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Office of the Secretary
PCAOB
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Washington
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THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

By email: *PCAOB Rulemaking Docket No. 029*

Dear Sir

PCAOB RELEASE NO 2009 - 005: CONCEPT RELEASE ON REQUIRING THE ENGAGEMENT PARTNER TO SIGN THE AUDIT REPORT

The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the PCAOB's Concept Release on requiring the engagement partner to sign the audit report.

The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

Our comments have been prepared with the help of our many members working around the world who have detailed knowledge and practical experience of US, EU and other regulatory regimes.

When changes were proposed in the UK requiring audit engagement partners to sign audit reports in their own name on behalf of the firm, auditors and others expressed considerable concern, not least about the possibility of unintended consequences, and we echo PCAOB member Goelzer's sentiments regarding the need for caution for that reason.

It is early days for the new signing regime in the UK¹ under which an audit cycle has yet to be completed; it is therefore still too early to draw conclusions about the actual and perceived impact that the regime has had on audit quality. To date, most of the issues have been logistical in nature; for example, some smaller firms of UK auditors have experienced challenges in implementing the regime arising from the death, incapacity or unavailability of engagement partners to sign the audit report.

¹ the regime applies to financial years beginning on or after 6 April 2008

Only time will tell if some of the more significant misgivings expressed are well-founded. These include concerns that the change might be misunderstood as representing a change in the liability regime, that inappropriate conclusions might be drawn about audit quality on the basis of the identity of the audit partner alone, and that the regime might make it difficult for high risk businesses to find good auditors.

Our work in this area shows that while regulatory reports show audit quality in the UK to be fundamentally sound, UK investors and others clearly believe that audit quality will be improved by the new regime. While these perceptions matter, measuring improvements in audit quality is not easy and UK opinions continue to differ markedly as to whether audit quality is in fact likely to be improved as a result of the regime change. Firms only appear to be issuing new guidance to deal with logistical challenges associated with the new signing regime rather than their overall audit approach. Thus while auditors may feel differently when required to sign in their own names on behalf of the firm, they admit to no significant changes to the audit procedures conducted. A perception among users that quality has been improved through the partner signature requirement that is not matched by actual changes in auditor behaviour risks widening the expectation gap, particularly if the expectation is that auditors will be making significant changes to their audit approach to address this requirement in a similar manner to the significant changes made by many companies when the CEO and CFO certification requirements were introduced by Section 302 of the Sarbanes Oxley Act 2002.

We are not experts in the vexed area of US auditor liability. The UK auditor liability regime, and the regime in other European countries differs significantly to that in the US. We do not therefore presume to opine on that issue, and we look forward to reading the comments of those better placed than us to do so.

Comment by the PCAOB on the liability issue in any standard exposed would carry some weight, but we find it difficult to envisage how any proposals that admit to the possibility that the liability of engagement partners will be altered as a result of their signing the audit report, are likely to gain acceptance. A linch pin of the UK approach is the safe harbour provided in the legislation requiring the identification of the engagement partner. If no such safe harbour can be provided, the PCAOB may have to find other methods of improving audit quality and transparency. Such methods might include developing some other mechanism for identifying the engagement partner without requiring him or her to sign the audit report.

We are encouraged that the PCAOB is addressing engagement partner signatures on audit reports and we consider a Concept Release to be the right starting point. The ICAEW has been at the forefront of this debate in the UK, through the work of the Audit Quality Forum and its publication *Identifying the Audit Partner*, and we are grateful for the PCAOB's recognition of this work.

We are pleased to provide answers to the PCAOB's questions below and I am happy to discuss any of the points raised in this response.

Yours faithfully

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Questions and Answers

1. Would requiring the engagement partner to sign the audit report enhance audit quality and investor protection?

and

2. Would such a requirement improve the engagement partner's focus on his or her existing responsibilities? The Board is particularly interested in any empirical data or other research that commenters can provide.

Common sense suggests that some may pay more attention to detail and underlying documentation when their own names appear on a document. But we have no evidence, anecdotal or otherwise, to suggest that the conduct of audits has changed or will change as a result of the introduction of the regime requiring audit partners to sign audit reports in their own names on behalf of the firm in the UK. Other than dealing with logistical matters associated with the new regime, audit firms do not appear to have issued new guidance on the conduct of audits.

Requiring the engagement partner to sign the audit report may enhance the *perception* of audit quality and investor protection in the eyes of some, particularly investors, which is important, although this perception may widen the expectation gap. Certainly an expectation that auditors will undertake significant additional procedures as a result of the change in the same way that companies implemented new procedures following the introduction of the CEO and CFO certification requirement under Section 302 of the Sarbanes Oxley Act would be undesirable.

3. Would disclosure of the engagement partner's name in the report serve the same purpose as a signature requirement, or is the act of signing itself important to promote accountability?

Disclosure of the engagement partner's name in the report, or elsewhere, would serve the same purpose as a signature requirement, but probably not as well. The act of signing is likely to promote a greater sense and appearance of accountability, particularly to investors. Disclosure of the engagement partner's name might be helpful if signatures were not deemed possible as a result of the liability regime.

4. Would increased transparency about the identity of the engagement partner be useful to investors, audit committees, and others?

and

5. Would such information allow users of audit reports to better evaluate or predict the quality of a particular audit? Could increased transparency lead to inaccurate conclusions about audit quality under some circumstances? We are particularly interested in any empirical data or other research that commenters can provide.

Increased transparency about the identity of the engagement partner is certainly desired by investors and others (although we would be alarmed if audit committees were not aware of the identity of engagement partners) but it is critical (certainly in

the UK) that all concerned understand that the engagement partner is signing for and on behalf of the firm, not in a personal capacity, and that the liability regime is unchanged. While users may believe that knowing the identity of the audit engagement partner may help them evaluate or predict the quality of an audit, this information alone may lead them to draw erroneous conclusions. Users' expectations regarding the performance of a particular engagement partner are not always going to be met.

6. Are there potential unintended consequences of requiring the engagement partner to sign the audit report that the Board should be aware of?

Yes. Some smaller firms of UK auditors have experienced challenges in implementing the regime arising from the death, incapacity or unavailability of engagement partners to sign the audit report. Such issues might be addressed as FAQs or similar in any exposure draft.

Other *potential* consequences include:

- the change being misunderstood as representing a change in the liability regime
- inappropriate conclusions being drawn about audit quality on the basis of the identity of the audit partner alone
- making it difficult for high risk businesses to find good auditors
- signatures exposing partners and their families to unacceptable personal risks
- bright young people being deterred from entering the profession in the first place, and
- creating an expectation amongst users that one individual is responsible for the audit opinion and the decisions on the audit whereas in practice audit quality is not solely the responsibility of the lead partner, but that of everyone who works on the audit and, more importantly, the firm.

7. The EU's Eighth Directive requires a natural person to sign the audit report, but provides that "[i]n exceptional circumstances, Member States may provide that this signature does not need to be disclosed to the public if such disclosure could lead to an imminent, significant threat to the personal security of any person." If the Board adopts an engagement partner signature requirement, is a similar exception necessary? If so, under what circumstances should it be available?

The purpose of this exception is largely to protect the engagement partner and his or her family from threats of violence or intimidation that occasionally emanate from extremists associated with some single interest pressure groups. A recent example in the UK involved Huntingdon Life Sciences where animal rights activists carried out an aggressive campaign against the company and its advisors, including partners and employees of the company's audit firm.

It is important to note that this legislation has been enacted in the UK such that a strong case has to be made for the exception to apply, the mere possibility of a threat to personal security will not generally suffice because the risk needs to be serious, and a resolution authorising non-publication needs to be passed by the company.

8. What effect, if any, would a signature requirement have on an engagement partner's potential liability in private litigation? Would it lead to an unwarranted increase in private liability? Would it affect an engagement partner's potential liability under provisions of the federal securities laws other than Section 10(b) of the Securities Exchange Act, such as Section 11 of the Securities Act of 1933? Would it affect an engagement partner's potential liability under state law?

and

9. Are there steps the Board could or should take to mitigate the likelihood of increasing an engagement partner's potential liability in private litigation?

We do not presume to comment on this complex area of US legislation and we look forward to reading the comments of those better placed than us to do so but we offer the following observations:

- S504 (3) of the Companies Act 1985 provides some protection to UK auditors against personal civil liability with the use of the following form of words which contain a term of art commonly used in UK legislation

The senior statutory auditor is not, by reason of being named or identified as senior statutory auditor or by reason of his having signed the auditor's report, subject to any civil liability to which he would not otherwise be subject.

- the liability regime in many continental European countries is such that the auditor's liability is determined or capped by statute in any case.

10. Some commenters on the ACAP Report who expressed concern about liability suggested that a safe harbor provision accompany any signature requirement. While the Board has no authority to create a safe harbour from private liability, it could, for example, undertake to define the engagement partner's responsibilities more clearly in PCAOB standards. Would such a standard-setting project be appropriate?

The responsibilities of the engagement partner are broad, not easy to define, scattered throughout auditing standards and definitions are in any case double edged. If the purpose of the exercise were to provide some comfort or protection to engagement partners in the place of safe harbour, we think it unlikely to succeed. While defining or describing the engagement partner's responsibility in standards might help in defending an engagement partner once litigation has commenced, it is inevitable that litigants would seek, sometimes successfully, to interpret that definition aggressively against engagement partners.

11. If the Board adopts an engagement partner signature requirement, would other PCAOB standards, outside of AU sec. 508 and Auditing Standard No. 5, need to be amended?

We believe that changes should be made to paragraph 9 of AU 311 *Planning and Supervision* to make it clear that the engagement letter should explain the consultation process that the firm has in place, including the internal consultation that firms may undertake in arriving at their audit judgement. The engagement letter should also clarify that claims can only be brought against the firm, as that is the entity making the report, not the audit engagement partner.

12. Should the Board only require the engagement partner's signature as it relates to the current year's audit? If so, how should the Board do so? For example, should firms be permitted to add an explanatory paragraph in the report that states that the engagement partner's signature relates only to the current year?

and

13. If a signature requirement is adopted, should a principal auditor that makes reference to another auditor also be required to make reference to the other engagement partner? Would an engagement partner at the principal auditor be less willing to assume responsibility for work performed by another firm under AU sec. 543?

These complex areas are not addressed in the UK as the situations described do not arise. However, we observe that simplicity and consistency are virtues when introducing potentially contentious changes, but that they sometimes conflict and have unintended consequences. We look forward to the PCAOB's proposals in these areas.

Only requiring the engagement partner's signature as it relates to the current year's audit is simple but inconsistent with reporting requirements where the audit report covers all periods presented. This may lead to confusion for users. If the requirement is extended to all periods presented then transitional arrangements are likely to be necessary.

Consistency in references to other auditors in audit reports is desirable but forcing such disclosure when the other auditor operates in a regime which does not have similar disclosure requirements may cause conflict.

14. Auditors are not required to issue a report on a review of interim financial information, though AU sec. 722, *Interim Financial Information*, imposes requirements on the form of such a report in the event one is issued. Should the engagement partner be required to sign a report on interim financial information if the firm issues one?

The PCAOB may wish to consider deferring this question in order to ensure that the main objective of identifying the audit partner in the audit report is achieved without delay. The issue of interims can be revisited at a later date.

15. Would requiring the engagement partner to sign the audit report make other changes to the standard audit report necessary?

We are not aware that auditors in Europe have found it necessary to insert caveats, disclaimers or other modifications to the standard audit report as a result of identifying the audit partner in the audit report. Any additional wording is likely to amount to an unhelpful (boilerplate) distraction.

16. If the Board adopts a signature requirement, should it specify a form of the engagement partner's signature? For example, should the engagement partner sign on behalf of the firm and then “by” the engagement partner?

The engagement partner should sign for and on behalf of the firm. Another signature would imply that the responsibility for the audit opinion is somehow divided between the firm and the engagement partner. If there is no intention to change the liability of the engagement partner this is critical.