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

PCAOB Rulemaking Docket Matter No. 023 -
Proposed Auditing Standard, *Evaluating Consistency of Financial Statements,* and Proposed Amendments to Interim Auditing Standards

Dear Mr. Secretary:

KPMG LLP appreciates this opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or Board) Release No. 2007-003, that includes the following Appendices (collectively, the Proposals):

- Proposed Auditing Standard – *Evaluating Consistency of Financial Statements*, and
- Proposed Amendments to Interim Auditing Standards.

We would like to take this opportunity to formally recognize the efforts of the PCAOB and its staff in development of the Proposals. We support the Board's efforts to revise its auditing standards in recognition of the FASB's revised accounting and disclosure requirements for changes in accounting principles and error corrections. Further, we support the Board's proposal to remove the hierarchy of generally accepted accounting principles (GAAP) from its interim auditing standards in light of the FASB's proposal to include the GAAP hierarchy in its accounting standards.

We offer the following comments for your consideration in finalizing the provisions of the Proposals:

Voluntary and Involuntary Changes in Accounting Principles

The proliferation of new and revised accounting literature in recent years has resulted in the common recognition of consistency and comparability matters in the auditors' report for accounting changes mandated by the FASB. While we fully support auditors' report recognition for voluntary changes in accounting principles and restatements of prior year financial statements to correct material misstatements, we believe that little benefit is derived from auditors' report recognition of those changes in accounting that result from the issuance of new or revised standards by the accounting standard setters. Rather, the significance of voluntary changes in accounting principles disclosures may be diluted when no distinction is drawn between voluntary and involuntary changes for purposes of recognition in the auditors' report.

Accordingly, we recommend that the Board consider whether it is necessary to require recognition in the auditors' report for changes in accounting principles that result from promulgation of new or revised standards by the accounting standard setters. We believe that the usefulness of recognition in the auditors' report of changes in accounting principles would be enhanced if such recognition was required only for voluntary changes in accounting principles.

Alignment with SEC Staff Accounting Bulletin No. 108

SEC Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108), provides guidance on the correction of prior year financial statements for immaterial errors in accounting. In SAB 108, the SEC Staff differentiates between immaterial corrections and material restatements of prior year financial statements. We believe that the disclosures required by FASB Statement No. 154, *Accounting Changes and Error Corrections,* are not required for immaterial corrections of prior year financial statements. In addition, we believe that current practice is to not recognize immaterial corrections of prior year financial statements in the auditors' report. Paragraph 4 of the Proposed Auditing Standard states that, "The auditor should recognize the following matters relating to the consistency of the company's financial statements in the auditor's report if those matters have a material effect on the financial statements:

a. A change in accounting principle

b. An adjustment to correct a misstatement in previously issued financial statements."

Paragraph 9 of the Proposed Auditing Standard states that, "The correction of a material misstatement in previously issued financial statements should be recognized in the auditor's report on the audited financial statements through the addition of an explanatory paragraph, as explained in AU sec. 508." We believe that the intent of paragraphs 4 and 9 of the Proposed Auditing Standard could be clarified by explicitly stating that the auditors' report need not recognize immaterial corrections of prior year financial statements. This additional clarification would more closely align the provisions of the Proposed Auditing Standard with the notion of corrections of immaterial misstatements of prior year financial statements in SAB 108.

In addition, we suggest that the word "material" be added before the word "misstatement" in the last sentence of paragraph 18A, the first sentence of paragraph 18B and the first sentence of paragraph 18C of amended AU sec. 508 included in the Proposed Amendments to Interim Standards. We believe that these changes would further clarify that recognition in the auditors' report is required only when the prior year financial statements have been restated to reflect the correction of a material misstatement, and thereby more closely align with the guidance in SAB 108.

Paragraph 3 of the Proposed Auditing Standard

The penultimate sentence of paragraph 3 of the Proposed Auditing Standard states that, "When the auditor reports on two or more years, he or she should evaluate whether the financial statements reported on are consistent (1) with each other and (2) with the prior year's financial statements, *if presented with the financial statements reported on"* [emphasis added]. We believe that the italicized wording of this sentence is confusing. The auditors' report makes reference only to those financial statements presented by the issuer and, accordingly, it appears that (1) and (2) noted above effectively are equivalent notions. In order to appropriately address comparability of financial statements between years, we believe that the above italicized portion of the penultimate sentence of paragraph 3 should be eliminated.

Proposed Amendment to AU sec. 508.57

AU sec. 508.57 addresses the unusual circumstance where an auditor expresses a qualified or an adverse opinion on an entity's financial statements when management has not justified as preferable a change to an allowable accounting principle. Specifically, AU sec. 508.57 indicates that the auditors' opinion on the financial statements for the period of change should be modified as long as those financial statements are presented and reported on. The auditors' opinion on financial statements for periods subsequent to the period of change need not be modified.

We recognize that the Board is not proposing substantive revisions to AU sec. 508.57. However, this guidance generally is not applicable in audits of issuer financial statements due to the SEC's preferability letter requirements. In addition, the circumstances under which such guidance would become applicable in a non-issuer audit environment are rare.

Notwithstanding the fact that the guidance in AU sec. 508.57 rarely is applicable in an audit of financial statements, we fundamentally disagree with the premise that the passage of time remedies the misstatement that originally led to modification of the auditors' opinion. We believe that a change in accounting to an "inferior" principle is akin to a departure from generally accepted accounting principles, and the auditors' opinion should be modified consistent with other departures from generally accepted accounting principles. Accordingly, we believe that the Board should consider elimination of AU sec. 508.57 in its final standard.

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We appreciate the opportunity to comment on the Proposals. If you have questions or comments regarding information included in this letter, please contact Sam Ranzilla, (212) 909-5837, sranzilla@kpmg.com, or Craig W. Crawford, (212) 909-5536, ccrawford@kpmg.com.

Very truly yours,

KPMG LLP

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