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

August 18, 2003

Dear Mr. Secretary:

**Rulemaking Docket Matter No. 006**

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board), *Proposed Rules on Inspections of Registered Public Accounting Firms*, (Proposed Rule) released July 28, 2003. The Proposed Rule has been issued pursuant to Section 104 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).

The overarching objective of the provisions of Sarbanes-Oxley, including Section 104, is one of furthering the public interest through improving financial reporting, governance, and audit quality. We wholeheartedly support the efforts of the Board in striving to achieve this objective.

We respectfully present for your consideration our observations on the Proposed Rule, including suggestions that we believe will improve the overall quality and effectiveness of the final rule, consistent with the objectives of Sarbanes-Oxley. These suggestions are explained in the remainder of this letter.

**Proposed Rule 1001 – Definition of Professional Standards**

Proposed Rule 1001 carries over the definition of professional standards contained in Section 2(a)(10) of Sarbanes-Oxley. We request that the Board provide clarification as to the meaning of accounting principles "dealt with in the quality control system of a particular registered public accounting firm" in the context of professional standards. In conjunction with proposed Rule 4009 regarding required firm responses to inspection reports, it would appear that this definition may provide an incentive to a registered public accounting firm to adopt quality control procedures no more stringent than those externally mandated. This seems inconsistent with the overarching objectives of Sarbanes-Oxley.



As such, we recommend the Board clarify its position as to the ramifications of non-compliance with accounting principles “dealt with in the quality control system of a particular registered public accounting firm” in relation to those externally mandated and consider adopting two categories for reporting criticisms and deficiencies. We recommend that the category of criticisms and deficiencies related to non-compliance with accounting principles dealt with in the quality control system be stated as recommendations for improvement. Registered public accounting firms could be required to report on their responses to such recommendations but such responses would not require determination by the Board as to whether they satisfactorily addressed the criticisms or defects in order to preserve confidentiality. We believe such a reporting scheme would properly align the objectives of each registered public accounting firm and the Board without increasing the professional risk of a firm who has set standards that exceed the minimum quality control elements mandated.

## **Section 4. Inspections**

### **Proposed Rule 4000 – General**

We request that the Board provide by rule clarification regarding the “other persons” that they may authorize to participate in particular inspections or categories of inspections. We are concerned that the authority to appoint agents to carry out the responsibilities of the Board was not contemplated in Sarbanes-Oxley and we believe such assignment of the responsibilities specifically vested in the Board raises concerns regarding confidentiality of client and firm proprietary information as well as the objectivity and competence of the “other persons.” In light of these concerns we believe that the Board should limit the involvement of “other persons” to specialists in such areas as may be required to assist the Board in specialized industries or application of professional standards thereon and that the final rule should specifically set forth the circumstances in which the Board may authorize “other persons” to participate in inspections. Furthermore, the rule should set forth the procedures that the Board will employ to ensure the competence and objectivity of the “other persons,” and explicitly note that “other persons” will be required to adhere to the Board’s Release No. 2003-008, *Ethics Code for Board Members, Staff and Designated Contractors and Consultants*.

### **Proposed Rule 4004 – Procedure Regarding Possible Violations**

As compared to Section 104(c)(1) of Sarbanes-Oxley, Proposed Rule 4004 broadens the population of external parties for which the Board may report possible violations of the standards described in the Proposed Rule to include “any other person.” We request that the Board clarify its intent and legal basis for proposing to expand Sarbanes-Oxley in this manner. We believe such expansion is inappropriate considering the objective of inspections stated in Section 104(a) of Sarbanes-Oxley, which is to assess the degree of compliance of registered public accounting firms with the standards set out therein.

Additionally, we request that the Board clarify both how it plans to classify identified or suspected violations, and the threshold that will apply in deciding which violations are reported or whether to commence an investigation. Having a defined and transparent process will ensure consistent application.

We believe the note to proposed rule 4004, which allows the Board to share information that indicates a possible violation of the standards with parties “other than those specifically described” in the Proposed Rule exceeds the authority explicitly granted in Section 104 of Sarbanes-Oxley and undermines the principle of confidentiality set forth in Section 105(b)(5)(B) of Sarbanes-Oxley. We believe the interests of the Board and registered public accounting firms would be better served by limiting the parties with which the Board shares information to the Commission and the appropriate regulatory authorities, as contemplated in Sarbanes-Oxley. The Commission and the appropriate regulatory authorities have existing processes to investigate and act on possible violations that protect the rights of the parties involved, while reserving the right to refer such information to other appropriate parties.

#### **Proposed Rule 4005 – Record Retention and Availability**

We recommend that any future rules that the Board proposes with respect to record retention and availability be consistent with the Commission’s record retention rules set forth in Release Nos. 33-8180 and 34-47241.

#### **Proposed Rule 4007 – Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report**

We have concerns regarding the inability of a registered public accounting firm to review a revised draft inspection report prior to its issuance and distribution as a final report under proposed Rule 4007. We believe that the Board should provide by rule for the review of a revised draft inspection report by the firm under review to ensure that the revised draft is consistent with facts and circumstances the firm believes are relevant to the matters discussed therein and to provide an opportunity for the firm’s accompanying letter of response to completely and accurately address all matters included therein.

In our letter containing comments on the Board’s Rulemaking Docket Matter No. 001 dated March 28, 2003, we expressed our belief that the best interests of the Board and the public are served by ensuring that the Board’s rules and conduct comport with the standards of constitutional due process. We believe that the lack of a requirement for the Board to provide a final inspection report to the firm under review prior to issuance of the final report, and the lack of a process to arbitrate disagreements about the content of final inspection reports raise serious concerns about due process and is in direct contradiction to Section 104(h)(1)(A) of Sarbanes-Oxley.

We fully recognize that inspection reports will be a valuable tool to identify opportunities to improve our existing quality control process. We believe a formal process to resolve disagreements regarding the content of inspection reports would strengthen the reports and enhance the effectiveness of improving audit quality through the inspection process. Further regarding proposed Rule 4007, we believe the proposed 30 day window in which a firm is required to provide its response to a draft inspection report is not sufficient to assure a thorough, comprehensive response. We respectfully request that the Board extend the proposed time frame from 30 to 60 days. We believe such an increase will provide adequate opportunity to gather and assemble relevant information without sacrificing the timeliness or efficiency of the inspection process.

In the Proposed Rule, the Board also allows a firm to identify information that it wishes to keep confidential. We believe that the Board should issue guidelines with respect to information that it is willing to characterize as confidential and the basis for such treatment.

#### **Proposed Rule 4008 – Transmittal of Final Inspection Report**

We request that the Board clarify the types of information it contemplates including in the letters or comments accompanying the transmittal of the Board’s report to the Commission or other authorized regulators and whether that information will go beyond the scope of what is covered in the report. Sarbanes-Oxley does not grant the Board authority to provide such additional letters and comments and we are concerned that such communication may not comport with the principles of due process described above.

Additionally, we request that the Board clarify what circumstances might exist and what information it envisions might need to be omitted from the report when it is transmitted to the authorities listed in proposed Rule 4008(c).

#### **Proposed Rule 4009 – Firm Response to Quality Control Defects**

The Proposed Rule does not include a characterization of potential violations, or clear definitions of the terms “criticisms” and “potential defects.” We request that the Board provide more explicit guidelines on the characterization of potential violations, including definitions of the noted terms, and an understanding of how specifically the Board will comment on the quality control systems of registered firms.

Under proposed Rule 4009(a), the Director of the Division of Registration is responsible for reviewing evidence that a registered public accounting firm has improved its quality control system and remedied any noted defects no later than 12 months after the issuance of the Board’s final inspection report of such firm. The Proposed Rule also states that “the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in

the quality control system of the firm identified in the final inspection report and, if not, why not.” It is unclear whether the firm will be granted the opportunity to discuss the recommendation with the Director or supplement its previous submission with analysis or additional evidence when the Director indicates that the initial submission is not satisfactory. In the interest of due process, we recommend that the final rule give firms under review the opportunity for discussion and the submission of additional evidence under these circumstances.

Proposed Rule 4009(c)(3) contemplates that registered accounting firms may formally request Commission review of any determination by the Board that a firm submitted response to quality control defects identified in a particular inspection report does not satisfactorily address the criticisms or defects noted in that inspection report. It suggests, however, that the report will be made public 15 days after such request for review, unless otherwise directed by Commission order or rule. Given the potential impact of the information released, the Commission must have an appropriate length of time to consider the circumstances surrounding the noted disagreement. We respectfully encourage the Board to extend the period of consideration to 30 days in order to ensure adequate time for contemplation and response.

We also reiterate our comments on proposed Rule 1001 regarding our recommendation that the Board specifically distinguish those criticisms or defects that result from deficiencies in meeting firm standards, from criticisms or defects that result from deficiencies in meeting professional standards. This distinction is essential to ensure that firms are not dissuaded from setting firm standards that are higher than professional standards and requirements.

Proposed Rule 4009 is silent as to the Board’s responsibility to perform a timely review of a firm’s response to the quality control defects and its responsibility to maintain the confidentiality of inspection reports that are the subject of a response submitted within 12 months of the issuance of the related inspection report but on which the Board has not issued a determination. We recommend the Board adopt rules that such determination be completed within 30 days of the submission by the firm and explicitly state that no information will be released publicly prior to the time a determination has been reached and the period allowed for seeking Commission review has expired, so long as the response is submitted within the required 12 month period following issuance of the inspection report.

### **Proposed Rule 4010 – Board Public Reports**

Proposed Rule 4010 contemplates the release of non-firm specific procedures, findings and results of inspections, with the identification of a firm or firms being permissible when their association with such information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means. We re-

quest that the Board clarify what it contemplates would fall into the category of “other lawful means” in this context.

### **Impact on Foreign Firms**

KPMG International and its non-US member firms encourage the Board to continue their dialogue with foreign regulators and to consider the specific issues faced by foreign firms. We look forward to commenting on future proposed rules that address foreign firms.

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KPMG International is a Swiss non-operating association which functions as an umbrella organization 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.

If you have questions regarding any of the information included in this letter, please call or write to Michael J. Baum, (212) 909-5604, [mjbaum@kpmg.com](mailto:mjbaum@kpmg.com).

Yours sincerely,

