

Heads Up

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The Board's main objective is to name the person who has primary responsibility for the audit and identify who, beyond the firm signing the auditor's opinion, is participating in the audit.

Improving Audit Transparency PCAOB Reproposes Requiring Disclosure of Engagement Partner and Certain Audit Participants

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On December 4, 2013, the PCAOB issued repropoed amendments to its auditing standards (collectively referred to as the "reproposal") as part of a [release](#)¹ to improve the transparency of audits. The reproposal would require disclosure in the auditor's report of (1) the name of the engagement partner² for the most recent period's audit and (2) the names, locations, and extent of participation (as a percentage of the total audit hours) of other independent public accounting firms that took part in the audit, as well as the locations and extent of participation of other persons (whether individuals or companies) not employed by the auditor who performed procedures on the audit. The Board's main objective is to provide additional information to users of financial statements and the related auditor's report about who has primary responsibility for the audit and who, beyond the firm signing the auditor's opinion, is participating in the audit. Prepared remarks delivered by Board members at the PCAOB's December 4, 2013, open meeting, during which the reproposal was approved for issuance, are available on the [Speeches & Statements](#) page of the PCAOB's Web site.

This *Heads Up* gives an overview of the reproposal. For a summary of remarks about the reproposal made by the PCAOB at the recent AICPA Conference on Current SEC and PCAOB Developments, see Deloitte's December 16, 2013, [Heads Up](#).

Background

Since 2005, the Board has sought input on several occasions from its Standing Advisory Group (SAG) about whether the PCAOB standards should be amended to require one or both of the following:

- The engagement partner's signature on the auditor's report.
- Disclosure of the name of the engagement partner in the auditor's report or in annual Form 2³ filings provided to the PCAOB by registered public accounting firms.

PCAOB discussions with the SAG and with the Board's Investor Advisory Group (IAG) have centered on whether such changes would (1) enhance audit quality and transparency and (2) make the auditor's report more useful.

¹ 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*.

² "Engagement partner" is defined in the appendix to PCAOB Auditing Standard No. 9, *Audit Planning*, as the "member of the engagement team with primary responsibility for the audit."

³ The PCAOB requires registered public accounting firms to file Form 2 (the Annual Report Form) in accordance with Section 102(d) of the Sarbanes-Oxley Act of 2002 and PCAOB Rule 2200. Form 2 covers a 12-month period from April 1 to March 31 of each year and includes information about audit reports issued, among other matters.

Editor’s Note: For more information about the PCAOB discussions held at SAG meetings, see Deloitte’s [December 16, 2011](#), [June 25, 2013](#), and [December 10, 2013](#), *Heads Up* newsletters.

The U.S. Department of the Treasury’s Advisory Committee on the Auditing Profession (ACAP) also considered whether the engagement partner should be required to sign the auditor’s report in his or her own name. When the ACAP issued its [final report](#)⁴ on October 6, 2008, it encouraged the PCAOB to pursue rulemaking on this topic.

To obtain further input from the public, the PCAOB issued a [concept release](#)⁵ on July 28, 2009, which requested feedback from stakeholders on whether the auditor with final responsibility should be required to sign the auditor’s report. On the basis of the comments received in response to the concept release and further deliberations, the Board issued a [proposal](#)⁶ (the “original proposal”) on October 11, 2011, to require, among other things, the disclosure of (1) the name of the partner (without a signature) in the auditor’s report or Form 2, or in both, and (2) certain other participants in the audit. The PCAOB reproposal is the result of modifications the Board made to the original proposal on the basis of comment letter feedback as well as ongoing discussions with the SAG and IAG and available empirical research considered by the Board.

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Editor’s Note: Current PCAOB standards require the auditor’s report to be signed by the audit firm. While nothing in the PCAOB’s standards prohibits the engagement partner from being named in or signing the auditor’s report, this is not a current U.S. practice. The names of engagement partners are known by audit committees, management, and others; however, such information is not widely disclosed in a public manner in the United States. In contrast, the Eighth Company Law Directive (the “Eighth Directive”) issued by the European Union (EU) on May 17, 2006, requires member states to adopt a requirement for the engagement partner to sign the auditor’s report. Article 28 of the Eighth Directive provides that “[w]here an audit firm carries out the statutory audit, the audit report shall be signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm.” According to the PCAOB, as of November 2013, 27 of the 28 EU members have enacted conforming legislation.

In addition, on July 25, 2013, the International Auditing and Assurance Standards Board (IAASB) released Proposed ISA 700 (Revised),⁷ which provides that the “name of the engagement [partner] shall be included in the auditor’s report for audits of financial statements of listed entities unless, in rare circumstances, such disclosure is reasonably expected to lead to a significant security threat to the individual.” The IAASB is currently studying and deliberating comments on its proposal. If adopted as proposed, the IAASB requirement will become the practice in many countries around the world where ISAs are implemented.

Disclosure of the Name of the Engagement Partner

The reproposal would require the auditor’s report to include the name of the engagement partner for the most recent audit period. An example in the reproposal illustrates that such disclosure would appear at the end of the first paragraph of the auditor’s report in a sentence stating, “The engagement partner on the audit for the [period] ended [date] was [name].”

The release discusses commenters’ concerns about disclosing the name of the engagement partner in the auditor’s report (e.g., limited usefulness, the possibility of distorting perceptions about how the audit is conducted, greater exposure to liability, risks to personal security, reputational considerations) and explains some of the reasoning reflected in the Board’s repropounded amendments. Overall, the PCAOB maintains that while

⁴ *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury.*

⁵ PCAOB Release No. 2009-005, *Concept Release on Requiring the Engagement Partner to Sign the Audit Report.*

⁶ PCAOB Release No. 2011-007, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2.*

⁷ Proposed International Standard on Auditing (ISA) 700 (Revised), *Forming an Opinion and Reporting on Financial Statements.*

Providing information about certain other participants in the audit could help financial statement users (1) ascertain whether other independent public accounting firms identified are registered with, and subject to inspections by, the PCAOB and (2) access the results of such inspections, if applicable.

the concerns raised in comments may be valid, the unique role served by the engagement partner on the audit team is of such importance that the shareholders should have access to this information when they are asked to ratify the company’s selection of the audit firm for the forthcoming audit.

The PCAOB acknowledges that disclosure of the engagement partner’s name in the auditor’s report for the current period may initially provide only limited useful information to investors and other financial statement users. However, the release explains that over time, such disclosure “could enable investors and other financial statement users to research the number, size, and nature of companies and industries in which the partner served as engagement partner.” Disclosure of an engagement partner’s name would also enable disciplinary actions and other forms of litigation against the engagement partner to be identified, if applicable. In addition, data related to an engagement partner’s involvement with “a restatement or issuance of an audit opinion with a going concern modification” could be collected. The Board believes that taken collectively, the identity of the engagement partner and related information could be useful to investors and other financial statement users.

Disclosures About Certain Other Participants in the Audit

The reproposal would require disclosures about certain other independent public accounting firms and other persons not employed by the auditor that participate in the audit. The type of disclosures would be based on the extent of participation by such other firms or persons and whether the participation by such other firms or persons is estimated to be 5 percent or more of the total audit hours as of the date of the auditor’s report.

The disclosure requirement is aimed at providing users of financial statements with information regarding the involvement of such other participants in the audit engagement. The information provided could help financial statement users (1) ascertain whether other independent public accounting firms identified are registered with, and subject to inspections by, the PCAOB and (2) access the results of such inspections, if applicable.

Under the reproposal, the following information would be disclosed in either (1) an explanatory paragraph of the auditor’s report inserted below the opinion paragraph and any other explanatory paragraphs or (2) an appendix that is referred to in the auditor’s report below the opinion paragraph and any subsequent explanatory paragraphs:

	Disclosures If Participation Meets or Exceeds 5% Threshold	Disclosures If Participation Is Less Than 5% Threshold
Independent public accounting firms (such firms may or may not be affiliated with the accounting firm issuing the auditor’s report)	<ul style="list-style-type: none"> The name of the firm(s). The country of headquarters’ office location. The percentage of hours attributable to the audits or audit procedures performed in the audit in relation to the total hours for the most recent period’s audit. This information may be provided as either a single percentage or a series of ranges as follows: <ul style="list-style-type: none"> 5% to less than 10%. 10% to less than 20%. 20% to less than 30%, and so forth. 	<ul style="list-style-type: none"> [Insert number] other firms, whose individual participation is less than 5% of the total audit hours, participated in the audit. Their aggregate extent of participation was [insert either a single percentage or the appropriate range].

The type of disclosure regarding other participants depends on whether the 5 percent threshold is met.

	Disclosures If Participation Meets or Exceeds 5% Threshold	Disclosures If Participation Is Less Than 5% Threshold
Other persons not employed by the auditor (participation aggregated by country)	<ul style="list-style-type: none"> The phrase "persons not employed by our firm." The country of residence of the natural persons. The percentage of hours attributable to the audits or audit procedures performed in the audit in relation to the total hours for the most recent period's audit. This information may be provided as either a single percentage or a series of ranges as follows: <ul style="list-style-type: none"> 5% to less than 10%. 10% to less than 20%. 20% to less than 30%, and so forth. 	<ul style="list-style-type: none"> Other persons from [insert number] countries not employed by our firm, whose aggregate extent of participation by country is less than 5% of the total audit hours, participated in the audit. Their aggregate extent of participation was [insert either a single percentage or the appropriate range].

Editor's Note: The reproposal's required disclosures about certain other participants in the audit differ from those of the original proposal in the following ways:

- Whereas the original proposal would have required the auditor's report to specifically name those persons not employed by the auditor that meet or exceed the disclosure threshold, the reproposal would require such persons to be identified in the auditor's report (or in a referenced appendix) only as "persons not employed by our firm." Under the reproposal, the names of other independent public accounting firms participating in the audit that meet or exceed the 5 percent threshold would need to be disclosed.
- In the reproposal, the disclosure threshold has been increased to 5 percent from 3 percent.
- Whereas the original proposal would have required the percentage of audit hours worked by other participants to be disclosed as a single number, the reproposal would allow such information to be disclosed as either a single percentage or a series of ranges.
- Unlike the original proposal, which excluded from its scope information about persons engaged by the auditor with specialized skill or knowledge in a particular field other than accounting or auditing, the reproposal would require such information to be included in the disclosures.

The reproposal specifies that disclosures about the following participants in the audit are excluded from its scope:

- Individuals performing the engagement quality review . . .
- Persons performing a review pursuant to Appendix K⁸ . . . and
- Persons employed or engaged by the company who provided direct assistance to the auditor, including:
 - Internal auditors, other company personnel, or third parties working under the direction of management or the audit committee, who provided direct assistance in the audit of internal control over financial reporting; and
 - Internal auditors who provided direct assistance in the audit of the financial statements. [Footnotes omitted]

⁸ SEC Practice Section (SECPS) 1000.45 Appendix K, *SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants*.

The “Board has assumed that engagement partners and participating accounting firms named in an auditor’s report would have to consent as well to the inclusion of their names in such an auditor’s report filed with, or included by reference in, another document filed under the Securities Act with the Commission.”

Consent Requirements

Auditors issuing an auditor’s report filed with the SEC in connection with a registration statement must consent to including their names in documents filed with the Commission and would be subject to liability under Section 11 of the Securities Act of 1933 (the “Securities Act”). The release explains that the “Board has assumed that engagement partners and participating accounting firms named in an auditor’s report would have to consent as well to the inclusion of their names in such an auditor’s report filed with, or included by reference in, another document filed under the Securities Act with the Commission.” The administrative process of obtaining the necessary consents from a potentially much larger number of participants in the audit could pose practical challenges. As a result, a company may need additional time to finalize a registration statement.

Editor’s Note: In the release, the PCAOB also addresses liability considerations related to the reproposal’s disclosure requirements.⁹

Economic Considerations

Economic analysis is an important element of the Board’s rulemaking activities. The JOBS¹⁰ Act requires the SEC to perform a specific economic analysis when considering whether PCAOB rules, including auditing standards, should apply to audits of emerging growth companies (EGCs).¹¹ (For more information, see Deloitte’s April 2, 2012 (updated May 8, 2012), *Heads Up*.) Accordingly, the release includes questions¹² that request feedback on the economic considerations related to the reproposal.

In addition to highlighting potential direct and indirect costs associated with the reproposal, the PCAOB also considered (and ultimately rejected) four alternative disclosure approaches:

- *Signing the auditor’s report* — The reproposal requires the naming of the engagement partner, which the PCAOB believes would confer most of the potential benefits of a signature requirement while mitigating some of the concerns.
- *Disclosure in the firms’ annual reports filed with the PCAOB on Form 2* — The PCAOB ultimately concluded that since Form 2 is at a minimum an annual filing, there could be a lengthy delay in the disclosure of useful information to investors and other financial statement users.
- *A new, targeted PCAOB form* — The PCAOB believes that this alternative is not preferable because it would involve effort and cost as well as require investors to search more than one database to find all the necessary information.
- *Disclosure of the required information either in the audit committee report filed with the proxy statement or in the auditor’s report* — This approach was rejected because users would have difficulty finding inconsistently located information.

Feedback on the Release

We encourage stakeholders to study the reproposal and submit comments to the PCAOB.

In particular, the release seeks feedback on the following:

- The usefulness and accessibility of the proposed disclosures.
- Costs associated with the repropounded amendments, including costs related to obtaining consents as well as any other direct or indirect costs.
- The effects of the repropounded amendments on competition.
- Whether the repropounded amendments should apply to audits of EGCs.

⁹ See page 20 of the release.

¹⁰ Jumpstart Our Business Startups.

¹¹ As defined in Section 3(a)(80) of the Exchange Act.

¹² See pages 42–44 of the release.

Submitting Comments

Comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the PCAOB's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 029 in the subject or reference line and should be received by the Board no later than 5:00 p.m. (EST) on February 3, 2014.

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