



United States Government Accountability Office  
Washington, DC 20548

November 3, 2010

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803

Subject: PCAOB Rulemaking Docket Matter No. 031: PCAOB Release No. 2010-005,  
Application of the “Failure to Supervise” Provision of the Sarbanes-Oxley Act of 2002 and  
Solicitation of Comment on Rulemaking Concepts

This letter provides the U.S. Government Accountability Office’s (GAO) comments on the Public Company Accounting Oversight Board’s (PCAOB) rulemaking concepts with respect to the “Failure to Supervise” Provision of the Sarbanes-Oxley Act of 2002.

We appreciate the PCAOB’s efforts to further the public interest and protect investors, and agree that the quality of a firm’s audit practice may be directly affected by the quality of supervision within the firm. However we have concerns about issues discussed in the release and related materials. Specifically (1) the rulemaking concepts do not align with the practice problems related to a failure to supervise, and (2) rulemaking may not be the most appropriate venue to pursue the PCAOB’s stated objective.

### **The Rulemaking Concepts Do Not Align with the Practice Problems Related to a Failure to Supervise**

The proposed rule requiring firms to clearly identify and document supervisory responsibilities does not align with the findings and concerns cited by PCAOB as the reason for issuing the PCAOB’s rulemaking concept. PCAOB Board members discussed a number of practice problems at the PCAOB’s August 5, 2010 open board meeting, including inadequate supervision and review, a lack of thoroughness in engagement partner and manager review of audit documentation, and the appearance that engagement partners did not devote sufficient attention to their responsibilities or that their commitment to engagements did not appear to correlate with the engagement risk. In summary, the Acting Chairman of the Board stated that *“when something goes wrong in an audit, the problem can frequently be traced to some type of supervisory breakdown.”*

However, such practice problems would not be addressed by proposing rules requiring firms to make and document clear assignments of relevant supervisory responsibilities throughout the firm. Although requiring firms to document their assignment of supervisory

responsibility could increase accountability for subsequently identified deficiencies in supervision, it is not clear that the rulemaking concept would improve audit quality. For example, it is unclear how proposed rules would improve auditor supervision of work performed by assistants from outside the firm or located in other countries, and the proposed rules do not address the complexity and practicality related to clearly identifying and documenting supervisory responsibilities on large engagements that may have rotating staff, supervisors and management.

The misalignment of the proposed rules and the problems related to the failures to supervise could create confusion and increase documentation requirements without improving audit quality.

### **Rulemaking May Not Be the Most Appropriate Venue to Pursue the PCAOB's Stated Objective**

PCAOB seeks comment on conceptual approaches to rulemaking that might complement the application of section 105(c)(6) of the Sarbanes-Oxley Act of 2002 and lead to improved supervision practices and improved audit quality, based on the premise that increased accountability will lead to improved supervision practices and audit quality. However, the use of rulemaking and sanctions may not be the most appropriate venue to pursue the PCAOB's stated principal objective of increasing accountability for supervisory responsibilities.

Instead, we believe that a well-documented quality control system and associated audit documentation together will normally provide sufficient identification of supervisory responsibilities within a firm and, therefore, the proposed rulemaking is unnecessary. If, however, the Board strongly believes there is a need for firms to clearly identify and document supervisory responsibilities, then the PCAOB's intent could best be achieved by enhancing PCAOB Quality Control and Auditing Standards. The PCAOB Quality Control Standards currently provide the necessary framework for a firm to develop both a system of quality control and a method to monitor the effectiveness of that quality control system. Auditing Standard No. 10, *Supervision of the Audit Engagement*, which establishes requirements for supervision of audit engagements, including the supervisory responsibility of the engagement partner, was adopted by PCAOB on August 5, 2010 and is pending SEC action.

If the Board believes that PCAOB standards do not adequately address the need for firms to identify and document the allocation of supervisory responsibilities, the Board should amend or revise the standards using general terms rather than proposing new rules. For example, revising paragraph 22 of the PCAOB's interim *Quality Control Standard #20*, which discusses the assignment of responsibility and is referenced in note 20 of the PCAOB Release, could clarify the requirements to clearly identify and document supervisors and their responsibilities, as follows:

## Quality Control Section 20

### System of Quality Control for a CPA Firm's Accounting and Auditing Practice

#### Assignment of Responsibilities

.22 Responsibility for the *design* and *maintenance* of the various quality control policies and procedures should be assigned to an appropriate individual or individuals in the firm. In making that assignment, consideration should be given to: (1) the proficiency of the individuals, (2) the authority to be delegated to them, and (3) the extent of supervision to be provided. **The supervisory responsibilities for each engagement should be included in the engagement documentation.** However, all of the firm's personnel are responsible for *complying* with the firm's quality control policies and procedures.

We support the Board in its effort to further serve the public interest and protect investors, but we believe that the rulemaking process is not the most appropriate venue for improving audit supervisory practices.

We thank you for considering our comments on this very important issue.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin", with a stylized flourish at the end.

James R. Dalkin  
Director  
Financial Management and Assurance