



19 December 2011

Our ref: ICAEW Rep 122/11

Your ref: PCAOB Rulemaking Docket Matter No. 29

Office of the Secretary,  
PCAOB, 1666 K Street,  
N.W., Washington, D.C. 20006-2803.  
USA

Dear Sir

**IMPROVING THE TRANSPARENCY OF AUDITS: PROPOSED AMENDMENTS TO  
PCAOB AUDITING STANDARDS AND FORM 2**

ICAEW is pleased to respond to your request for comments on PCAOB Release No. 2011-007 of October 11, 2011 entitled *Improving the Transparency of Audits: Proposed Amendments To PCAOB Auditing Standards and Form 2*.

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

Yours sincerely

Katharine E Bagshaw FCA  
ICAEW Audit and Assurance Faculty  
T+ 44 (0)20 7920 8708  
F + 44 (0)20 7920 8708  
E: [kbagshaw@icaew.com](mailto:kbagshaw@icaew.com)



## ICAEW REPRESENTATION

### **ICAEW RESPONSE TO THE PCAOB'S REQUEST FOR COMMENT ON *IMPROVING THE TRANSPARENCY OF AUDITS: PROPOSED AMENDMENTS TO PCAOB AUDITING STANDARDS AND FORM 2***

Memorandum of comment submitted in December 2011 by ICAEW, in response to the PCAOB's consultation *Improving the Transparency of Audits: Proposed Amendments To PCAOB Auditing Standards and Form 2* published in October 2011.

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the PCAOB's proposals *Improving the Transparency of Audits: Proposed Amendments To PCAOB Auditing Standards and Form 2* published in on 11 October 2011 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 136,000 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

### Disclosure of Other Participants in the Audit

5. We support PCAOB's desire to improve transparency in auditor reporting. We also understand the discomfort of investors concerned about a lack of clarity regarding who is responsible for large multi-national audits, who has performed them, and the extent to which reliance has been placed on the work of auditors in distant jurisdictions whose business practices and cultures may not be well-understood in the US.
6. Unfortunately, we believe that the PCAOB, with the best of intentions, risks creating a charter for more uncertainty, not less. Implementing these proposals could be seriously counterproductive. Providing a great deal of information about who has been involved with the audit in an attempt at improving transparency may well increase confusion about who is responsible for the audit, because there is an element of a trade-off between transparency and accountability. Excessive transparency in the form of information overload is not good for accountability. If everyone appears to be responsible, no-one is. There is a risk that investors will not be able to see the wood for the trees which would defeat the object of the proposals.
7. We believe that what investors really need to know is who is responsible for the audit. They have a right to know who has been involved in the audit but this information does not belong in the auditors' report. If a long list of people involved in the audit appears in the auditors' report, doubt will be cast, at best, on whether the engagement partner identified in the report, or indeed the firm, is actually responsible for the audit.
8. We do not believe that transparency is an end in itself, and we do not believe that of itself it will enhance investor protection. Having information is not the same as understanding it or putting it to good use and there is a risk that accountability will be lost in a sea of spurious transparency. A more appropriate home for this information would be with the audit committee, which should be in a good position to evaluate it and communicate salient points to the board and investors. It is likely that extensive public disclosures about firms involved in

multinational audits will be tracked. Attempts will be made to equate poor audit quality with the extensive use of other firms, without proper consideration of the (usually very sound) reasons for using local auditors. It is possible that as a result, firms may inappropriately seek to restrict the performance of audits to members of network firms in the interests of appearance, regardless of the effect on audit quality, increasing audit costs, and quite possibly the cost of capital if the wrong messages are sent to the market.

9. While the proposals do not address the merits or otherwise of divided responsibility, we strongly believe that this continued practice is the root of many of the problems that the PCAOB is trying to remedy,

### **Auditor signature proposals**

10. Proposals for disclosure of the identity of the engagement partner are uncontentious and satisfy a deep-seated need among investors to know who within the firm has responsibility for the engagement. When similar proposals in the UK were first put forward, firms were wary of the possible effects of identifying the engagement partner. They were also sceptical about the implicit expectation that auditor behaviour would change. As with any change, at first, the novelty value made people sit up and pay attention but the effect rapidly wore off and there is now little mention of the subject. We believe that the initial scepticism about the effects of identification on auditor behaviour has been borne out. The UK requirements, despite the additional requirement for a signature, do not appear to us to have resulted in much, or indeed any behavioural change. Identifying the engagement partner might have improved perceptions of transparency but we have yet to be convinced of a significant effect on audit partner, firm or engagement team behaviour, other than an increase in administrative requirements. Requiring a signature, as opposed to simply identifying the engagement partner probably makes little difference but on balance, we believe that a signature deflects attention, probably inappropriately, from the firm as a whole.

## **RESPONSES TO SPECIFIC QUESTIONS**

### **Disclosure of the Engagement Partner**

#### **A: The Proposed Audit Report Disclosure**

*1. Would disclosure of the engagement partner's name in the audit report enhance investor protection? If so, how? If not, why not?*

11. Disclosure of the engagement partner's name in the audit report may improve transparency but we do not believe it will of itself enhance investor protection.

*2. Would disclosing the name of the engagement partner in the audit report increase the engagement partner's sense of accountability? If not, would requiring signature by the engagement partner increase the sense of accountability?*

12. We have yet to be convinced that disclosing the name of the engagement partner or indeed requiring signature by the engagement partner in the audit report increases the engagement partner's sense of accountability in any of the jurisdictions in which the requirement is in place.

*3. Does the proposed approach reflect the appropriate balance between the engagement partner's role in the audit and the firm's responsibility for the audit? Are there other approaches that the Board should consider?*

13. There is a risk that the identification of the engagement partner deflects attention from the responsibility of the firm as a whole. In most jurisdictions, the US being a notable exception where the audit committee appoints the firm, the shareholders are responsible for approving the appointment of the firm, not the individual engagement partner.

4. *Would the proposed disclosure clearly describe the engagement partner's responsibilities regarding the most recent reporting period's audit? If not, how could it be improved? and*
5. *Would the proposed disclosure clearly describe the engagement partner's responsibilities when the audit report is dual-dated? If not, how could it be improved?*
14. If a requirement to disclose the engagement partner name is introduced, it would be preferable not to have more than one name in the audit report. Distinguishing between the partners responsible for the current year audit and the prior period audits would inevitably lead to confusion. It is certainly possible to envisage a situation where three partners are named as being responsible for each of the years presented which would not be helpful to investors.
15. The issue of dual dating is more problematic given that the incremental audit work performed for the dual dating period may be limited. Accordingly, while dual dating is retained within PCAOB standards, the proposed disclosure is probably appropriate in such circumstances.
6. *Would the proposed amendments to the auditing standards create particular security risks that warrant treating auditors differently from others involved in the financial reporting process?*
16. The PCAOB notes ICAEW concerns about security risks to auditors in its proposals but does not deal with the issue. We note that with a few exceptions, other advisers are not identified personally in the financial reporting process. Those who are identified are generally individuals who occupy senior positions in the reporting entity and whose appointment in an individual capacity is approved by the shareholders. Audit firms, on the other hand, are appointed as the auditor and not individual engagement partners. The audit engagement partner stands alone as a third party professional under these proposals and while under European law there are limited exceptions to deal with security concerns, no such protection is afforded under the PCAOB's proposals.
7. *Would the proposed amendments to the auditing standards lead to an increase in private liability of the engagement partner? and*
8. *What are the implications of the proposed disclosure rule for private liability under Section 10(b)? and*
9. *Would the disclosure of the engagement partner's identity affect Section 11 liability? If so, what should the Board's approach be?*
10. *Would the disclosure of the engagement partner's identity have any other liability consequences (such as under state or foreign laws) that the Board should consider? and*
11. *Would a different formulation of the disclosure of the engagement partner ameliorate any effect on liability?*
17. We make no comment on those parts of these questions which, as a matter of US law, are outside our expertise. However, some protection to European auditors is afforded by European law, as noted in the proposals. Nevertheless, we would be concerned if in fact disclosure were to generate actions against partners in the US.

## **B: The Proposed Amendment to Form 2**

12. *If the Board adopts the proposed requirement that audit reports disclose the name of the engagement partner, should the Board also require firms to identify the engagement partner with respect to each engagement that the firms are otherwise required to disclose in Form 2? and*

13. *If the Board does not adopt the proposed requirement that audit reports disclose the name of the engagement partner, should the Board nonetheless require firms to identify the engagement partner with respect to each engagement that the firms are otherwise required to disclose in Form 2? and*

14. *Disclosure in the audit report and on Form 2 would provide notice of a change in engagement partner only after the most recent period's audit is completed. Would more timely information about auditor changes be more useful? Should the Board require the firm to file a special report on Form 3 whenever there is a change in engagement partners? and*

15. *A change in engagement partner prior to the end of the rotation period could be information that investors may want to consider before the most recent period's audit is completed. Should the Board require the firm to file a special report on Form 3 when it replaces an engagement partner for reasons other than mandatory rotation to provide an explanation of the reasons for the change?*

18. *If the identity of the engagement partner is disclosed in the audit report, it would appear to be a natural follow-on for the same information to appear in Form 2. Changes in engagement partner can often appear more significant than they actually are and the PCAOB needs to consider whether the administrative cost of collecting this information will be of any real benefit other than to satisfy curiosity.*

## **Disclosure of Other Participants in the Audit and Referred-to Accounting Firms**

### **A. Disclosure When Assuming Responsibility or Supervising**

#### **1. Applicability of the Proposed Disclosure**

16. *Is it sufficiently clear who the disclosure would apply to? If not, how could this be made clear? and*

19. **Yes**

17. *Is it appropriate not to require disclosure of the individual who performed the EQR? If not, should disclosure of the engagement quality reviewer be required when the EQR is performed by an individual outside the accounting firm issuing the audit report or should the disclosure be required in all cases? and*

18. *Is it appropriate not to require disclosure of the person that performed the Appendix K review? and*

19. *Is it appropriate not to require disclosure of persons with specialized skill or knowledge in a particular field other than accounting and auditing not employed by the auditor or persons employed or engaged by the company who provided direct assistance to the auditor?*

- 20.** We cannot see how investor protection will be genuinely enhanced by disclosure of the EQR, or the person that performed the Appendix K review, or the specialists described in Q19 in any circumstances. Such information is simply too low level and granular to have any significance to investors and may appear to further dilute the responsibility of the firm for the audit opinion. Furthermore, Appendix K is clear that the Appendix K reviewer, who may well be employed by another firm, is not responsible for the audit. Disclosing that individual's name would likely give the misleading impression that they were in fact responsible for the audit.

## **2. Details of the Disclosure Requirements**

*20. Would disclosure of off-shoring arrangements (as defined in the release) or any other types of arrangements to perform audit procedures provide useful information to investors and other users of the audit report? If yes, what information about such arrangements should be disclosed? And*

*21. Would disclosure in the audit report of other participants in the audit provide useful information to investors and other users of the audit report? Why or why not? and*

*22. Are the proposed requirements sufficiently clear and appropriate with respect to identifying other participants in the audit? If not, how should the proposed requirements be revised? and*

*23. Are the proposed requirements sufficiently clear as to when the name of a public accounting firm or a person would be required to be named in the audit report? Is it appropriate that the name of the firm or person that is disclosed is based on whom the auditor has the contractual relationship? and*

*24. Would disclosure in the audit report of other participants in the audit have an impact on the ability of independent public accounting firms to compete in the marketplace? If so, how would the proposed requirement impact a firm's ability to compete in the marketplace? and*

*25. Are there any challenges in implementing a requirement regarding the disclosure of other participants in the audit? If so, what are the challenges and how can the Board address them in the requirements?*

- 21.** It is important, as noted in our main points above, that transparency does not obscure accountability. It is likely that there will be inappropriate focus on the location of the relevant office at the expense of understanding how tightly the office is controlled, which is more important from an audit quality point of view. It is important that such disclosures are made in context. Investors are better served by an explanation that significant operations in India are audited by offices in India than a bald statement to the effect that a percentage of the audit was conducted by an office in India.

- 22.** If PCAOB does require such disclosure, we suggest that the relevant participants be categorised as follows:

- Network firms registered with the PCAOB
- Non-network firms registered with the PCAOB
- Firms not registered with the PCAOB

- 23.** It may also be appropriate to further identify within each category those firms in countries where the PCAOB is not currently able to conduct inspections.

## **3. Disclosure of Percentage of the Total Hours in the Most Recent Period's Audit, Excluding EQR and Appendix K review**

26. *Is the percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review, a reasonable measure of the extent of other participants' participation in the audit? If not, what other alternatives would provide meaningful information about the extent of participation in the audit of other participants? and*

27. *What challenges, if any, would requiring the percentage of audit hours as the measure of the other participants' participation present? and*

28. *Should the Board require discussion of the nature of the work performed by other participants in the audit in addition to the extent of participation as part of the disclosure? If so, what should be the scope of such additional disclosures? and*

29. *Would the proposed disclosure of the percentage of hours attributable to the work performed subsequent to the original report date in situations in which an audit report is dual-dated be useful to users of the audit report?*

30. *Is the example disclosure in the proposed amendments helpful? Would additional examples be helpful? If so, what kind?*

24. We do not believe that the percentage of total hours is either a reasonable measure of the extent of the other participants' participation, nor do we believe that its disclosure will be useful to investors or enhance investor protection. The percentage of hours expended does not necessarily correlate with audit risk or reflect the experience of the individual. Clearly, hours spent by the lead client service partner are more important to audit quality than those of a new associate employed by another participant in the audit.

25. Furthermore, where network firms are tightly controlled, such information will not reveal the extent to which one firm performed work for others within the network. While a description of the nature of the work performed would be necessary to make any sense of the figures, it would likely be lengthy, complex and boilerplate. It would risk being a *de facto* disclosure of the audit strategy to the auditee and the world at large, and indirectly disclosing information about the entity's operations that should properly be disclosed by management.

#### **4. Thresholds**

31. *Should disclosure of the names of all other participants in the audit be required, or should the Board only require disclosing the names of those whose participation is 3% or greater? Would another threshold be more appropriate? and*

32. *Is the proposed manner in which other participants in the audit whose individual extent of participation is less than 3% of total hours would be aggregated appropriate?*

26. We do not understand the rationale for the 3% threshold and believe it could lead to excessive disclosure if each individual firm were named. It may be more logical to use a 20% threshold consistent with the definition of 'substantial role' in the PCAOB's rules.

#### **B: Disclosure When Dividing Responsibility**

33. *Are the requirements to disclose the name and country of headquarters' office location of the referred-to firm sufficiently clear and appropriate?*

27. The proposed requirements are clear but we are not convinced that this level of detail will be helpful to investors.



*34. Are there any challenges associated with removing the requirement to obtain express permission of the referred-to firm for disclosing its name in the audit report? If so, what are the challenges and how could they be overcome?*

**28.** We do not comment on this issue which is a matter of US law and practice.

*35. In situations in which the audit report discloses both the referred-to firm and other participants in the audit, would using different disclosure metrics (e.g., revenue for the referred-to firm and percentage of the total hours in the most recent period's audit for the other firms and persons) create confusion? If so, what should the disclosure requirements be in such situations?*

**29.** It seems self-evident that two sets of metrics will cause confusion. The extant metrics are at least well-established.

**E** [kbagshaw@icaew.com](mailto:kbagshaw@icaew.com)

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