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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. 005

KPMG appreciates the opportunity to comment on the Public Company Accounting Oversight Board's *Proposed Rules on Investigations and Adjudications* (Proposed Rule), which was released on July 28, 2003. The Proposed Rule has been issued pursuant to Sections 102 and 105 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or the "Act").

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.

In this instance, we believe there are several aspects of the proposed rules that should be reconsidered by the Board. As an initial matter, the period that the Board has given parties to comment on the Proposed Rule is extremely short. The subject matter of the Proposed Rule will significantly impact the accounting profession and the manner in which services are provided to thousands of public companies. The livelihood of individual auditors also could be dramatically affected by the shape of the final rules. Providing a mere three-week comment period is inadequate to address the important public-policy issues at stake; that inadequacy is exacerbated by the length of the Proposed Rule, and the overlap between the comment period and the firm registration period imposed by Sarbanes-Oxley. In future rulemakings, KPMG hopes the Board will embrace more reasonable comment deadlines that are conducive to more considered notice and comment rulemaking.

In the Proposed Rule, the Board proposes to establish a regime that would allow it to conduct investigations of registered public accounting firms and associated persons, to initiate disciplinary proceedings against such firms and persons, and to impose sanctions on regulated firms and persons. Sarbanes-Oxley of course grants the Board considerable authority to establish this regime; however, in doing so, Congress required that the Board

establish "*fair procedures* for the investigating and disciplining of public accounting firms and the associated persons of those firms" within the limits of the Act. *See* Section 105(a) of Sarbanes-Oxley (emphasis added). Our comments below focus primarily on the requirement that Board procedures be fair.

We present several general areas in this comment letter where we believe the proposed rules can be modified to more adequately reflect and fulfill Congress's mandate under Section 105(a) of Sarbanes-Oxley. Within each area, we discuss in more detail our comments on the Proposed Rule and present recommendations, where appropriate, to improve the Board's investigations and adjudications rules. We look forward to working with the Board to create an investigatory and disciplinary regime that is fair, effective, and consistent with public interest.

1. Definitional Issues

We have several concerns with the definitions in the Proposed Rule. Our concerns are particularly acute with respect to the terms identified below because the potential adverse impact of these definitional issues cascades throughout the proposal.

"Professional Standards" – In its release relating to inspections, the Board proposes to define "professional standards" to include "accounting principles."[1] This term appears several times throughout the Proposed Rule where its usage will be problematic. For example, the definition of "disciplinary proceeding" under Proposed Rule 1001(d)(i) refers to "professional standards," as do Proposed Rules 5100(a)(4), 5101(a), and 5300, which relate to initiation of informal and formal investigations and sanctionable conduct, respectively. We believe this construction could subject registered firms and associated persons to investigations or discipline where generally accepted accounting principles ("GAAP") simply may be deemed to have been misapplied. This could be the case even where a firm has acted with due professional care and/or the application of GAAP in a particular circumstance is debatable and no clear answer lies in the professional literature.

Instead, we believe the Board's final rules should replace the term "professional standards" with "auditing and related professional practice standards" because the latter term, which has already been separately defined by the Board, appropriately reflects the role of the auditor in the audit process.[2] In this way, the Board would focus on the auditor's conduct and would create an appropriate link between serving as an issuer's auditor and

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[1] *See* PCAOB Rulemaking Docket Matter No. 006 (Proposed Rules on Inspections of Registered Public Accounting Firms), Release No. 2003-013, July 28, 2003. (There appears to be a typographical error with respect to "Rule 1001(p)(iv)" in that the Board has given the same rule designation to the definitions of both "person" and "professional standards.")

[2] *See* Rule 1001(a)(viii).

the actual scope of the auditor's role, rather than expanding such exposure to include accounting principles.

"Hearing Officer" (Rule 1001(h)(i)) – To counter criticism that a Board proceeding is not sufficiently objective, the Board should modify the definition of "hearing officer" in the Proposed Rule. As drafted, "any person" could be designated by the Board to oversee a disciplinary proceeding.[3] In contrast, the U.S. Securities and Commission (the "Commission") requires that an individual overseeing a hearing must be an administrative law judge.[4] The Board should follow the Commission's example in this regard and also provide that hearing officers must be administrative law judges or their functional equivalents at the Board level to ensure their familiarity with Board procedures and standards and to ensure sufficient impartiality. At a minimum, the final rule should provide that the Board may not designate as a hearing officer any Board staff or third party who is or has been involved in the investigation or prosecution of a firm or an associated person. These suggested revisions will help minimize claims that hearing officers lack impartiality.

2. Non-cooperation Proceedings

Proposed Rule 5110(a) grants the Board expansive authority to institute disciplinary proceedings for the perceived failure to cooperate with an investigation or for providing testimony that "may" have been "false or misleading or that omits material information." Instead, these standards are so vague as to be unworkable.

The application of this proposed standard could subject firms and associated persons to disciplinary proceedings, and the draconian sanctions that can result from these proceedings, for objectively harmless conduct. For example, an insignificant disagreement between an examinee and the Board's staff could expose a firm or an associated person to a disciplinary proceeding under this proposal. Similarly, a firm could be subject to non-cooperation proceedings simply for asserting in good faith a legal privilege or position with which the Board or its staff disagrees or for denying that auditing standards were violated. Moreover, the Board's proposal does not enumerate the types of information that must be disclosed during the course of an investigation. Thus, firms and associated persons have no guidance as to when they may be deemed, after the fact, to have failed to provide "material information." These vague standards fail to provide fair or discernable rules for instituting disciplinary proceedings for non-cooperation.

Our concerns regarding the potential for abuse that could result from this proposal are only amplified when considering that under Proposed Rule 5110(b), special expedited procedures will govern those disciplinary proceedings instituted for non-cooperation. In

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[3] Proposed Rule 1001(h)(i).

[4] *See* 17 C.F.R. 201.110; 17 C.F.R. 200.30-10.

the course of those proceedings, under the proposed rules respondents would have only five days to answer a potentially complex order instituting proceedings; be subject to arbitrarily limited discovery; and have no right to submit post-trial briefs. In addition, these expedited procedures could lead to harsh sanctions, such as suspension, termination of registration and up to $15 million in penalties. In view of these concerns, we believe the Board's final rule should expressly identify the particular acts that will constitute non-cooperation; and should ensure that all procedures connected with the Board's authority to institute non-cooperation proceedings are both fair and workable.

3. Privilege And Confidentiality Concerns.

Sarbanes-Oxley repeatedly makes clear that information gathered during Board investigations and disciplinary proceedings is to remain generally confidential. Nevertheless, the proposal, in several different areas, does not clearly provide adequate protection for information arising out of investigations and disciplinary proceedings. Similarly, we believe that the proposed rules are often insensitive to the legitimate privilege protections of registered public accounting firms, associated persons, and their clients. In particular, the proposed rules below could be improved to ensure fairness and compliance with the intent of Sarbanes-Oxley.

Rule 5104 – Proposed Rule 5104—which permits the Board to "inspect the books and records of such firm or associated person to verify the accuracy of any documents supplied" under an accounting board demand for documents—provides no protection for privileged information in those books or records. Undoubtedly, a public accounting firm's books and records will contain some privileged information. Nevertheless, the proposed rule as drafted does not allow public accounting firms to designate certain records as privileged and to withhold them from examination. Without such a protection, the Board, although it is restricted from obtaining privileged documents under Proposed Rule 5106, may, in fact, end up reviewing such information during a Rule 5104 examination.

Rule 5108 – Proposed Rule 5108 permits the Board to disclose investigatory records to the Securities and Exchange Commission, the Attorney General of the United States, an "appropriate Federal functional regulator," state attorneys general, and "any appropriate State regulatory authority." The Act requires, however, that "each of [the agencies receiving Board investigatory information] shall maintain such information as privileged and confidential."[5] We believe that Proposed Rule 5108 does not adequately implement this statutory requirement.

For example, no investigatory information should be released without a confidentiality agreement with the receiving agency. Without such an agreement, the recipient agencies

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[5] Act, § 105(b)(5)(B)(ii)(IV).

could disclose this information to the public. The Note to the Board's proposed rule is not sufficiently protective in this regard. While the Note may protect the information from introduction into evidence or discovery in civil litigation, the Note does not explicitly bar a recipient agency from disclosing the information to the public.[6] The Note is, therefore, an incomplete implementation of the Act, which also requires the recipient agency to "maintain the confidential and privileged nature of the information."

In addition, the Board should also develop rules that protect shared information from disclosure under the requirements of state law. The Note does not address, for example, the appropriate treatment of information shared with state agencies under state public records and "freedom of information" acts, which may require disclosure of this type of information when in the hands of a state agency. In order to carry out the Act's requirement that state agencies maintain the confidentiality of shared information, the Board should explicitly state its intention to preempt contrary state law by rule, to the extent that such state law would require the disclosure of shared information. Similar confidential treatment should be accorded to the "discussions" identified in the second note to Rule 5108.

Finally, we suggest that a firm or person that is the subject of the shared information be notified when the Board makes a disclosure to an authorized agency. These notifications would further secure the confidentiality of information shared under Rule 5108 by allowing affected persons to protect their rights in any applicable state or federal court proceeding regarding the disposition of that information.

4. Procedural Protections In Investigations

The procedural protections for both formal and informal investigations under the Proposed Rule should be modified to allow firms and associated persons the ability to participate fairly and productively in Board investigations. We believe the issues identified below relating to investigations can be cured by incorporating elements of procedural protections offered in analogous contexts by the Commission and by otherwise clarifying vague language.

Rule 5101 – In addition to the concern discussed above regarding the Board's proposed authority to initiate a formal investigation under Rule 5101(a)(1) on the basis of a violation of "professional standards," this proposal does not require notification of firms and associated persons in the event a formal investigation is initiated. Firms and associated persons should be provided appropriate notice regarding the initiation of a formal investigation in order to gather relevant documentation and materials related to the inquiry, and

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[6] Rule 5108(b) Note (stating that the shared information "shall be confidential and privileged *as an evidentiary matter* (and shall not be subject to civil discovery or other legal process) in any proceedings in any federal, or State court or administrative agency.") (emphasis added).

to engage counsel. In this regard, the notice of formal investigation should detail the relevant subject matter of the investigation and its scope.

Rules 5102 – Proposed Rule 5102(a) authorizes the Board and its staff to require testimony from firms and associated persons regarding any matter that the Board considers "relevant or material" to an investigation. While we do not mean to suggest that the Board need adopt qualitative standards for relevance or materiality, the Board should incorporate a "reasonableness" standard into the general authority that it has under Rule 5102(a) so that the Board and its staff cannot simply institute a formal investigation in order to set out on unfettered fishing expeditions into a firm's practice and business.

Additionally, the Board should clarify that in permitting "counsel" for an examinee to attend an examination under Proposed Rule 5102(c)(3), such counsel may be either in-house counsel or outside counsel retained by the examinee. The Board would place unjustified economic burdens on associated persons by acting otherwise. The Board also should clarify that even in those instances where an examinee retains outside counsel, in-house counsel for the firm may be permitted to attend the examination, in the examinee's discretion. Finally, the rules should clarify that, as has long been recognized in SEC proceedings, attendance by a non-attorney with technical expertise who is assisting counsel in his or her representation of a client is normally appropriate.

Rule 5103 – Proposed Rule 5103(a) similarly requires that firms and associated persons will have to produce audit work papers and other documentation that the Board or the staff considers "relevant or material" to an investigation. Again, because compliance with a production demand under 5103(a) will turn on subjective analysis of these terms, the Board should incorporate a "reasonableness" standard into its final rules on this point.

Additionally, we assume that where Rule 5103(b) indicates that "original documents shall be produced," this is intended to mean only that the originals need be made available for inspection and copying, not that firms or associated persons be required to turn over originals to the Board indefinitely, or in cases where the staff is satisfied with the production of copies.

Rule 5109 – Proposed Rule 5109 permits a registered public accounting firm or associated person to submit a "statement of position" to the Board regarding the contents of an investigation. Because the proposal does not also require the Board's staff to notify a registered public accounting firm or associated person of their intention to recommend disciplinary proceedings, this "right" to submit a statement is meaningless as a practical matter. In this regard, the Board's procedures deviate from those of the Commission and

deprive a potential respondent of the ability to avoid disciplinary proceedings when such proceedings are patently unjustified.[7]

Although Proposed Rule 5109(d) allows a public accounting firm or associated person to request a description of the "indicated violations" from the Board's staff, whether the request is granted is left to the staff's "discretion." Moreover, without any provision for notice, an investigated person or firm generally would not have any reasons to request such information from the Board. Unlike the Commission's *Wells* procedures, the proposed rule does not provide that the staff will affirmatively notify a public accounting firm or associated person that it is about to recommend the initiation of disciplinary proceedings. Given the draconian effects that would flow from the mere pendency of a disciplinary proceeding, a registered public accounting firm or associated person should have a *meaningful* right to persuade the Board not to initiate a proceeding. The Board would also benefit from the Commission's experience under the *Wells* procedure, by being able to draw upon detailed explanations from firms and associated persons, as appropriate, and to focus its reasoning more efficiently as a result.

5. Procedural Protections In Disciplinary Proceedings

The procedural protections offered in Board disciplinary proceedings also require supplementation. Without significant revision, the proposal threatens disciplinary proceedings that will be neither fair nor likely to produce results that are in the public interest. Below we have set forth our most significant concerns.

Overly Broad Power To Consolidate Disciplinary Proceedings

In Proposed Rule 5200(d), the Board reserves to itself and its hearing officers the power to consolidate any proceedings that "involv[e] a common question of law or fact." This proposal is based on the laudable goal of ensuring that similarly situated respondents receive similar treatment and are not prejudiced by inconsistent factual findings or legal conclusions reached in separate proceedings. However, we urge the Board to recognize that joinder will often prejudice respondents by depriving them of the ability effectively to present individualized elements of their case. Although ensuring a consistent resolution of identical legal questions from case to case is important, we are confident that this end can be achieved through meaningful, searching review by the Board of initial decisions.

Inadequate Notice of Charged Conduct

The Board has taken a positive step by requiring that the initial notice of a proceeding to investigate misconduct give the associated person or firm some notice of the allegations

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[7] *See* Procedures Relating to the Commencement of Enforcement Proceedings and Termination of Staff Investigations, Securities Act Release No. 5310, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) P79,010, at 82,183-86 (Sept. 22, 1972).

at issue. However, we are concerned that proposed Rule 5201 may not provide adequate notice, for two reasons. First, the rule does not provide any minimum standards for the adequacy of notice, stating only that it must contain reasonable detail about the alleged misconduct. Second, Rule 5201(d) confers a virtually unlimited power to the Board and the hearing officer to amend the order instituting proceedings or notice of hearing, effectively depriving a respondent of any assurance of reasonable notice. These two issues are related: the hearing officer's power to grant amendments to the order or notice raises the concern that the initial order or notice will be deliberately phrased as vaguely as possible in order to leave room for subsequent amendment.

To address the first concern, the Board should provide a more specific list of disclosures required for the order, such as: the time period during which the misconduct is alleged to have occurred; the persons alleged to be involved in the conduct; the places at which the conduct occurred; and the mental state (such as willfulness or negligence) with which the respondent is charged with having acted. Alternatively, the Board could use the standard it has already incorporated into its draft rule for subpoenas, proposed Rule 5408(a): that the alleged misconduct be stated "with particularity." Although we understand that the Board wishes to preserve its flexibility, we urge the Board to consider that the order or notice is the functional equivalent of a government complaint and should provide an equivalent degree of notice, particularly because respondents are given extremely limited discovery rights and therefore have little opportunity beyond the order to discover the basis for the charges.

To address the second concern, the Board should be able to amend an order or notice only to add questions of law or fact that are germane to those already included. Of course, the Board would retain its authority to open a new disciplinary proceeding should it uncover evidence of wrongdoing that is outside the scope of the first proceeding. The Board should also provide respondents with notice that it is considering amending the initial order.[8] Finally, the Board should expressly provide that neither it nor a hearing officer may amend an order or notice if it would unfairly prejudice a respondent. This minimal limitation, which applies even to most amendments to federal civil complaints, would be particularly valuable, given the proposed rules' lack of any guarantee that respondents will receive adequate preparation time between the initiation of a proceeding and the holding of a hearing.

Severity of Sanctions

In Proposed Rule 5300(a), the Board has appropriately reserved the right to impose severe sanctions in response to particularly outrageous wrongdoing, precisely as Congress

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[8] Respondents are already guaranteed a limited degree of notice and opportunity to respond when the hearing officer orders amendment, because under proposed Rule 5201(d)(2) the hearing officer can amend only on motion, and under proposed Rule 5408(b) respondents have five days to respond to motions.

intended in passing subsection 105(c)(4) of the Sarbanes-Oxley Act. We also appreciate that with the phrase "subject to the applicable limitations under Section 105(c)(5) of the Act," the Board has incorporated into this proposed rule the limitation that Congress crafted to ensure that the most stern punishments are reserved for the most egregious offenses. We note, however, one possible ambiguity that arises from the Board's incorporation of the Section 105(c)(5) limitation by reference: that limitation might be read not to apply to proceedings instituted pursuant to Rule 5200(a)(2) for failure to supervise, because Sarbanes-Oxley mentions those proceedings in a separate subsection. The Board should make explicit that the most severe penalties, *i.e.*, those in Rule 5300(a)(1)-(3) and (4)(ii), can be imposed only on a finding of intentional wrongdoing or repeated negligence, whether the respondent is charged with a primary violation or a failure to supervise.

Similarly, the Board should make clear that it will impose the severe sanctions for a failure to cooperate listed in proposed Rule 5200(b)(1) only when the failure to cooperate is clearly undertaken with intent to obstruct the investigation. As we have discussed above, the proposed rules give the Board extremely broad power to impose discipline for the highly amorphous and ill-defined offense of "failure to cooperate." Even if (as we recommend) the Board defines this offense more narrowly, it still may encompass a category of less-than-willful acts for which draconian sanctions are inappropriate. The Board should therefore make clear that the harshest penalties, such as revocation of registration, may be imposed only where there is a clear intent to obstruct the investigation. Leaving such matters, unstated, to the Board's discretion will not serve the Board's interests in the long run; in a highly charged case, for example, the Board will benefit from the existence of a clearly stated rule, adopted generally and not for the matter before it.

We also note that by cross-referencing Proposed Rule 5200(a)(4), Proposed Rule 5200(b)(1) permits the Board to impose monetary sanctions for failure to cooperate, of up to $750,000 on an individual or $15 million on an accounting firm. The Board's statutory basis for imposing such a monetary penalty for failure to cooperate is uncertain. The Act specifies that the penalties for failure to cooperate may include suspension, barment, or revocation, or appropriate "lesser sanctions." It is not at all clear that a $15 million fine is a permissible "lesser sanction." We think the better reading is that "lesser sanctions" are those for which the Act does not prescribe a scienter requirement, such as censure or additional professional education or training. We accordingly urge the Board to amend proposed Rule 5200(b)(1) to cross-reference proposed Rule 5200(a)(1)-(3) and (a)(5)-(6).

Firms' Reasonable Care In Discovering A Suspension Or Bar

The proposed rules do not specify the standard of "reasonable care" that accounting firms must exercise in verifying that none of their associated persons has been suspended or barred. Of course, a firm that acts reasonably should not be subject to discipline, and we agree that "reasonable care" may appropriately be retained as the catchall standard.

However, we encourage the Board to define at least one specific procedure that, if followed, is deemed to be "reasonable care" *per se*.

Such a "safe harbor" might include obtaining from all applicants a signed, written certification that they are not precluded by any disciplinary order of the Board from becoming an associated person of a registered public accounting firm, and requiring employees to make a similar certification on a regular basis. It is particularly important that the Board give some definition to the standard of "reasonable care" because the Board sanctions regime is new and there is as yet no generally accepted, suitably efficient procedure for researching an individual accountant's disciplinary history with the Board.

6. Discovery Procedures

We believe that it is crucial that the Board's procedures be, and be perceived to be, fair and objective. To that end, there is a significant need to reconsider the effect of several of the proposed rules governing discovery procedures and how they are applied.

The proposed rule gives the Board a robust array of discovery tools. The Board may issue a "demand" for testimony of an accounting firm or associated person or for the production of documents from an accounting firm or associated person. As discussed in Section 2 above, the Board can leverage this power with its authority to bring "non-cooperation" proceedings, in which a vague, subjective finding of "non-cooperation" can result in severe sanctions. The Board has already signaled its intent to use non-cooperation proceedings in this way, conceding that an "important objective" of the non-cooperation proceedings will be to "compel the cooperation in question at a time when it is still useful to the investigation."[9] The Board also may issue a "request" for testimony or documents from parties other than accounting firms and associated persons. In addition, the Board may request that the Commission issue a subpoena on its behalf. These formal discovery mechanisms supplement the investigative tools that the Board has assumed in connection with its regular inspections of accounting firms.

The Proposed Rule does not give respondents a commensurate set of tools to facilitate their response. While the Board has granted the Division of Enforcement and Investigations a broad power to compel testimony, a respondent's ability to summon people to testify is severely limited. For example, a respondent's right to compel the testimony of witnesses is limited to testimony "at the designated time and place of the hearing."[10] A respondent's decision to compel a witness's testimony or to compel the production of documents is subject to the approval of the hearing officer. *Id*. In addition, should the Board's enforcement division summon the testimony of a third party, the respondent has

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9 Release at A2-xlv.

10 Proposed Rule 5424(a).

no right to attend that person's interview. These provisions are simply unfair. Fundamental fairness suggests that the subject of an investigation be given the right to collect the information that is relevant to the case, but the discovery tools proposed in the rule leave the target without adequate discovery mechanisms.

The Proposed Rule also unreasonably limits the extent to which evidence that has been gathered would be disclosed to the respondent. For some documents, the Proposed Rule only requires the Division of Enforcement and Investigations to make available "documents prepared or obtained . . . *prior to the institution of proceedings*." Proposed Rule 5422 (emphasis added). This rule diverges sharply not only from the traditional constitutional protections afforded to criminal defendants, but also from the rules of the Commission. The Commission's rule explicitly incorporates the doctrine of *Maryland v. Brady*, 373 U.S. 83, 87 (1963), in which the Supreme Court held that the prosecutors have an ongoing constitutional obligation to disclose exculpatory evidence to a defendant. *See* 17 C.F.R. § 201.230(b)(2). The Commission's rules implicitly recognize that an enforcement proceeding is quasi-criminal in nature, and respondents are entitled to protections that are similar to those to which a criminal defendant is entitled. The Board's enforcement proceedings are similar in nature and therefore, the Board's proposed rule, at a minimum, should be made to conform with the rule adopted by the Commission.

Proposed Rule 5424(a)(1)(iv)(A) would allow the Board to withhold "any document prepared by a member of the Board or the Board's staff that has not been disclosed to any person other than Board members, Board staff, or persons retained by the Board . . . ." Proposed Rule 5424(a)(1)(iv)(A). This provision would allow the Board to withhold documents that were shown to and discussed with Board members and other Board personnel, even though the same Board members might review the respondent's matter on appeal, and other personnel might serve as hearing officers. This rule would protect, and therefore encourage, *ex parte* contacts between the Board's enforcement division staff, other Board personnel, and Board members.

The effects of this provision are particularly pronounced when viewed in conjunction with Proposed Rule 5403. As discussed in Section 7 below, Proposed Rule 5403 purports to prohibit *ex parte* contacts between hearing officers and parties, but the Rule defines "parties" to exclude all Board divisions except that which has "primary responsibility" for the matter. Personnel from other divisions that may have substantial, but not "primary," involvement in the matter are not prohibited from talking to hearing officers about cases and facts in issue. Consequently, Proposed Rules 5403 and 5424(a)(1)(iv)(A) work in tandem to allow the Board to share information and opinions that might eventually influence the outcome of hearings. These provisions create a zone of secrecy that the respondent cannot penetrate, potentially undermining the fairness and impartiality that the Board seeks. The respondent should be entitled to inspect, copy, and respond to every non-privileged document that has been shown to a Board member or other person who

might later be called to hear his matter. Proposed Rule 5424(a)(1)(iv)(A) therefore should be deleted.

Under the Proposed Rule, the Division of Enforcement and Inspections itself is relieved of certain burdens of discovery that fall heavily upon respondents. For example, the Board's enforcement division is not required to maintain a log of the documents it withholds, absent a specific request from the hearing officer. *See* Proposed Rule 5244(b). Even under these circumstances, there is no requirement that the log be produced to the respondent. *See id*. By contrast, the respondent is required to maintain an extensive log, which must "identify the nature of the privilege (including attorney work product) that is being claimed; . . . the type of document; . . . the general subject matter of the document; the date of the document; and such other information as is sufficient to identify the document . . . including, . . . the author of the document, the addressees of the document, and any other recipients shown in the document, and, where not apparent, the relationship of the author, addressees, and recipients to each other . . . ." Proposed Rule 5106(a). Such disproportionate obligations potentially compromise the actual and perceived fairness of the Board's adjudicatory process and should be corrected.

Proposed Rule 5427 also provides allows for disciplinary proceedings to be resolved against a respondent on summary disposition. The division, however, has greater access to pre-hearing discovery and, thus, the division has a distinct advantage in proving its motions for summary disposition. Indeed, under the proposal, the respondent will be unable to examine any witnesses who do not voluntarily appear until the hearing itself. Faced with such a motion by the division, the respondent, with limited access to the evidence, will not always be able to establish persuasively the existence of a genuine issue of material fact sufficient to defeat the motion. In light of the inequitable discovery provisions, serious reconsideration should be given to whether the Division of Enforcement and Inspections should have the power to move for summary disposition or, indeed, whether summary judgment mechanisms are appropriate to resolve disciplinary proceedings at all in most instances.

7. Ex Parte Contacts.

Proposed Rule 5403 would prohibit *ex parte* contacts between hearing officers and parties. However, the proposed rule defines "party" to include only the "interested division" of the Board; that is, the division that the Board has given "primary responsibility" for the matter. Proposed Rules 1001(h)(ii), 1001(p)(iii). This definition ignores the fact that multiple divisions may have substantial involvement in a matter, even if only one division has "primary responsibility" for it. In order to preserve the impartiality and fairness of the hearing process, the definition of "interested division" should be broadened to include all divisions with substantial involvement in a matter.

8. Timing Concerns.

Although we generally appreciate the Board's attempt to craft its rules in a manner that allows for the speedy resolution of proceedings, the Board risks sacrificing fairness for perceived efficiency. We submit that the Board will effectively enhance the efficiency of proceedings if it adopts deadlines that parties perceive as reasonable from the outset rather than inviting protracted squabbles over extensions and other due process concerns. Our timing concerns apply throughout the proposal, but several examples follow below.

For instance, Proposed Rule 5102(b)(1) requires the Board to give an examinee "reasonable notice" of the examination. The commentary to the proposal, however, indicates that less than five-business-days may qualify as "reasonable notice."[11] It is simply not reasonable to think that less than five days constitutes "reasonable notice" in the context of a Board investigation. Firms and associated persons will need at a minimum 21 days to begin gathering relevant materials and engage competent counsel, and the Board should modify its final rule to take such needs into account accordingly.

Similarly, the Board's discussion of Proposed Rule 5103 relating to production of documents undercuts the terms of the rule itself, which as drafted requires that a Board demand for the production of documents "set forth a reasonable time and place for production." Notwithstanding the plain "reasonableness" standard set forth in the text of the rule, the commentary indicates that there is no "minimum notice requirement before production shall be due," and that while the Board "anticipates that the staff will provide at least five business days notice before production is due," such notice may also "be less than five days."[12] This commentary disregards the complexities of document production requests and makes no accommodation for the time it takes to identify and to gather the responsive documents—which in many instances will be extremely voluminous, held in several different locations, and maintained in different forms—and to assess confidentiality and privilege claims with respect to these documents. Accordingly, we request that the Board maintain the "reasonableness" standard in the final rule and provide guidance in its commentary to the final rule this standard will mean not less than 21 days from the date of receipt of a production request.[13]

In addition, we agree that, when the Board imposes a money penalty on a registered firm or an associated person, the Board should be able to impose further sanctions for subsequent noncompliance with the pending order. However, we are concerned that as a prac-

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[11] Release at A2-x.

[12] Release at A2-xii.

[13] The Federal Rules of Civil Procedure provide for a similar thirty-day period within which to respond to a request for production. *See* Fed. R. Civ. P. 34(b).

tical matter, Proposed Rule 5304 simply does not allow a sufficient period of time for payment in full before the Board is allowed to summarily suspend the registered firm or associated person. Although suspensions imposed for nonpayment are rescinded if the penalty is paid within 90 days, this does not adequately address the problem, especially in the case of firms, which would be obliged to cease all audit work – and likely suffer a permanent loss of clients – as soon as the suspension took effect.

We think that this problem is readily resolved by specifying when the Board may issue the written notice giving the respondent seven days to render payment. The rule should provide that if a money penalty is not paid within 30 days after exhaustion of all reviews and appeals, and the termination of any stay, the Board may issue the written notice currently provided for in the proposed rule. The Board's power to order the suspension seven days after the respondent receives the notice and the respondent's ability to cure the breach by paying within 90 days would remain unchanged.

Proposed Rule 5421 allows responding parties only five days to file an answer to an order instituting non-cooperation proceedings. To answer accurately and effectively, however, respondents or their counsel would have to conduct a complete investigation into the surrounding facts and circumstances, which would be impossible under the proposed rule. The time period therefore should be extended to at least 21 days.

Finally, Proposed Rule 5468(a) allows only five days to seek Board review of an action taken by the staff or third parties under authority delegated by the Board. This time period is not sufficient to compile the facts and legal support that a petition for review would require. The time period therefore should be extended to at least 21 days.

10. Implications For Non-U.S. Firms.

Based on recent experience with the firm registration process, the use of the term "associated person," as defined in Rule 1001(p)(1) in any Board rule has important, and often seemingly unintended, consequences for non-U.S. foreign public accounting firms. This is also the case with the Board's investigation and adjudication proposal, which essentially appears to subject "associated persons," as well as firms, to the entire panoply of rules regarding investigations, proceedings, and sanctions.

As the Board discussed at length in its final release regarding registration, however, foreign public accounting firms are subject to "unique" issues and accommodations need to be made in view of these issues.[14] In addition, the Board and foreign regulators are en-

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[14] PCAOB Release 2003-007 (May 6, 2003) at 14 (recognizing "that the registration of foreign public accounting firms raises unique issues"). The Board also realized that complications involving foreign firms were compounded by the difficulty of determining the potential conflicts with non-U.S. law, and

gaged in a continuing dialogue regarding application of the Board's rules to non-U.S. firms.

In view of the unique issues raised by application of the Board's rules to non-U.S. firms, including associated persons, and the ongoing dialogue between the Board and foreign regulators, the Board should engage in supplemental rulemaking that specifically addresses the application of the investigations and disciplinary proceedings regime to non-U.S. firms. In doing so, the Board should temporarily exempt non-U.S. firms from the definition of "associated persons" for purposes of the final rule, until the supplemental rulemaking is concluded. We look forward to working with the Board on these issues regarding non-U.S. firms and to commenting on future rulemaking addressing application of the investigations and disciplinary proceedings rules to non-U.S. firms.

11. Supplementary Constitutional And Administrative Procedures Act Protections.

Congress stated in Section 101(b) of Sarbanes-Oxley that the Board is not "an agency or establishment of the United States Government." In previous comment letters to the Board, KPMG has expressed its belief that the Board is, indeed, a quasi-governmental agency whose procedures must comport with due process, and, moreover, that the interests of the Board and the public are best served by ensuring that Board rules and conduct comport with the standards of constitutional due process. The same procedural protections that serve as a backdrop to the Commission's rules by virtue of the Commission's status as a governmental agency should, we believe, also apply to the Board's rules.

The Commission's rules do not always expressly reflect the gamut of procedural protections to which a respondent is entitled because these rules are supplemented by the significant protections inherent in the Constitution and numerous other federal statutes, including the Administrative Procedure Act. Express provisions that mirror these supplemental protections in all material respects should be spelled out in the final rules. Therefore, consistent with our comments, we believe the Board should strive to incorporate the protections inherent in the Constitution and the Administrative Procedure Act into its final rules in order to promulgate efficient and equitable rules, as Congress mandated under Section 105(a) of Sarbanes-Oxley.

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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

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thus adopted Rule 2105, which allows information to be withheld on the basis of a demonstrated conflict with non-U.S. law.

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, then please call or write to Michael J. Baum, (212) 905-5604, mjbaum@kpmg.com.

Yours sincerely,

KPMG