertaining to proceedings which must be identified under other Items of Part V. We believe that Part V must be amended to permit applicants to omit information from their responses "where disclosure would violate confidentiality rights of individuals protected by law." Another difficulty posed by the rule is the virtual impossibility of compliance to the extent that "persons associated with the applicant at the time that the events in question occurred" includes any "independent contractor or entity". KPMG suggests that the applicant only should be charged with the responsibility to use its "best efforts" to assemble information regarding proceedings involving those who are not partners or employees of the applicant.

Information concerning administrative and legal matters is confidential and should be protected from disclosure

Finally, we believe that the procedures for the protection of confidential information under Rule 2300 offer an ineffective and cumbersome means of protection of the sensitive public and non-public information submitted under Part V. This information could be damaging to the interests and reputations of individuals and be subject to misuse by the competitors and adversaries of the registrant. Conversely, we cannot contemplate how permitting unrestricted access to this data would advance the Board's mission or serve the legitimate interests of the public. We comment on the problems presented by the mechanics of Rule 2300 below; with respect to the Part V information, however, KPMG suggests that the nature of this information supports amending the Board's proposed rules to provide confidential treatment of all information in this portion of the application.

Listing of Filings Disclosing Accounting Disagreements with Public Company Audit Clients

In our foregoing comments, we raised questions as to the reasons why the Board was requesting from the applicant information that is already filed with and publicly available from the Commission. Item 6.1 of proposed Form 1 requires disclosures with respect to the existence of disagreements with issuers. We believe that the Board should consider whether reporting of such situations by a US public accounting firm is timely or simply a duplication of publicly available information. Under current practice, the issuer must file a Form 8-K that discloses the nature of the disagreement, along with correspondence from the public accounting firm that denotes the firm's agreement or disagreement with the information contained within the Form 8-K.

We believe that a more cost efficient and timely method for the Board to obtain information pertaining to such accounting disagreements with respect to US firms is to have the Board incorporate into its electronic data system, a direct link to the SEC EDGAR database in which it can access the pertinent Forms 8-K on a real-time basis.

We also note that in Item 6.1(b) of proposed Form 1 the Board is requesting additional information with respect to matters pursuant to Item 304(a)(3) of Regulation S-K, 17 C.F.R.

229.304(a)(3). We believe that the request for the disclosure information, as currently defined in Item 6.1(b), is too broad and inconsistent with the information request in Item 6.1(a) and with the correlating provisions of Sarbanes-Oxley. As we recommended in the foregoing paragraph, we believe the Board should consider sources that are already readily available in the public domain for such disclosures or information.

Protection of Confidential Information

Proposed Rule 2300 provides a procedure for guarding certain confidential information provided in the registration application. The procedure is burdensome to the applicant and, apart from the Board's comment in footnote 11 of its proposing release (PCAOB Release No. 2003-1) that the Board is not an agency of the government and thus not bound by laws restricting disclosure of information, there is no rationale advanced why the Board nonetheless should not follow the familiar and effective Freedom of Information Act (FOIA) procedures instead. The procedures under proposed Rule 2300, especially those requiring an individualized and detailed justification of the need for confidential treatment in connection with each request (proposed Rule 2300(d)(2)), are unwieldy and compliance by applicants will be unnecessarily time-consuming. The resolution of these confidentiality issues will saddle the Board with a significant burden as well. A FOIA-type approach is preferable, permitting the applicant in good faith to designate information as confidential under the terms provided by proposed Rule 2300, and honouring the presumption of confidentiality unless challenged, at which point the applicant will be required to support its claim.

In this respect, there should also be a general presumption for all foreign public accounting firms that if the registration information provided is not publicly available in the foreign country then there should be an automatic presumption that it will also not be made public in the US.

In addition, the Board has set no criteria or standard of proof for its resolution of confidentiality requests, and has provided no opportunity to be heard and no form of review of its decisions, contrary to the standards of administrative due process.

PART II – ISSUES UNIQUE TO FOREIGN FIRM REGISTRATION

KPMG is pleased to note that the Board has recognised that there are issues associated with non-US firms' registration and encourages the Board to continue to work with overseas governments, regulators and professional bodies to resolve these issues.

We wish to stress, however, that registration outside of the US is complicated by both the existence of local laws and regulatory bodies. We believe that as a general principle, the registration process itself must not cause any foreign firm to breach local laws. Where such conflicts exist the Board must work with national governments and regulators to resolve the issue. In addition, we believe that the registration process itself should be harmonised, in so far as is possible, with registration information already required by equivalent overseas regulators (to minimise inefficiencies and unnecessary costs).

In its proposing release, the Board indicated its intent to convene a public roundtable discussion concerning the registration and oversight of foreign public accounting firms, and invites commentators to address a number of questions. Our thoughts on these questions are set out below.

Question 1 - Is it feasible for foreign public accounting firms to register within 180 days of the date of the Commission's determination that the Board is capable of operating? Should foreign public accounting firms be afforded some longer period (e.g., an additional 90 days) within which to register?

This is the first time this much information (both in terms of volume and detail) has ever been requested from foreign public accounting firms by any national regulator. Many firms will not be sufficiently prepared to produce this detail of information within the short time frame proposed in the rules.

Obtaining reliable and complete information for a very large number of individual practices (we currently believe that KPMG would be required to register in at least 40 countries) would involve the development of new systems and processes in many jurisdictions (all of which must be rigorously tested).

A further issue for non-US firms is that the proposed Form 1 is written explicitly with US accounting firms in mind. Non-US firms are inevitably going to encounter difficulties in translating some of the requirements into local equivalents. Legal advice will have to be obtained to determine what the local legal equivalent codes and statutes are for the required disclosures of various civil, criminal and other proceedings, in particular in identifying specific local law equivalents for the direct sections of the United States Code quoted in Item 5.5 a (3) of proposed Form 1.

In addition, in many countries outside the US, the overall fee information requested under item 3.1 of proposed Form 1 (analysed by audit, other accounting, tax and other services) is unlikely to be readily or consistently available from domestic accounting firm's information systems. Indeed in many countries there is no requirement for accounting firms to analyse audit and non-audit fees in such a way, except for the information required for US proxy statement purposes, which, in many countries, is accumulated for relatively few companies largely through manual processes. Accordingly it will be extraordinarily difficult for many accounting firms to analyse total fee income in the required format. It is very unlikely that this information could be reliably produced within 180 days. Not only will this be an enormous effort for the initial registration; as we also expect the Board to require that this information be periodically updated, we believe it will be a substantial effort each time a firm is required to provide an update.

Based on all of these issues we suggest an extension of at least one year should be granted to foreign firms before the initial registration is required. This extension would give more time to non-US firms to establish appropriate systems and processes to enable reliable information to be submitted during the registration process. However, the practical difficulties cannot be overestimated and time alone will not necessarily enable the legal obstacles discussed in question 4 below to be overcome. This period should also therefore be used to continue discussions between the Board and overseas governments and regulators to agree how conflicts with local laws could either be resolved or be addressed during the registration process.

Question 2 - Are there any portions of Form 1 that are inapplicable, or that should be modified, in the case of non-U.S. applicants?

There are certain portions of the proposed Form 1 which we believe should be modified for non-US applicants.

Firstly, we suggest that Item 3.1 (Applicant's Revenue) of the proposed Form 1 should be modified to take account of the difficulties described above in analysing total firm revenue in the manner required. We suggest that (if a total revenue analysis is required at all) foreign firms should be permitted to analyse their total revenue in a manner consistent to that in which they manage their business.

In addition, the fee disclosures required under Part II of the Form 1 are not required disclosures in many non-US countries. This information will not be readily available from many firm's accounting systems. We suggest therefore that for foreign public

accounting firms that this information only be required for those issuers for which the applicant has prepared an audit report during the current calendar year.

We also believe that Item V (Listing of Certain Proceedings Involving the Applicants Audit Practice) is unduly onerous for all accounting firms (our general comments on this proposal are given on page 15). In addition though, we believe that the information requested on any criminal, civil, government or administrative and disciplinary action or other proceedings brought against individuals has little relevance to the Board if the individual concerned does not participate in or contribute to the preparation of an audit report of an issuer. The provision of such sensitive information (which may not previously have been on the public record especially where the case is pending) could be seriously prejudicial to both the accounting firm and the individual concerned. We suggest therefore that, for non-US applicants, the information required for individuals be limited to those involved in the preparation of an issuer's audit opinion during the periods required for disclosure. We would also like to draw to your attention the legal impediments which exist in certain jurisdictions to providing much of the information required under Item V.

We believe that the consent required under Item 8.1 must be modified for those foreign jurisdictions where an employer is prohibited under local employment laws (e.g., Germany and Canada) from making it a condition of an employee's employment that the employees consent to co-operate with the Board. In addition, we believe that legally this consent could not be given for those countries where legal impediments to registration exist (e.g., in Switzerland where it is the individual rather than the public accounting firm who is held personally liable for any Swiss law violations) until those impediments have been appropriately resolved.

The issue of legal impediments to registration is discussed further in Question 4 below.

Question 3 - In addition to the information required by Form 1, is there any additional information that should be sought from non-U.S. applicants?

The Board needs to have a detailed understanding of the oversight and monitoring processes already in operation by national regulators. However, it would be more efficient for the Board to request this information directly from the local regulatory agencies themselves, rather than from individual applicants. Thus, the Board should implement a process to identify the primary regulatory body that oversees the accounting profession in each significant jurisdiction, and communicate directly with such regulators about these matters.

Question 4 - Do any of the Board's registration requirements conflict with the law of any jurisdiction in which foreign public accounting firms that will be required to register are located?

The obligations that are associated with registration (e.g., consenting to give testimony or making documents available to the Board together with the general presumption that all registration information would be made public) conflicts with the domestic legislation of a number of countries.

In helping determine the legal impediments to registration the major accounting firms (Ernst & Young, KPMG, PricewaterhouseCoopers and Deloitte Touche Tohmatsu) have commissioned Linklaters and Alliance ("Linklaters") to undertake legal research on key countries. Much of the legal interpretation included in our letter is based upon the Linklaters report. We refer the Board to this report for full details of actual and potential conflicts with law in the countries investigated.

Based on the Linklater's work, there are common legal issues associated with the registration process for many countries; specifically conflicts around the issues of client and third party confidentially, data protection and employment law. We believe that there are specific issues that the Board will need to resolve in this respect for many countries; across the European Union (EU) generally (for data protection issues), France, Switzerland, Germany, Japan, Israel and the UK to name but a few. Also in Canada there are client confidentiality and privacy law issues which must be resolved. Accordingly, whilst domestic applicants in these countries may want to register with the Board, their domestic legislation might make this a criminal offence.

EU wide issues

The major legal issue for EU member states is that much of the information required by the Board would amount to "personal data" under European Commission (EC) directive 95\46\EC dealing with data protection. Such data includes the details of all accountants associated with each firm and information relating to criminal, civil or administrative actions or disciplinary proceedings pending against each firm. Consent by the proposed "data subject" is one relevant condition for processing the data without breaching the requirements of the directive. However, whilst issuers might accept that they need to provide consent in order to enable their auditor to register, the issue is less clear for employees and associated persons.

In addition, the directive prohibits transfers of personal data to countries outside the European Economic Area which do not provide adequate data protection or which are not prepared to enter into appropriate contractual arrangements to provide that

protection. This principle would be relevant to the disclosure of any personal data required by the Board.

France

In France, legal issues would arise if client or other information (i.e. testimony) were required by the Board as part of the registration process. Articles L225-240 of the French Commercial Code decrees that audit firms are prohibited from communicating any knowledge gained by the auditor in the course of his engagement to a third party. There are criminal and disciplinary sanctions as well as possible civil liabilities for violation of this principal. Client consent would allow the auditor to gain protection from civil liability but not the criminal liability associated with the transmission of this information.

Current French legal provisions provide for a release from professional secrecy obligations to the benefit of the French Market regulator (i.e., Commission des Operations de Bourse (COB)). However, no specific French legal provision provides for a waiver to the benefit of a foreign controlling body such as the Board. Therefore, any communication to the Board would be considered as a breach of professional secrecy.

Switzerland

Swiss accounting firms are subject to several secrecy provisions under Swiss law, the violation of which is a criminal offence. Some of these provisions are contained in the Swiss Penal Code and others in specific acts regulating certain types of Swiss company. As a general rule it is the individual who is punishable for violations of these laws rather than the firm itself. Article 321 of the Swiss Penal Code requires that auditors maintain the confidentiality of their client's affairs. A breach of this article is a criminal offence. It is irrelevant whether the information is revealed orally, in writing or by furnishing copies of working papers; all of these methods are considered to breach the confidentiality duty imposed by Article 321. In addition to the Swiss Penal Code, client confidentiality is also protected under Article 47 of the Banking Act (for Swiss banks) and Article 43 of the Federal Act on Stock Exchanges and Securities Trading Act (for issuers on the Swiss stock exchange).

However, these provisions not only protect the confidentiality interest of the audited company but also the confidentiality interests of any relevant third parties affected. Obtaining consent of clients to release papers would not prevent a breach of the Code as this would not protect the third parties affected (e.g., in the case of a Swiss bank consent would also have to be obtained by all of the bank's clients).

In addition to the above, legal impediments exist regarding the provision of details of legal proceedings against Swiss applicants which is not publicly available information. Specifically, Article 273 of the Swiss Penal Code prohibits the forwarding of information that is not publicly known to foreign governmental bodies. Client consent could not exempt an accounting firm from any liabilities arising from breaching this article.

Germany

In Germany audit firms are required to maintain client confidentially under both professional regulations and under Section 323 of the German Commercial Code and Section 43 of the Accountants Ordinance. Any breach of these provisions is a criminal offence. The accountants duty to keep information confidential is mirrored by a personal right to refuse to testify (under Section 383 of the Civil Procedures Act and Section 53 Criminal Procedures Act). Furthermore, in accordance with the accountants right to refuse to testify under Section 97 of the Criminal Procedures Act, the working papers of an accountant cannot be seized for use as evidence in criminal proceedings where the accountant has refused to testify.

In order to address issues of client confidentiality and secrecy, as required by the German Commercial Code, specific consent would be required. Whilst issuers might have little choice but to provide consent if they are not themselves to breach the Board's rules, it is by no means certain that individual employees of the firm could be forced to give consent, particularly if they are not themselves involved in the audit of issuers. In addition, it is pertinent to note that the constitutional right of individuals not to give self-incriminating testimony could not be waived by German registered public accounting firms as the right does not belong to a firm but rather to the individual.

Similarly, under the German data protection law, any disclosures made under items 5.1 to 5.5 of proposed Form 1 need to be subject to the consent of all parties involved. It is unlikely that non-issuers would ever give consent to release this information.

Finally, it is doubtful as to whether amending an employee's contract of employment to force them to co-operate with the Board (or otherwise face dismissal) would be upheld in German Courts as it appears to contravene the German Protection from Dismissal Act.

Japan

In Japan registration with the Board is likely to give rise to client confidentiality issues under Article 27 of the Law concerning Certified Public Accountants (Law No 103 of 1948). This law prohibits an accountant from providing client confidential secrets to a

third party without due reason. Similar client confidentially issues arise for auditors under their Obligations under the Civil Code (Law No.89 of 1896). Client consent would not totally resolve these issues as the consent could not cover any third party confidential information obtained during the course of the audit.

In addition, much of the personal data required under the Proposed Rules for registration would likely contravene a new proposed Japanese Data Protection Law.

Finally, both the employee consent (required as part of registration) and the proposed disciplinary powers of the Board potentially conflict with Japanese Employment law.

Israel

In Israel potential issues with registration arise in respect of conflicts with the Israeli Privacy Protection Law (1981) which prohibits the violation of the privacy of another person without that person's consent and potentially with Israeli labour law (where even if consent is given a court may rule that the consent is not validly given).

United Kingdom (UK)

In the UK there are potential legal conflicts arising in respect of data protection (described above), client confidentiality and employee confidentiality.

The duty of an auditor to maintain client confidentiality is embodied in English Common Law. Although express client consent for releasing this information to the Board could be given this could never release the auditor from confidentiality obligations to any relevant third party (to whom a common law duty of confidentiality is also owed).

In addition, the requirement for a public accounting firm to agree to secure consent from all employees regarding their compliance with requests for testimony and the production of documents could give rise to potential employment liabilities (in particular liability for unfair dismissal). Even if consent is obtained (i.e., being made a condition of employment) employees may have the right to refuse to testify or disclose documents on the grounds of the privilege against self-incrimination. Finally, UK public accounting firms could find themselves subject to unfair dismissal claims if required by the Board to dismiss or suspend employees when such sanctions are unreasonable in the circumstances.

It is important to note that in those countries where there are legal impediments over access to working papers, this will not only hinder the ability of those foreign accounting firms concerned to register with the Board, but it will also hinder the ability of those US accounting firms that rely upon the opinion of those foreign firms to comply with Section 106 (b) (2) of the Sarbanes-Oxley Act (i.e. consenting to provide the working papers of that foreign public accounting firm to the Board).

These conflicts are by no means an exhaustive list but are indicative of the types of issues that the Board will have to address before many foreign public accounting firms can register. There are a number of possible solutions available to the Board depending on the circumstances in each jurisdiction. The Board could either try to negotiate with overseas governments for a waiver of the respective laws or it could enter into a specific agreement (through the extension of existing memoranda of understanding with overseas regulators) to delegate any issues that breach local laws to the local regulator. Failing this, the Board must exempt foreign public accounting firms from that aspect of the registration (or oversight) which causes the breach in local law.

Question 5 - In the case of non-U.S. firms that are required to register because they play a substantial role in the preparation and furnishing of an audit report on a U.S. issuer, is the Board's definition of "substantial role" appropriate?

Our comments on the definition of 'substantial role' are given on page 11.

Question 6 - Should the requirements to register be different for foreign public accounting firms that are "associated entities" (as defined in the Board's rules) of U.S. registered public accounting firms than for foreign firms that are not associated with U.S. registered firms?

No, we do not believe that the registration requirements of foreign public accounting firms that are 'associated entities' of US registered public accounting firms should be any different from those that are not associated with US registered firms.

Question 7 - Should registered foreign public accounting firms be subject to Board inspection? Could the Board, in some cases, rely on home-country regulation in lieu of inspection of foreign public accounting firms? If so, under what circumstances could this occur?

Firstly, it is acknowledged that the Board has certain oversight obligations under Sarbanes-Oxley which it needs to fulfil.

However, KPMG believes that the inspection of foreign public accounting firms should be exercised by a competent regulatory authority either national or supranational (such as the EU) otherwise there will be dual oversight for audit firms operating in major countries outside of the US.

Dual oversight is undesirable as it may be unlawful where it breaches national sovereignties, will be inefficient, costly and will potentially lead to conflicts with national regulators. For example, certain countries' regulatory and legal systems forbid foreign inspectors from conducting inspections of local audit firms on their national territory (e.g. Germany, Switzerland, UK, Israel and Japan). In the case of Switzerland and Germany, the consent of the relevant registered public accounting firm would not suffice to overcome the legal impediments, for these countries the Board needs the permission of the local governments concerned. However, for the UK, Israel and Japan inspections could be undertaken as long as the public accounting firm gave their consent. However, where consent was refused the local courts would be unlikely to find in favour of the Board (as parallel regulatory powers for these countries to exercise oversight on US public accounting firms do not exist).

In order to bridge the obligations that the Board has under Sarbanes-Oxley and the issues and conflicts described above, we suggest that the Board continue its dialogue with regional and national regulators. This dialogue should establish firstly where equivalent oversight regimes exist and secondly ascertain how the Board can obtain the reliance that it needs from other national regulators, who in turn may take account of the applicable firm quality control procedures.

Question 8 - Aside from Board inspection, are there other requirements of the Act from which foreign public accounting firms should be exempted? If so, under what circumstances?

KPMG does not believe that the Board should be responsible for undertaking investigations and disciplinary actions where a competent local regulator already fulfils this role. We believe that the existence of two regulators undertaking investigations and disciplinary actions is a cause for major concern.

Firstly there may be conflicts between the two regulators, specifically where diverging decisions are reached by the differing bodies on the same issue. This will be complicated by registered public accounting firms having to operate two sets of standards (be they auditing, quality control or ethics). A further undesirable consequence would be loss of investor confidence if the differing findings were publicised.

The disciplinary system envisaged by the Sarbanes-Oxley Act would also create a double jeopardy for many auditors who will also be subject to national disciplinary systems. This would contravene the principles of natural justice enshrined in domestic laws as well as under the Universal Declaration of Human Rights.

Question 9 - Are there requirements different from those the Act imposes on all registered public accounting firms that the Board should apply to foreign public accounting firms?

See responses to previous questions.

Question 10 - Should the Board's oversight of foreign registered public accounting firms that are "associated entities" (as defined in the Board's rules) of U.S. registered public accounting firms be different than its oversight of foreign public accounting firms that are not associated entities of U.S. registered firms? Should the U.S. registered firm have any responsibility for the foreign registered firm's compliance with the Board's rules and standards?

With regard to the first question, we do not see why a firm should be treated differently based on whether it is affiliated with a US registered firm.

However, to the extent that national or supranational regulators consider unique characteristics of networks of firms in their oversight regimes, then the Board should consider such differences.

With regard to the second question, we do not believe that a US firm should be assigned any responsibility for a foreign registered firm's compliance with the Board's rules and standards.

PART III – OTHER COMMENTS

Electronic Submission of Application

Proposed Rule 2101 requires applicants to file the application and exhibits thereto electronically through the Board's Web-based registration system. We recognise the efficiency of an automated registration process. However, we have two concerns with the Board's proposal.

KPMG's most significant concern is related to the security and confidentiality of the information submitted. The Board recognises that all applications will contain some confidential information, and our concern relates both to the transmission of the information to the Board and security of the data once it has been accepted into the Board's system.

The Board proposes that applications be submitted over the Internet, an unsecured public network. The Board should recognise that confidentiality could be compromised during the transmission of information over the Internet and design the system to provide for an appropriately secure method of transmission. The Board should advise potential applicants of the measures taken to ensure security. Additionally, the description of the system as "Web-based" suggests that the system will be perpetually connected to the Internet. Similar to our previous recommendation, we recommend that the Board design the system to appropriately secure confidential information from unauthorised access, secure all information available on its system, both public and confidential information, from unauthorised tampering, and advise potential applicants of the measures taken to ensure security and confidentiality. We believe it is incumbent that the Board's system should undergo a thorough, independent review resulting in an attestation report that such controls are secure.

Our second concern relates to the design of the information submission process. As proposed, applicants will need to submit vast amounts of information to the Board. To do so efficiently, the system should be designed so that an applicant may download from the Board's system the form of application, input the required information "off line," and then submit the completed application form. Additionally, the system should allow information to be gathered in an appropriate data storage medium by the applicant and electronically uploaded into the Board's system. We believe that a system design in which the data must be entered into the system on line in real time would be unduly burdensome.

Registration Fee

In the Analysis of Proposed Registration Rules, the Board contemplates that the amount of the registration fee required by Proposed Rule 2103 will be determined by formula and that fees will vary based on the size of the applicant. We believe that the Board has selected the wrong criterion for determining the amount of the registration fee. The size of the applicant is not a direct measure of the amount of regulated audit services rendered by the applicant to its issuer audit clients. The mix of audit and non-audit services provided by accounting firms, as well as the mix of issuer and non-issuer clients, can vary considerably among firms. Fees based solely on the size of the firm thus may not be equitable among the firms; for example, if equal fees are

assessed to two firms and the first firm provides a smaller percentage of services to issuer clients as compared to the second firm, we believe the fee assessment will not be fair to the first firm. Criteria that are more appropriate are the number and size of the applicant's issuer audit clients – the same criteria used to determine the amount of fees that are to be levied directly on issuers. Additionally, a fee should be assessed with respect to all issuer audit clients; therefore, for issuers with relatively small market capitalisation, the Board should establish a minimum fee. This will increase the likelihood that the registration fees assessed will bear an appropriate relationship to the level of auditing relating to an applicant's issuer audit clients.

Additionally, any registration fee should not include the cost of creating and maintaining the Board's systems and other infrastructure, and should be restricted to the administrative costs of processing applications. Otherwise many activities relating to the "examination/inspection" process will be assessed to applicants, which conflicts directly with the provisions of Sarbanes-Oxley.

Other Comments on Proposed Form 1

Item 1.6, Associated Entities of Applicant

Item 1.6 of proposed Form 1 pertains to associated entities of the applicant. The Board should clarify what information a registered public accounting firm that is a member of an international network or international association of firms is required to provide with respect to such members in its registration application. We believe the Board's intent is for the applicant to report the name and national office address of such other member firms, and not detailed information about the member firms' financial matters, personnel, litigation and other proceedings. (For example an individual KPMG member firm would have no ability or recourse to compel compliance with a demand for such information, if requested to do so by the Board). We recommend that the Board state this more explicitly in its final rules.

Item 1.7, Applicant's Licenses

Item 1.7 of proposed Form 1 pertains to the applicant's licenses. The Board should reconsider whether requiring the applicant to provide every license or certification number is desirable. We believe the Board's intent is for the applicant to provide a listing of licenses and certificates from relevant state or national boards of accountancy (or form of entity with similar jurisdiction) evidencing the regulatory permission for the firm to practice public accounting in that jurisdiction. However, as the proposed Item is currently written, the applicant could construe the requirement to include business licenses from municipalities, counties, etc. The Board should clarify the type of license or certification that it is requesting of the applicant.

Item 2.3, Issuers for Which Applicant Expects to Prepare Audit Reports During the Current Calendar Year

In our foregoing comments, we raised questions as to the reasons why the Board was requesting from the applicant information that is already provided to the Commission by issuers. Item 2.3 of proposed Form 1 pertains to the issuers for which the applicant expects to prepare audit reports during the current calendar year. Because of the timing of the annual audit cycle, it is not uncommon for a firm to be in a position of having to conduct a timely review of the interim financial information for an issuer audit client's first fiscal quarter prior to the completion of the annual client continuance process. It is not until that client continuation process is complete that the firm is in a position to conclude on whether it will enter into an arrangement to prepare or issue an audit report for the current year. For individual issuers, client continuance procedures occur over different periods of the year. In addition, situations may exist at the time of filing an application with the Board, where the applicant may expect to perform the annual audit, but where execution of a formal arrangement or engagement contract has not occurred. Another factor that has a direct effect on reporting such arrangements is that for public companies, the audit committee and shareholders must ratify or approve the appointment of the external auditor and such appointments take place continuously during the calendar year. As such, we believe the Board should reconsider the purpose and usefulness of this proposed requirement.

Item 2.4, Issuers for Which Applicant Played, or Expects to Play, a Substantial Role in Audit

Item 2.4 of proposed Form 1 pertains to issuers for which the applicant played, or expects to play, a substantial role in the audit. As noted in our comments with regard to Proposed Rule 1001 (n), we believe that accumulating this data may be difficult, especially if the Board imposes the time and fees criteria for determining "substantial role". We reiterate that the Board should reconsider requesting information with respect to those situations where the applicant audited or expects to audit more than 20 percent of the issuer's consolidated assets as of the end of the issuer's preceding fiscal year or revenue for the issuer's preceding fiscal year.

Cost of Compliance

The Proposed Rules require applicants to provide a large amount of information regarding their issuer audit clients and related fees, and overall firm revenues, much of which is not readily summarised from existing information systems. It also is proposed that firms provide a substantial amount of information regarding all of the accountants employed and litigation against the firm and its accountants and similar proceedings related to its audit practice. In addition, the Board is establishing a complex and costly infrastructure to collect, maintain and analyse this information. We observe, however, that the Proposing Release does not discuss the justification for the significant costs of complying with the Proposed Rules and the related infrastructure. We also have a concern that the largest firms will bear a disproportionate amount of these costs, especially for the creation of the Board's systems and infrastructure. Also, as indicated elsewhere in this letter, we question the need for the Board to obtain certain specific

information, and whether Sarbanes-Oxley provides a basis to request such information. We believe the Board should provide an analysis of the costs and benefits of its proposals, and specifically address and provide its rationale for requesting information that is not explicitly contemplated by Sarbanes-Oxley.

Comment Period

Finally, we wish to respond to the Board's deadline for receiving comments with respect to its proposed rules for the registration process. While we recognise that the Board is attempting to meet its April 26, 2003 operating deadline to the Commission, parties wishing to respond to the Board's proposed rules had only 24 days in which to read, interpret, and comment on the proposals. Many of the Board's proposed rules appear ambiguous and contain intricacies that may have far reaching implications for an applicant. We have met the Board's deadline in the spirit of cooperation and support; however, we believe a longer comment period would have been an appropriate decision by the Board, in which it would have afforded respondents the time needed to better understand the proposed rules. Accordingly, we recommend that comment periods for future Board proposals be more consistent with customary due-process procedures.