5 February 2014

Our ref: ICAEW Rep 14/14

Your ref: PCAOB Rulemaking Docket Matter No. 029

Office of the Secretary
PCAOB
1666K Street NW
Washington
DC20006-2803

Dear Sir

PCAOB Release No 2013-009

Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit

ICAEW is pleased to respond to your request for comments on *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

PCAOB RELEASE NO 2013-009

IMPROVING THE TRANSPARENCY OF AUDITS: PROPOSED AMENDMENTS TO PCAOB AUDITING STANDARDS TO PROVIDE DISCLOSURE IN THE AUDITOR'S REPORT OF CERTAIN PARTICIPANTS IN THE AUDIT

Memorandum of comment submitted in February 2014 by ICAEW, in response to the PCAOB consultation *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit* published in December 2013

Contents **Paragraph(s)**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit* published by the PCAOB in December 2013, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.

MAJOR POINTS

ICAEW support for the revised proposals regarding naming the engagement partner, and desire for the issues to be resolved expeditiously for the benefit of all stakeholders

5. The debate over naming the engagement partner has been a long one and we urge the PCAOB to take the necessary steps to finalise its proposals on a timely basis so that investors and auditors can move on. We noted our support for the PCAOB in its efforts to improve the transparency of audits in our response to its October 2011 exposure on the same subject (ICAEW Rep 22/11), and we welcome these revised proposals. Investors have legitimate concerns about responsibility for the audit, who has performed the work on large multi-national audits and the extent to which reliance has been placed on the work of unconnected auditors in distant jurisdictions. Their concerns need to be addressed.

6. In our view, the main justification for naming the engagement partner lies in the fact that investors want it, and that it will do no harm. This is sufficient. In this context, of less importance is:

- our view that in the long run, naming the engagement partner is unlikely to have much effect on auditor behaviour;
- academic evidence suggesting that naming the engagement partner will improve audit quality, which is indirect and based on complex assumptions about proxies for audit quality;
- the lack of comment on the subject either way since its introduction in Europe.

However, we respectfully suggest that the PCAOB seeks to avoid unduly raising expectations about auditor behaviour in response to the proposed new requirements, for these reasons.

Caution regarding the proposal to name others involved in the audit

7. While we acknowledge that the group engagement partner may not be responsible for the full audit opinion, we remain unconvinced about the value of the proposed disclosures relating to other participants in the audit, and we remain concerned about unintended consequences which may include misleading investors about responsibility for the audit. We have similar concerns about the new proposals to disclose the identity of specialists involved in the audit. That said, in other respects these proposals represent an improvement on the original proposals. In particular, we welcome the replacement of the proposed requirement to name many individual other participants in the audit with a requirement to disclose firms and categories of persons. We also welcome the option to disclose a single number or ranges. Nevertheless, we strongly urge the PCAOB to take this final opportunity to consider carefully whether some of its proposals might actually be counter-productive, and how it might ensure that the enhanced audit quality and investor protection it seeks are most likely to be achieved.

Naming other participants in the audit

8. In ICAEW Rep 22/11 we noted our view that if more than one individual or firm involved in the audit appears in the audit report, doubt will be cast on whether the engagement partner identified, or indeed the firm, is actually responsible for the audit. We remain of this view. The revised proposals now include a further requirement for the disclosure of non-accounting/auditing specialists involved in the audit which will add to the potential for confusion regarding responsibility for the audit. Furthermore, the proposals as they stand have no reference to the specialist's skills or qualifications and, as with other disclosures, the main issue seems to be where participants are located. It is possible that some firms will want to alert investors to the fact other participants are US expatriates and we fear the development of a quite inappropriate focus on location or nationality, over more important issues such as competence and the quality of regulatory oversight.

9. This is *not* to say that we believe that information about who has performed the audit work should be withheld from investors. Rather, we believe that the information might be better located outside the audit report, and cross-referred to it when the relevant threshold is crossed.

10. The PCAOB has considered requiring that these disclosures be made in Form 2 or in a new form filed with the PCAOB. While we agree that there are disadvantages to this approach, requiring inclusion of the information in the audit report is not without disadvantages either. We urge the PCAOB to reconsider this decision in the light of the confusion and genuine threats to accountability that will be presented by including information about other participants in the audit in the audit report. We note in this context the lack of academic evidence cited by the PCAOB in support of these proposals.

11. We remain of the view that disclosure of the percentage of total audit hours performed by other participants in the audit is a poor metric. Investors are concerned about the risks facing the entities in which they invest, including the risk of material misstatement in the financial statements. The percentage of total hours conducted by other participants in the audit tells them nothing about this, nor is it a reasonable measure of the significance of the other participants' participation. The proposed metric is much more likely to highlight areas in which audit effort was expended on a large volume of routine, low-risk transactions. It is important that such disclosures, if they are to be made, are made in context. An explanation that significant operations in India are audited by offices in India is better than a bald statement to the effect that a percentage of the audit was conducted by an office in India, particularly given the extent of back-office outsourcing and the use of shared service centres by major corporations. If the PCAOB proceeds with this requirement, it should actively encourage the disclosure of this type of contextual information.

12. We acknowledge problems associated with trying to develop financial metrics such as those based on a proportion of revenue, profits or assets, for example, or indeed metrics relating to

the extent of senior partner involvement, even though they are likely to be better correlated with risk. Nevertheless, we believe that all such metrics are likely to be more relevant than audit hours. Furthermore, we believe that auditors use financial metrics rather than hours to communicate the extent of participation by others in communications with audit committees. Creating a disconnect between what is communicated to readers and what is typically communicated to audit committees is undesirable. At the very least, metrics other than hours are worthy of further consideration.

13. The distinction between domestic and foreign auditors is less important that the distinction between those who prepare, and those who control and review the papers, and those firms that are inspected by the PCAOB and those that are not. Investors are much more likely to be concerned about situations in which working papers are retained offshore than they are about situations in which they are retained by the group auditors and are subject to the direct supervision of the engagement partner. They are also more likely to be concerned about firms that have not been inspected. We also see no reason to differentiate between foreign offices that are part of the reporting firm and separate legal entities owned by the reporting firm.

14. We welcome the increase in the threshold of disclosure from 3% to 5% but, as indicated in ICAEW Rep 22 /11, we remain of the view that it should be higher. We understand that one of the principal concerns is with situations in which a substantial proportion of the work is performed by other firms. In order to focus on the more extreme cases, would it not be better to require disclosure when a much higher threshold, such as 20%, is triggered? Such disclosures would be less common and thus likely to have a greater impact.

15. Better disclosures at a higher level might also be made if a link was established between these disclosures about other participants in the audit, and paragraph 10 of AS16 which requires auditors to communicate to the audit committee the planned level of involvement of others in the audit and the basis for the auditor's determination that he or she can serve as principal auditor, where significant parts of the audit are to be performed by other auditors.

Naming the engagement partner

16. We acknowledge the academic work performed on the effects of naming the engagement partner but we caution against raising expectations regarding its likely impact on audit quality and investor protection. Disclosure of the engagement partner’s name in the audit report may improve transparency but it will not, of itself, enhance investor protection.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1. Would the reproposed requirements to disclose the engagement partner's name and information about other participants in the audit provide investors and other financial statement users with useful information? How might investors and other financial statement users use the information?

Q2. Would the name of the engagement partner or the extent of participation of other participants be useful to shareholders in deciding whether to ratify the company's choice of registered firm as its auditor? If so, how?

17. The reproposed requirement to disclose the engagement partner's name will be useful to investors if the information is used in an appropriate manner.

18. Despite the fact that the group engagement partner may not be responsible for the full audit opinion, as they stand, the proposed requirements to disclose information about other participants in the audit risk confusing investors as to who is responsible for the audit, about where audit effort has been directed, and by whom it has been performed. This is partly a function of the proposed requirement to disclose information about other participants *in the audit report*, rather than cross-referencing to information elsewhere, which would be preferable, and partly a function of weaknesses in the disclosure requirements themselves as outlined elsewhere in this response.

Q3. Over time, would the reproposed requirement to disclose the engagement partner's name allow databases and other compilations to be developed in which investors and other financial statement users could track certain aspects of an individual engagement partner's history, including, for example, his or her industry expertise, restatement history, and involvement in disciplinary proceedings or other litigation?

a. Would such databases or compilations be useful to investors and other financial statement users? If so, how?
b. b. Would they provide investors and audit committees with relevant benchmarks against which the engagement partner could be compared? If so, how?

Q4. Over time, would the reproposed requirement to disclose the other participants in the audit allow investors and other financial statement users to track information about the firms that participate in the audit, such as their public company accounts, size of the firms, disciplinary proceedings, and litigation in which they have been involved? Would this information be useful to investors and if so, how?

Q5. Is the ability to research publicly available information about the engagement partner or other participants in the audit important? If so, why, and under what circumstances?

19. The reproposed requirement to disclose engagement partners' names would facilitate further development of existing databases in which investors track certain aspects of an individual engagement partner's history. Time will tell if this information is actually useful to investors.

Q6. Would the reproposed requirement to disclose the engagement partner's name promote more effective capital allocation? If so, how? Can an engagement partner's history provide a signal about the reliability of the audit and, in turn, the company's financial statements? If so, under what circumstances?

20. We consider it unlikely that disclosure of the identity of the engagement partner would have a significant effect on the allocation of capital.

Q7. Would the reproposed requirements to disclose the engagement partner's name and information about other participants in the audit either promote or inhibit competition among audit firms or companies? If so, how?

21. We consider it unlikely that disclosure of the identity of the engagement partner would have a significant effect on competition among audit firms or companies.

Q8. Would the reproposed disclosure requirements mislead investors and other financial statement users or lead them to make unwarranted inferences about the engagement partner or the other participant in the audit? If so, how? Would there be other unintended consequences? If so, what are those consequences, and how could they be mitigated?

22. As they stand, unless a good level of contextual information is provided, the reproposed requirements regarding other participants in the audit might well mislead investors, *not* into making unwarranted inferences about the other participants in the audit, about whom they are likely to know very little, but into making unwarranted inferences about the quality of the group audit itself.

23. We note in our major points above our belief that while information about other participants should not be withheld from investors, more thought needs to go into what needs to be disclosed, and where.

24. Investors might well be misled regarding responsibility for the audit simply because information about other participants is disclosed in the audit report. It would be better to disclose this information in Form 2 or in a specially designed form, both of which could be cross-referenced to the audit report.

25. A percentage of total hours is likely to be misleading because of the lack of correlation between hours and audit risk. If the PCAOB proceeds with this requirement, it must try to ensure that such statements are made in context and that appropriate caveats are made regarding the inferences that can be drawn.

Q9. What costs could be imposed on firms, issuers, or others by the reproposed requirement to disclose the name of the engagement partner in the auditor's report? Please provide any available empirical data. Will there be greater or lesser effects on EGCs or auditors of EGCs than on other issuers or auditors of other issuers?

26. The PCAOB’s arguments to the effect that the additional costs will be small are based on the assumption that disclosure of the engagement partners name will have no effect on the performance of the audit. This is in direct conflict with the PCAOB’s clearly stated belief that the requirement can and should affect auditor behaviour, by making auditors more attentive and compliant.

Q10. What costs could be imposed by the application of the consent requirement to an engagement partner who is named in the auditor's report? Please discuss both administrative costs to obtain and file consents with the SEC, as well as any indirect costs that might result. How could insurance or other private contracts affect these costs?

27. We do not comment on this question.

Q11. Would application of the consent requirement to an engagement partner named in the auditor's report result in benefits, such as improved compliance with existing auditing requirements? Will there be greater or lesser effects on EGCs or auditors of EGCs than on other issuers or auditors of other issuers?

Q12. Would the reproposed amendments increase the engagement partner's or the other participants' sense of accountability? If so, how? Would an increased sense of accountability for engagement partners or other participants have an impact on audit quality? If yes, please provide specifics.

28. Notwithstanding the academic evidence cited by the PCAOB, we have no evidence to suggest that naming the engagement partner will change auditor behaviour. That said, it is to be hoped that if the proposed requirement to name the audit engagement partner *does* have an effect on auditor behaviour, that it will be positive.

Q13. What costs could be imposed on firms, issuers, or others by the reproposed requirement to disclose the information about other participants in the auditor's report? Please provide any available empirical data. Will there be greater or lesser effects on EGCs or auditors of EGCs than on other issuers or auditors of other issuers?

Q14. What costs could be imposed by the application of the consent requirement to other firms that are named in the auditor's report? Please discuss both administrative costs to obtain and file consents with the SEC, as well as any indirect costs that might result. How could insurance or other private contracts affect these costs?

Q15. Would application of the consent requirement to other firms named in the auditor's report result in benefits, such as improved compliance with existing requirements? Will there be greater or lesser effects on EGCs or auditors of EGCs than on other issuers or auditors of other issuers?

29. The proposals do not appear to deal with situations in which other participants are unwilling to provide the relevant consents. We can envisage situations in which, for example, audits of components are conducted under ISAs and additional work is performed to meet PCAOB requirements. Other auditors may well be unwilling to provide consents in such cases because their work was not conducted in accordance with PCAOB standards without, at the very least, further clarification in the audit report. The negotiations in such situations may well consume resources.

Q16. Would disclosure of the extent of other participants' participation, within a range rather than as a specific number, provide sufficiently useful information to investors and other financial statement users? Why or why not? Would the reproposed requirement to disclose the extent of other participant participation within ranges impose fewer costs than a specifically identified percentage?

30. An option to disclose a range rather than a single figure would be helpful not least because the use of hours is not a perfect metric, and absolute figures would lend a spurious appearance of accuracy to the disclosures.

Q17. Would increasing the threshold for individual disclosure of other participants to 5% from the originally proposed threshold of 3% improve the relevance of the

disclosure? Would it reduce potential costs? Would another threshold, such as 10%, be more appropriate? If so, why?

31. We noted in ICAEW Rep 22/11our belief that a threshold of 20% would be consistent with the definition of a 'substantial role' in the PCAOB's rules. We note in our major points above our belief that a lower threshold will result in a higher volume of disclosures with less impact.

Q18. Under the reproposed amendments disclosure would not be required when audit work is offshored to an office of the firm that issues the auditor's report (even though that office may be located in a country different from where the firm is headquartered), but disclosure would be required when audit work is performed by a foreign affiliate or other entities that are distinct from the accounting firm issuing the auditor's report.

a. Should all arrangements whether performed by an office of the firm issuing the auditor's report in a country different from where the firm is headquartered, a foreign affiliate or another entity that is distinct from the accounting firm issuing the auditor's report be disclosed as other participants in the audit? Why or why not?

32. We note in our major points above our belief that disclosures at a higher level linked to the requirements of paragraph 10 of AS16 would be appropriate. These cover the requirements to communicate to the audit committee the planned level of involvement of others in the audit, and the basis for the auditor's determination that he or she can serve as principal auditor, if significant parts of the audit are to be performed by other auditors.

33. The two important distinctions in this context are not between domestic and foreign auditors, but between those who prepare and those who control and review the papers, and those firms inspected by the PCAOB and those that are not. There is a significant difference between situations in which:

- auditors have work performed offshore, and all working papers produced by the offshore team are sent to the head office team and reviewed by the lead partner, regardless of whether a network firm is used;
- the working papers are retained in the offshore location.

34. We also see no reason for distinctions to be made between foreign offices that are part of the reporting firm and separate legal entities owned by the reporting firm. Absent any contextual information, the proposed disclosures are likely to be of little value to investors and the PCAOB should encourage the disclosure of such contextual information.

Q19. Are there special considerations for alternative practice structures or other non-traditional practice structures that the Board should take into account regarding the reproposed requirement to disclose other participants in the audit?

35. We do not comment on this question.

Q20. Under the reproposed amendments, the auditor would be required to include the extent of participation of persons engaged by the auditor with specialized skill or knowledge in a particular field other than accounting and auditing ("engaged specialists") in the total audit hours and to disclose the location and extent of participation of such persons. The engaged specialists would not be identified by name, but would be disclosed as "other persons not employed by the auditor."

a. Is it appropriate to require disclosure of the location and extent of participation of engaged specialists? If not, why?

b. Would there be any challenges in or costs associated with implementing this requirement for engaged specialists? If so, what are the challenges or costs?

36. We fear that investors may be further confused regarding the responsibility for the audit by these new proposed disclosures. Disclosures are likely to be opaque and to beg more questions than they answer unless clear contextual information is encouraged or mandated.

Q21. In the case of other participants that are not public accounting firms (such as individuals, consulting firms, or specialists), is the participant's name a relevant or useful piece of information that should be disclosed? Does disclosure of the participant's location and the extent of the participant's participation provide sufficient information?

Q22. If the Board adopts the reproposed amendments for auditors to disclose the name of the engagement partner and certain information about other participants in the audit in the auditor's report, should the Board also require firms to disclose the same information on Form 2 or another PCAOB reporting form? Why or why not?

37. We note in our major comments above our belief that information regarding other participants should be cross referenced to Form 2 or another PCAOB reporting form. We do not believe that this information needs to be included in two places. Disclosing the name of the engagement partner in the audit report *and* in Form 2 or something similar is also unnecessary.

Q23. Are the reproposed amendments to disclose the engagement partner's name and information about other participants in the audit appropriate for audits of brokers and dealers? If yes, are there any considerations that the Board should take into account with respect to audits of brokers and dealers?

38. We do not comment on this question

Q24. Should the reproposed disclosure requirements be applicable for the audits of EGCs? Are there other considerations relating to efficiency, competition, and capital formation that the Board should take into account when determining whether to recommend that the Commission approve the reproposed amendments to disclose the engagement partner's name and information about other participants in the audit for application to audits of EGCs?

Q25. Are the disclosures that would be required under the reproposed amendments either more or less important in audits of EGCs than in audits of other public companies? Are there benefits of the reproposed amendments that are specific to the EGC context?|

39. We do not comment on this question

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