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Public Company Accounting Oversight Board
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Re: PCAOB Rulemaking Docket Matter No. 31, *Application of the "Failure to Supervise" Provision of the Sarbanes-Oxley Act of 2002 and Solicitation of Comment on Rulemaking Concepts*

Dear Board Members and Staff:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board) Release *Application of the "Failure to Supervise" Provision of the Sarbanes-Oxley Act of 2002 and Solicitation of Comment on Rulemaking Concepts* and respectfully submit our comments and recommendations thereon.

We believe that an appropriately designed and functioning quality control system is of critical importance to audit firms and audit quality, and one of the underpinnings of the reliability of the financial data in the U.S. financial markets. In this regard, we support the Board's consideration of rulemaking in this area, which encompasses processes related to supervision and monitoring.

We note (through comments made by the Board, including those made by Acting Chairman, Daniel L. Goelzer, and Board Member, Steven B. Harris, on August 5, 2010) that the Board's intentions related to possible rulemaking are rooted in the perception that there are voluminous supervisory failures based on the Board's inspection findings. We agree that supervision is an important matter for the Board to address. Further, we believe that it is beneficial for the Board to increase dialogue with the profession regarding supervisory failures. Such dialogue will result in a deeper understanding of the nature of the perceived supervisory failures and their relationship to inspection findings, and may also result in further fact finding to ascertain the areas of supervision or monitoring that are most at risk. This action is necessary for the Board to be able to propose suitable rulemaking related to its quality control and auditing standards.

We firmly support robust quality control standards that address the assignment and documentation of supervisory responsibilities at the engagement and firm levels. However, engagement and firm level supervisory responsibilities differ. The ultimate responsibility for supervision and review at the individual engagement level rests with the engagement team – in particular, the engagement partner. Supervisory responsibilities at the firm level relate primarily to monitoring the operation of a firm's system of quality control as a whole and address, among other things, managing firm operations, providing technical and specialty support, and also procuring and managing resources. Firm level supervisory deficiencies ordinarily pertain to a failure in the system of quality control to either prevent or detect such deficiencies, but often do not directly link to a deficiency in a particular engagement. It is not possible for firm level personnel to directly supervise all, or portions of, every audit engagement. The Board's rulemaking should be clear in acknowledging this aspect of supervision and monitoring.

We appreciate the fact that the Board's approach to inspections acknowledges the fundamental difference in engagement level quality controls and other firm level functions that relate to audit quality. Any system of quality control has inherent limitations. Due to such limitations, the Board and its inspection and enforcement personnel should not presume that deficiencies or a particular engagement failure provides direct evidence that the entire system is ineffective or that an individual with firm level supervisory responsibilities has direct responsibility over an engagement level predicate violation. Firm level supervisory personnel ordinarily are not solely responsible for such violations, particularly with respect to actions taken in relation to previous violations. Such actions often involve decision-making processes and input from various groups and individuals within a firm in assessing and responding to engagement level deficiencies.

For the reasons stated herein and in our responses to the Board's specific questions below, we believe that the Board should not pursue rulemaking related to supervisory responsibilities separate from the requirements of its quality control and auditing standards. Any such rulemaking should be focused on enhancing a firm's existing assignment and documentation of supervisory responsibilities, without imposing an approach that requires firms to assign individuals to specific and sole areas of responsibility within the system of quality control. Any proposals that attempt to draw a direct line of accountability from individual engagement level supervision to firm level supervision and monitoring may not be feasible or may result in inappropriate conclusions.

Rulemaking approaches

The following comprises our responses to the Board's request for specific comments related to possible rulemaking approaches.

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 believe that it is appropriate to pursue the objectives relating to supervisory responsibilities through rulemaking, but that such rulemaking should be made in conjunction with the Board's decision to propose revisions to its interim quality control standards, in consideration of the Board's complete understanding of the nature of the supervisory failures. We do not believe that a separate rule outside of such quality controls standards, or the Board's auditing standards, is necessary or appropriate. See our responses to questions 3 and 7.

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.

We believe that our objectives and processes are similar to other public accounting firms in that our firm establishes supervisory policies and procedures at both the engagement and firm levels. Professional standards guide the development of these quality control policies and procedures, which are documented within the firm's various manuals and audit tools. Firm training is provided to reinforce the firm's policies and procedures. The firm also relies on its system of quality control, including its internal inspections and monitoring activities and its external inspections, in determining whether changes to such policies and procedures are needed to further strengthen audit quality. However, the engagement team is ultimately responsible for appropriately implementing the firm's policies and procedures and for the overall quality of the particular engagement.

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?

Supervisory responsibilities are established to improve, not diminish, audit quality. We believe, however, that a more detailed approach could have an unfavorable outcome and should not be pursued by the Board. Inappropriate emphasis may be placed on assigning individuals in specific areas of supervisory responsibility, in lieu of viewing supervision and monitoring as a collective effort involving several individuals and related firm processes. One outcome of this prescriptive approach is that it may affect a particular individual's perceived ability and initiative to consider and address supervisory matters outside of the individual's specific area of assignment. Firms may also be exposed to undue harm in the form of sanctions, loss of registration, or other reputational risk if the Board were to take enforcement action for a predicate violation against firm level supervisory personnel by focusing solely on the individual's responsibilities, without considering the firm's system of quality control as a whole. We believe that such consequences would result in diminished audit quality.

We agree with the Board that implementing a firm's quality control policies and procedures are responsibilities that relate to supervision. However, any rulemaking should make clear, similar to the Release, that there must be "sufficient connection" to a predicate violation to result in a sanction under section 105(c)(6). The Board provides an example whereby an individual who considers internal monitoring findings about deficiencies in an associated person's conduct fails to take reasonable steps to address such competency or conduct issues related to that associated person, in which case, depending on the facts and circumstances, the connection between that failure and the predicate violation could suffice to justify enforcement action. We believe that this will typically not be the case, particularly in larger firms where the monitoring function is appropriately segregated. Determining whether a deficiency in a firm's system of quality control has a sufficient connection to a predicate violation at the engagement level requires significant judgment, and therefore, a firm's assignment and documentation of supervisory responsibilities cannot, and should not, be the lone factor considered by the Board in making this connection for purposes of justifying enforcement action. For instance, in the aforementioned example, changes in engagement circumstances related to the particular entity or industry, professional standards, or otherwise may have also contributed to the subsequent predicate violation.

Rulemaking that is perceived to be intended solely to benefit the Board's inspection and enforcement activities could affect the clarity within which a firm assigns and documents its lines of accountability, ultimately affecting audit quality. We are concerned that such an approach could be viewed as fostering a "blame culture" that could negatively affect audit quality and the profession at large. We caution the Board to appropriately consider such views in assessing any proposed rulemaking.

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?

   As previously indicated, we believe that the Board should not use separate rulemaking as an expedient to revising its interim quality control standards. Accordingly, we do not believe that there are other related or different rulemaking objectives that the Board should undertake to complement the application of section 105(c)(6).

   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?

      In revising the Board's interim quality control standards, we encourage the Board to consider the International Auditing and Assurance Standards Board's International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, and its International Standard on Auditing 220, *Quality Control for an Audit of Financial Statements*, including the requirements and guidance therein related to supervisory responsibilities. The Board could enhance these responsibilities within the Board's quality control standards by also addressing the principal objectives of the proposed rulemaking to provide additional clarity regarding supervisory responsibilities within firms. However, we believe that the Board's standards should clearly delineate between engagement level and firm level quality controls, including supervision and monitoring.

      With respect to firm level supervision, we also believe that the Board's quality control standards should limit a firm's assignment and documentation of supervisory responsibilities to the following quality control elements identified in ISQC 1:

      - Leadership responsibilities for quality within the firm

- Relevant ethical requirements
- Acceptance and continuance of client relationships and specific engagements
- Human resources
- Engagement performance
- Monitoring.

We believe that the aforementioned elements generally encompass the concepts in the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control-Integrated Framework*. Consequently, the elements in ISQC 1 provide a framework against which a firm can establish, monitor, and evaluate the effectiveness of its system of quality control. We believe that adopting and enhancing ISQC 1 will provide the Board with opportunities to increase audit quality, particularly as it relates to supervisory and monitoring responsibilities within each of these elements.

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

Enhanced assignment and documentation of supervisory responsibilities pertaining to the elements of a system of quality control should generally improve audit quality. We believe that a more general approach based on a set of principles that guide a firm's assignment and documentation would provide sufficient flexibility based on organizational structure and size. A more detailed approach, however, may be difficult to craft and implement, and it could also have an adverse affect. See our responses to questions 2 and 6.

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

We do not believe that there are other significantly different approaches that might effectively accomplish the relevant objectives.

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

As previously indicated, we believe that the Board should not pursue a more detailed approach. We also believe that organizational structure and firm size could present significant impediments in developing and applying an approach that specifically identifies areas of supervisory responsibility for which specific individuals are to be assigned. The Board should hold discussions with firms of all sizes prior to concluding to undertake a more detailed approach.

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?

We do not believe that there are any areas of responsibility that should be included in either approach being considered by the Board that would not correspond to quality control or auditing standards. Supervisory responsibilities are an element of the policies and procedures a firm establishes to comply with such standards. Areas of responsibility that do not correspond to aspects of the Board's quality control or auditing standards would seem to be outside the scope of the Board's principal objectives.

We would be pleased to discuss our letter with you. If you have any questions, please contact Karin A. French, National Managing Partner of Professional Standards, at (312) 602-9160.

Sincerely,

Grant Thornton LLP