

*Auditing Standards Committee*  
*Auditing Section – American Accounting Association*

November 2, 2010

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

Via email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

**RE: PCAOB Rulemaking Docket Matter No. 31: 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**

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the *PCAOB Rulemaking Docket Matter No. 31: 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*.

The views expressed in this letter are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist the Board. If the Board has any questions about our input, please feel free to contact our committee chair for any follow-up.

Respectfully submitted,

Auditing Standards Committee  
Auditing Section - American Accounting Association

Committee Members:  
Chair – Joseph Brazel, North Carolina State University  
Past Chair – James Bierstaker, Villanova University  
Paul Caster, Fairfield University  
Brad Reed, Southern Illinois University

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**Responses to Specific Questions in Part II of the Release**

**Question #1**

*The principal objectives of the type of rulemaking described above would be clarity within firms about accountability for supervisory responsibilities and the creation of documentation identifying lines of accountability.*

*a. Is it appropriate to pursue the objectives through rulemaking, or are there reasons to pursue those objectives through other means?*

We think additional guidance on supervision is warranted. Formal documentation of supervisory structures within the firms may help to eliminate any potential gaps in supervisions, and guidance on structures to ensure that supervision is taking place seems valuable. However, it is worth considering if additional rules are needed, as opposed to some additional guidance.

Overall, clarity is needed. Clarity has been needed for some time now. According to Loscalzo (1991), disclosure and reporting of supervision on audits, as well as documentation, was a major problem in 1990. Since the PCAOB is at least occasionally finding similar problems, it remains a problem.

Also, it is likely that if audit professionals are explicitly aware of their responsibilities on an audit (what they are explicitly accountable for and who they explicitly are assigned to supervise), then we may see audit professionals (1) take the job of assigning qualified staff more seriously (and raise concerns when qualified staff are not available), (2) be more likely to report unethical behavior (either by the client or within the audit team), and (3) perform a more diligent job of review (e.g., use more effective face-to-face review methods over more efficient electronic review methods (Brazel et al. 2004 Payne et al. 2010)).

Last, it should be noted that firms have/are facing the compounding issues of a possible shortage of qualified staff, accelerated 10-K filing deadlines, increased audit requirements (e.g., AS 5). Lambert et al. (2010) describe these pressures and how, especially for busy season audits and audits of accelerated filers (vs. large accelerated filers), there is empirical evidence suggesting a reduction in audit / earnings quality when these audits experience mandatory reductions in post-fiscal year-end audit time due to accelerated filings.

*b. How are those objectives typically already being met within firms? On this point, the Board is particularly interested to hear from firms, of varying sizes, their views about how their structures and their existing quality control practices achieve these objectives.*

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A recent study sheds positive light on contemporary supervision and review processes. Agoglia et al. (2010) provide survey evidence that suggests that reviewers perceive in-person interaction during review as more effective and electronic interaction as more convenient. Given these findings, the authors conducted an experiment that explored whether misstatement risk and workload pressure influence the choice of review method. The authors find that these factors interact to affect reviewer behavior. Specifically, workload pressure can increase the likelihood of electronic review, but only when misstatement risk is low. When risk is high, reviewers choose to employ in-person reviews regardless of workload pressures. These findings are particularly relevant in light of changes in the regulatory environment that both emphasize the auditor's role in detecting fraud/errors and exacerbate traditional workload pressures during busy times of the year. These results suggest that reviewers *effectively* cope with these conflicting pressures by choosing alternative review formats.

*c. The Board is also particularly interested in hearing how investors, audit committees, and others who rely upon audited financial statements view the importance of these objectives.*

It is our belief that investors likely assume proper supervision is occurring throughout all levels of the CPA firm during an audit.

**Question #2**

*To the extent these objectives are pursued through Board rulemaking, are there potential unintended consequences to take care to avoid, i.e., ways in which pursuing the objectives might inadvertently diminish accountability or audit quality?*

This is an interesting question. It is certainly possible that if someone is not formally charged with supervisory responsibilities, their informal mentoring may be reduced since someone else now has that responsibility.

Also, an unintended consequence would be the same problem that occurs whenever more detailed rules replace guiding principles. The rules create loopholes which can be used to circumvent the system.

**Question #3**

*3. Are there related or different rulemaking objectives that would complement application of section 105(c)(6) that should be pursued instead of, or in addition to, the objectives described here?*

None of which we are aware.

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- a. *In particular, are there ways in which the Board's quality control standards should be revised that would complement or facilitate the application of section 105(c)(6) or otherwise require firms to give increased emphasis to the role of supervision throughout their audit practice?*

The PCAOB could consider providing some examples of proper supervision and the documentation of same.

**Question #4**

*What are the relative advantages and disadvantages of the two approaches described?*

The Board contemplates two approaches to crafting a rule regarding “the responsibilities of a registered public accounting firm and its supervisory personnel with respect to supervision” (PCAOB Release No. 2010-005, 1). The two approaches can be summarized as a general approach and a detailed approach. While the Board notes that both the general approach and the detailed approach would allow for some flexibility in how firms could apply with the rule, a detailed approach would leave less room for a registered public accounting firm to modify its supervision function appropriate to its business. This more detailed approach seems contrary to the concepts of quality control as contained in the professional literature. For example, QC § 20.4 states the following:

A firm's system of quality control encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of complying with professional standards. The nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

It is possible that a more detailed approach may prescribe an approach that does not fit well with the operations of a particular accounting firm. If the prescribed approach is not economical for the accounting firm, compliance with the rule may be reduced.

Finally, there is an analogy between the two approaches (general vs. detailed) contemplated in this solicitation of comment from the PCAOB and the on-going debate regarding principles based vs. rules based accounting standards. Using a principles-based approach, the PCAOB could specify the key objectives regarding supervision and provide some examples of how a firm could meet the objectives and let each firm adapt the examples to their specific situation.

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**Question #5**

*Are there significantly different approaches that might effectively accomplish the relevant objectives?*

While we endorse a more general approach, we feel it is necessary to provide explicit examples / best practices of how conceptual issues related to supervision can be applied (e.g., when planning how engagement management will review the work/audit documentation of staff (e.g., whether to review on-site or to review from a remote location), the risk associated with the audit area / client should be considered (Brazel et al. 2004; Agoglia et al. 2010).

**Question #6**

If the Board were to pursue the more detailed approach described above, how should the Board approach identifying the appropriate degree of detail?

The Board could identify best practices that may already exist within the firms.

**Question #7**

*Are there identifiable areas of responsibility that should be included in any such detailed approach even though they do not necessarily correspond to aspects of the QC standards?*

Some level of supervision should be occurring at each level of the audit. Thus, senior auditors ought to be supervising the work of staff auditors, managers ought to be supervising the work of staff auditors and seniors, etc. It may not be clear within *large* audit engagement teams (1) what the specific lines of supervision are and (2) who is explicitly accountable to whom.

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**References**

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