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

May 9, 2003

Dear Mr. Secretary:

PCAOB Rulemaking Docket Matter No. 004

KPMG appreciates the opportunity to comment on the Public Company Accounting Oversight Board's (Board) proposed rule, *Statement Regarding the Establishment of Auditing and Other Professional Standards* (Proposed Rule), which was released April 18, 2003, pursuant to Section 103(a) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).

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

Our comments relate to procedures for adopting or amending Professional Auditing Standards, including the Board's review of Interim Professional Auditing Standards in establishing permanent standards.

Advisory Groups and Task Forces

We are pleased that the Board has elected to convene a standing advisory group to participate in the standards-setting process. We expect that the Board will fully utilize the talents of the various advisory group members and will ensure that participation by the group is substantive to the standards-setting process. In determining the size, composition and operating protocol of the advisory group, we recommend that the Board consider the following:

- A standing advisory group of no greater than 20 members; a group exceeding 20 members generally would not be effective in debating issues and reaching well-reasoned conclusions,
- Individuals from each of the largest auditing firms should be represented on the standing advisory group; the largest auditing firms audit the vast majority of issuers' financial statements,





- Non-U.S. auditors should be represented to give the Board insights into issues that may be unique to areas outside the U.S., and
- Operating policies should be established for the advisory group addressing, among other matters, 1) the process for making recommendations on standards for consideration by the Board, 2) the extent to which deliberations and findings of the advisory group will be made public, and 3) whether the advisory group will participate in the deliberations of all proposed standards.

Procedures for Adopting or Amending Professional Auditing Standards

The Proposed Rule indicates that the development of Professional Auditing Standards should be an open process in which the auditing profession, the preparers of financial statements, the investor community and others have the opportunity to participate. However, the Proposed Rule is not clear regarding the process the Board will adopt to set its agenda and to draft, review and deliberate proposed Professional Auditing Standards.

We believe that three elements are essential to ensuring a transparent process for developing Professional Auditing Standards that will promote public trust:

- The Board's process for developing its agenda should be clearly articulated and communicated to all interested constituencies,
- The Board's deliberations of Professional Auditing Standards should be conducted in a public forum, and
- The exposure process should allow sufficient time for interested parties to evaluate the proposed rules, their impacts, and the practical ramifications of implementation.

We agree that the Board should not be required to notify the recommending party or make a public announcement when concluding that a particular recommendation will not be acted upon, with one exception. We believe that all standard-setting related recommendations to the Board by the aforementioned standing advisory group should, by definition, become an agenda item for the Board to deliberate in a public forum.

Timely, thorough, and open deliberation of auditing, attestation and quality control matters will encourage public participation in the process of establishing and improving these standards. Meetings in a public forum should extend beyond releasing proposed rules for comment and issuing final rules. The deliberations of potential standards prior to exposure should be substantive and be conducted in a public forum. The processes currently used by the Financial Accounting Standards Board and the Emerging Issues Task Force present models for a transparent rulemaking process. These models promote objective decision making, careful consideration of the views of affected constituencies, and evaluation of the expected benefits in relation to expected costs. Where public hearings or roundtables are utilized in the evaluation



process, sufficient notice (30 days would be reasonable) should be provided to allow the various constituencies to plan for effective participation.

The proposed 21-day comment period for proposed standards does not allow sufficient time for interested parties, which will include non-U.S. constituents, to provide meaningful input on those standards. We believe that sixty days represents a more reasonable period for soliciting comments on proposed standards and is consistent with comment periods used by other standard-setting organizations such as the Financial Accounting Standards Board and the International Auditing and Assurance Standards Board. We believe that an open and meaningful due process is essential to ensuring credibility in any standard-setting exercise.

Auditing guidance that is more interpretive in nature might be structured along the lines of FASB Staff Positions with a shorter comment period (e.g., 30 days). Such interpretations would facilitate standard setting where clarification of existing Professional Auditing Standards is needed, but adoption of new Professional Auditing Standards or extensive modification of existing standards is not warranted in the circumstances.

Review of Interim Professional Auditing Standards

The review of each Interim Professional Auditing Standard and the Board's conclusion regarding the adoption of that standard as permanent, with or without modification, or the repeal of that standard, should be subject to the full due process procedures of the Board, including an appropriate comment period. While we believe that the Proposed Rule can be reasonably interpreted that the Board intends to submit the permanent adoption of Interim Professional Auditing Standards to its full due process, we encourage the final rule to be explicit in this regard.

The Board also needs to determine the manner in which it will promulgate permanent Professional Auditing Standards. We recommend that the Board adopt a method similar to that used by the U.S. General Accounting Office (GAO) to promulgate Government Auditing Standards. Under that method, the GAO incorporates by reference the majority of the auditing standards promulgated by the Auditing Standards Board (ASB) and specifies additional requirements and guidance applicable to the audits of Federal organizations, programs, activities and functions, and Federal financial assistance received by others. For example, if the Board intends to modify an existing Interim Professional Auditing Standard, the Board could publish any additional requirements and guidance applicable to the audit of the financial statements of a public company. Not only is this a practical approach, it will significantly enhance the auditing profession's ability to focus on and understand the differences between the auditing standards that have been used for many years and which will apply to the audits of the financial statements of non-public entities and the additional requirements promulgated by the Board.

Implications for Non-U.S. Firms

We encourage the Board to consider how any standards it proposes to adopt impacts non-U.S. firms. Some countries have recently modified local auditing standards to attempt to harmonize with U.S. standards. For example, in the case of Canada, the SEC



continues to accept Canadian generally accepted auditing standards for reporting on Canadian issuers that are eligible for the Multi-jurisdictional Disclosure System (MJDS). We also ask the Board publicly to support initiatives to converge international auditing standards.

Review of Internal Controls and Section 404 Attestation Standard

We support the Board's intention expressed in the Proposed Rule to address as a matter of priority the subject of internal control auditing and reporting. The existing standard (AT501) likely did not contemplate the broad-based, broad circulation and multiple industry reporting that is required by Section 404. We believe the draft standards exposed for comment by the ASB in March 2003 provide much needed guidance for the performance of an audit of an entity's internal control over financial reporting and would significantly strengthen auditor performance in all engagements to report on internal control. We encourage the Board to consider the public interest benefit of incorporating the enhancements in the ASB's exposure drafts into the Board's proposed rulemaking relative to internal control auditing and reporting. With regard to the planned "roundtable meeting" on this subject, we encourage the board to solicit participation from the auditing profession and relevant banking regulatory groups.

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If you have questions regarding any of the information included in this letter, then please call or write to write to Michael A. Conway, (212) 909-5555, mconway@kpmg.com. or Neil Lerner, + (44) 207 311 8620, neil.lerner@kpmg.co.uk

Yours sincerely,

KPMG