



## RELEASE

### I. Introduction

The audit report is typically an investor's primary source of information about the audit. Usually a single page, the report provides general information about how every audit must be conducted, states that the audit complied with applicable standards, gives the firm's opinion on the company's financial statements or internal control over financial reporting, and includes the signature of the firm that issued it. While the report provides useful information—the opinion, primarily—it tells the reader little about the key participants in the audit.

For example, while an audit today may involve only the registered firm issuing the report, it is more likely, at least for the largest audits, that two or more firms play a role. In many cases, these other firms are affiliated with the firm issuing the report and share a common brand name. Other times, there is no affiliation between firms working on an audit, or the firm issuing the report may use other participants from outside the firm to perform certain audit procedures. In most cases these other firms are engaged in auditing company operations in the country in which the other firm is located. Regardless of the approach, it is the engagement partner who is at the center of the effort. He or she "is responsible for the engagement and its performance," and must, therefore, make sure that the work and those who perform it are appropriately supervised and coordinated.<sup>1/</sup>

Generally, however, little, if any, of this is transparent to investors. The audit report typically contains no information about who served in the role of engagement partner, or whether the firm issuing the report actually performed all of the work.<sup>2/</sup> In

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<sup>1/</sup> See paragraph 3 of Auditing Standard No. 9, *Audit Planning*, and paragraph 3 of Auditing Standard No. 10, *Supervision of the Audit Engagement*.

<sup>2/</sup> There are no provisions requiring the disclosure of the name of the engagement partner or the name and extent of participation in the audit of other accounting firms or persons in the standards of the PCAOB, standards of Auditing Standards Board of the American Institute of Certified Public Accountants ("AICPA") or standards of the International Auditing and Assurance Standards Board. In some countries outside the United States, there are statutory requirements regarding disclosing the name of the engagement partner in the audit report. For example, the Eighth Company Law Directive of the European Union ("EU") requires the EU member states to adopt a requirement for the audit report to be "signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm." Directive 2006/43/EC of the European Parliament and of the Council, Article 28 (May 17, 2006). According to the Directive, "statutory auditor" means "a natural person who is approved

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June 2011, the Board issued a concept release seeking commenters' views on how the audit report can be made more useful to readers.<sup>3/</sup> That release is intended to generate a broad-based discussion on changes that could be made to the auditor's reporting model. In the meantime, however, the Board believes that certain targeted changes could be made to provide more transparency within the existing framework. Specifically, providing investors with the name of the engagement partner and the names of other persons and independent public accounting firms that took part in the audit would require only relatively modest changes to the audit report but could increase transparency by providing investors with information regarding certain key participants in the audit process.

Accordingly, the Board is soliciting comment on a series of amendments to PCAOB standards that would:

- Require the audit report to disclose the name of the engagement partner responsible for the most recent period's audit,
- Require registered firms to disclose in their PCAOB annual report on Form 2 the name of the engagement partner for each audit report already required to be reported on the form, and
- Require disclosure in the audit report about other persons and independent public accounting firms that took part in the most recent period's audit.

These proposals are each described in greater detail below. The Board seeks comment on all aspects of the proposed amendments.

## II. Disclosure of the Engagement Partner

On July 28, 2009, the Board issued a concept release seeking comment on whether the Board should require that the audit report include the engagement partner's

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in accordance with this Directive by the competent authorities of a Member State to carry out statutory audits." Id. at Article 2.

<sup>3/</sup> See *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* available at: <http://pcaobus.org/Rules/Rulemaking/Pages/Docket034.aspx>.

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signature in addition to the firm's signature.<sup>4/</sup> The concept release grew, in part, out of the 2008 Final Report of the Advisory Committee on the Auditing Profession ("ACAP") to the U.S. Department of the Treasury.<sup>5/</sup> That report recommended, among other things, that the PCAOB "undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report." The ACAP report stated that "[t]he Committee believes that the engagement partner's signature on the auditor's report would increase transparency and accountability."<sup>6/</sup>

The Board had heard similar views from members of its Standing Advisory Group ("SAG") with backgrounds as investors or investor advocates and from its Investor Advisory Group ("IAG").<sup>7/</sup> Beginning in 2005, the Board had sought the advice of its SAG several times on changes that could be made to the standard audit report, with a particular emphasis on whether the report should include the engagement partner's signature. Investor members of the SAG generally supported a signature requirement, while some other SAG members expressed concerns and noted the benefits of the existing requirement for the audit report to include the firm's signature.<sup>8/</sup> The IAG also discussed the signature requirement at its inaugural meeting in May 2010, at which time most IAG members expressed support for such a requirement.<sup>9/</sup>

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<sup>4/</sup> See *Concept Release on Requiring the Engagement Partner to Sign the Audit Report* available at <http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx>.

<sup>5/</sup> The ACAP was chaired by former Chairman of the Securities and Exchange Commission ("SEC") Arthur Levitt and former SEC Chief Accountant Donald Nicolaisen. Mark Olson, then Chairman of the PCAOB, was an observer.

<sup>6/</sup> U.S. Department of the Treasury, *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury*, VII:19, VII:20 (2008).

<sup>7/</sup> The names of SAG members and their biographies can be found on <http://pcaobus.org/Standards/SAG/Pages/Current.aspx>. The names of IAG members and their biographies can be found on [http://pcaobus.org/About/Advisory/Pages/Investor\\_Advisory\\_Group\\_Members.aspx](http://pcaobus.org/About/Advisory/Pages/Investor_Advisory_Group_Members.aspx).

<sup>8/</sup> See paragraph .08i of AU sec. 508, *Reports on Audited Financial Statements*.

<sup>9/</sup> The SAG discussed requiring the engagement partner to sign the audit report in February 2005, June 2007 and October 2008. After the Board issued the concept release, the SAG discussed the topic again at its October 14, 2009 meeting and the IAG discussed it at its May 4, 2010 meeting. Transcripts of the relevant

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The concept release explored how a signature requirement could enhance investor protection by increasing transparency into and accountability for the preparation and issuance of audit reports, as well as the concerns expressed by some commenters on the ACAP Report and at SAG meetings.<sup>10/</sup> The Board also asked whether a report on a review of interim financial information, if one is issued, should include the engagement partner's signature. The Board received 23 comment letters in response.<sup>11/</sup>

After considering commenters' views, including those expressed at meetings of the SAG and IAG, the Board has decided to propose a rule that would require the name of the engagement partner to be disclosed, but would not require the engagement partner's signature to be included in the audit report. As discussed below, such an approach would retain most of the potential benefits discussed in the concept release while seeking to mitigate concerns that a signature requirement would minimize the firm's role in conducting the audit. The changes would be made by amending AU sec. 508, *Reports on Audited Financial Statements*, and Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, which describe the required elements of the audit report. Additionally, the Board is proposing conforming amendments to certain other PCAOB standards that include examples of the report.

The Board is also proposing to amend Part IV of Form 2 – Annual Report Form to require registered firms to disclose the name of the engagement partner for each audit report already required to be reported on the form. This would make this information available in one place that could be easily retrieved since such reports are posted on the Board's website.

Appendix A to this release contains the proposed amendments for disclosure of the engagement partner. Appendix B to this release contains the proposed amendments to Form 2. The Board seeks comment on all aspects of the proposed amendments.

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portions of these meetings are available at:  
<http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx>.

<sup>10/</sup> The concept release noted that an engagement partner signature requirement would be in addition to, not in place of, the existing requirement for the firm to sign the audit report.

<sup>11/</sup> The comment letters are available at:  
<http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx>.

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### A. The Proposed Audit Report Disclosure

The concept release discussed two ways in which including the engagement partner's signature in the audit report might enhance investor protection. First, it stated that "a requirement for the engagement partner to sign the report may increase that individual's sense of personal accountability for the work performed and the opinion expressed, which could, in turn, have a positive effect on his or her behavior." The concept release also noted that some have suggested that the act of signing his or her own name may increase an engagement partner's sense of responsibility for the quality of the audit. The Board noted that, for these reasons, some commenters have suggested that a signature requirement would be analogous to the requirement in Section 302 of the Sarbanes-Oxley Act of 2002 for an issuer's chief executive officer ("CEO") and chief financial officer ("CFO") to make certain certifications about the company's financial statements.<sup>12/</sup>

Second, the concept release noted that a signature requirement "would increase transparency about who is responsible for performing the audit, which could provide useful information to investors and, in turn, provide an additional incentive to firms to improve the quality of all of their engagement partners." More specifically, the concept release suggested that providing financial statement users, audit committees, and others with the name of the engagement partner might provide them the opportunity to evaluate, to a degree, an engagement partner's experience and track record. If so, audit committees might increasingly seek out engagement partners who are viewed as performing consistently high quality audits, and the resulting competition could lead to an improvement in audit quality.

Investors and investor advocates who commented generally agreed that a signature requirement would enhance accountability and transparency and, in turn, investor protection. For example, the Council of Institutional Investors stated:

Armed with valuable information provided by the lead auditor's signature, investors and boards will demand skilled engagement partners. The Council consequently believes that enhanced focus on the performance of the lead

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<sup>12/</sup> Some commenters disagreed with the analogy between signing the name of the CEO or CFO and signing the name of the engagement partner and stated that the engagement partner's and the firm's responsibility for the audit report is well-established and understood, while, on the other hand, some CEOs and CFOs had attempted to avoid their responsibility for specific aspects of the financial reporting process, and the certification under Section 302 of the Sarbanes-Oxley Act of 2002 was intended to affirm that responsibility.

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auditor will motivate audit firms to strengthen the quality, expertise, and oversight of their engagement partners. By more explicitly tying the lead auditor's professional reputation to audit quality, requiring engagement partners to sign the audit report will further result in better supervision of the audit team and the entire audit process.<sup>13/</sup>

Similarly, a group of accounting professors, while "acknowledg[ing] that the current research does not definitively settle the issue," stated that a signature requirement "is likely to have a number of positive effects, including a change in partner behavior that would positively influence audit quality, and an increase in transparency for audit and financial statement users."<sup>14/</sup>

Another group of accounting professors similarly commented that "[b]ased on the existing research, it is unclear whether the signature of the engagement partner will improve audit quality," but suggested that "it seems likely that the signature requirement would enhance partner perceptions regarding personal accountability," and noted that "there is a variety of research in auditing contexts that suggests there are benefits that may result from requiring the engagement partner to sign the audit report." At the same

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<sup>13/</sup> Letter from Jonathan D. Urick, Analyst, Council of Institutional Investors, to J. Gordon Seymour, Secretary, PCAOB (September 4, 2009).

<sup>14/</sup> Letter from Audrey Gramling, Past President, Auditing Section of the American Accounting Assoc., Kennesaw St. University, Joseph Carcello, Ernst & Young Professor and Director of Research – Corporate Governance Center, University of Tenn., Todd DeZoort, Professor of Accounting and Accounting Advisory Board Fellow, University of Ala., and Dana Hermanson, Dinos Eminent Scholar Chair and Professor of Accounting, Kennesaw St. University, to J. Gordon Seymour, Secretary, PCAOB (August 14, 2009); see *also* Email from Stephen Zeff, Herbert S. Autrey Professor of Accounting, Rice University, to PCAOB (July 29, 2009), *attaching* Letter from Stephen Zeff to Advisory Committee on the Auditing Profession (June 25, 2008) (stating that "[t]he association of the engagement partner by name with the audit report should serve to lift his or her standard of professionalism" and that "[t]here is no justification for the anonymity that shrouds the identity of the engagement partner in the United States"). *But see* Allen Blay, Matthew Notbohm, Caren Schelleman, and Adrian Valencia, Audit Quality Effects of an Individual Engagement Partner Signature Mandate 29-30, available at: [http://aaahq.org/AM2011/display.cfm?Filename=SubID\\_2403.pdf&MIMEType=application%2Fpdf](http://aaahq.org/AM2011/display.cfm?Filename=SubID_2403.pdf&MIMEType=application%2Fpdf) (July 22, 2011) (reporting that the authors were "unable to document any relation between mandatory engagement partner-level signatures and audit quality in the Netherlands").

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time, they cautioned that the signature requirement could have a negative effect if it diminishes firm accountability, and that incorrect inferences could be drawn about the quality of audits associated with an individual partner because of "other factors that impact audit and financial reporting quality" and the "small number of audits associated with individual partners."<sup>15/</sup>

Other commenters, generally accounting firms and associations, did not believe that a signature requirement would enhance accountability or provide meaningful information to investors. Some suggested that engagement partners already feel accountable for the statements in the audit report due to existing factors such as the partners' sense of professionalism and strong interest in maintaining his or her own reputation as well as that of the firm, and the possibility of enforcement action by the Board or the Securities and Exchange Commission ("SEC"). These commenters generally believed that a signature requirement would not make engagement partners feel more accountable than they already do.

With respect to transparency, some auditors suggested that the identity of the engagement partner would not be useful to investors. Some believed that a company's audit committee is in a better position to evaluate information about the qualifications of an engagement partner and sufficiently represents investors' interests, making widespread disclosure of the engagement partner's identity unnecessary. Others expressed concern that databases would be developed that attempt to create a "box score" of partners' skills and qualifications, or to rank them by, for example, number of restatements.<sup>16/</sup> These commenters expressed concern that such efforts would result in investors receiving incomplete and misleading information or drawing inappropriate inferences about the audit based solely on the identity of the engagement partner.

Auditors also suggested that a signature requirement could minimize the role of a firm's quality control system in promoting audit quality. In the concept release, the Board said that it "agree[s] with those who have noted the importance of the expertise, quality control system, and skill of the firm as a whole," but "the skill and expertise of the engagement partner also undoubtedly contribute to audit quality." Some commenters continued to express concern that a signature requirement might be misunderstood by

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<sup>15/</sup> Email from Auditing Standards Committee, Auditing Section – American Accounting Associations to Office of the Secretary, PCAOB (September 9, 2009).

<sup>16/</sup> While overall restatement levels may be a general indicator of audit effectiveness, the fact of a restatement alone, without additional context, may not be a sufficient basis to make predictions about a particular engagement partner's performance.

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readers of the audit report to reflect significant changes in audit procedures, or a shift in responsibility for the audit from the firm to the engagement partner. Some commenters suggested that unintended consequences of a signature requirement might include engagement partners practicing “defensive auditing,” firms shedding their riskier clients, and talented individuals leaving, or refusing to enter, the profession, all of which, according to some commenters, could increase audit costs.

While the Board agrees with commenters that engagement partners already have reasons to feel accountable for their work,<sup>17/</sup> the Board is considering whether a partner who is publicly identified with an engagement report may feel even more accountable for the quality of the work that went into it. The Board’s inspections show that there is still significant room for improvement in compliance with PCAOB standards, including those that require auditors to perform the audit with due care and professional skepticism. Disclosing the name of the engagement partner may be one means of promoting better performance.

The Board is, by this proposal, considering whether additional transparency about the identity of the person responsible for the engagement could provide investors with useful information and could further incentivize firms to assign more experienced and capable engagement partners to engagements. Once in effect for at least five years, the additional transparency could also allow investors to consider whether the engagement partner was replaced sooner than is required under the partner rotation requirements in the Act and SEC rules.<sup>18/</sup> Could that additional transparency, in turn, promote auditor independence by discouraging audit clients from inappropriately pressuring the firm to remove an engagement partner? The Board will consider commenters’ views on these issues.

At the same time, the Board remains sensitive to concerns about minimizing the role of the firm or suggesting that the engagement partner is solely responsible for the audit engagement and its performance.<sup>19/</sup> Many commenters noted the important role

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<sup>17/</sup> Under PCAOB standards, the engagement partner is responsible for the engagement and its performance. See paragraph 3 of Auditing Standard No. 9, and paragraph 3 of Auditing Standard No. 10. Engagement partners also, as noted in the concept release, may be held liable in PCAOB and SEC enforcement actions without regard to whether they signed the audit report.

<sup>18/</sup> See Section 203 of the Act; Rule 2-01(c)(6) of Regulation S-X, 17 C.F.R. § 210.2-01(c)(6).

<sup>19/</sup> The engagement partner is not expected to fulfill his or her responsibilities alone. Rather, “[th]e engagement partner may seek assistance from appropriate

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that other professionals, including other members of the engagement team and national office partners, and the firm's quality control system play in performing a quality audit. Accordingly, the Board is proposing an approach that involves only one signature – i.e., that of the firm issuing the report – and that the Board therefore believes will better reflect the roles of both the firm as a whole and the engagement partner.<sup>20/</sup>

After considering comments on the concept release, the amendments the Board is proposing would require the audit report to disclose the engagement partner responsible for the most recent period's audit.<sup>21/</sup> The name of the engagement partner would be disclosed and the only signature included in the audit report would be the signature of the firm issuing the report. Inclusion of the partner's name would not increase or otherwise affect the duties and obligations of the engagement partner under PCAOB standards in performing the audit.

The proposed approach has most of the same potential benefits as a signature requirement. Disclosure should serve the same transparency purpose as a signature because the name of the partner would become known to readers of the report through either approach. Furthermore, to the extent that association of the partner's name with the report could increase his or her sense of personal accountability, disclosure would serve that purpose as effectively as would a signature requirement.

In the concept release, the Board asked whether disclosure of the engagement partner's name would serve the same purpose as a signature requirement or whether the act of signing itself is important to promote accountability. Relatively few commenters responded to this question. Of those who did, some said that there should

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engagement team members," see paragraph 4 of Auditing Standard No. 10. The proposed amendments would not affect this basic principle.

<sup>20/</sup> Because under the Board's proposal the partner would not sign his or her name on the audit report, the Board's proposal could also mitigate concerns expressed by some commenters that a signature requirement would encourage unnecessarily cautious auditing or discourage talented individuals from entering or remaining in the profession.

<sup>21/</sup> Few commenters responded to the question about whether the interim review report should include the engagement partner's signature. Of those who responded, commenters who opposed the signature requirement for the audit report were generally against requiring the signature for the interim review report. Some commenters believed that if a signature is required for the audit report, it should also be required for the interim review report. The Board is proposing to require the disclosure only in the audit report.

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be no difference between signing and disclosure, some said neither would improve accountability, and some said that a signature requirement would better enhance accountability. While the Board believes that disclosure strikes the appropriate balance between enhancing the engagement partner's individual accountability and preserving the firm's responsibility for the audit, the Board is particularly interested in receiving comment on this issue.

### Questions:

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

The concept release noted that an audit report typically contains an opinion on financial statements for more than one year and that the engagement partner on the most recent period's audit may not be the person who served in that role on the audits of the prior years presented in the report. The Board sought comment on whether it should only require the engagement partner's signature as it relates to the most recent period's audit. Of the few commenters who responded to that question, most noted practical issues that would need to be resolved if the engagement partner's signature was intended to reflect responsibility for anything beyond the current period. At the same time, some believed that a paragraph explaining that the signature only relates to the current period would make the report confusing or unnecessarily complicated.

After considering these comments, the Board is proposing to require disclosure of the engagement partner for the most recent period's audit only.<sup>22/</sup> The disclosure would be accomplished by adding a sentence to the audit report stating:

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<sup>22/</sup> For example, when comparative financial statements are presented as of 12/31/20X3 and 12/31/20X2 and for the three years ended 12/31/20X3, the proposed amendments would require disclosing in the audit report on these financial statements the name of the engagement partner (Partner A) responsible for the audit for the year ended 12/31/20X3. If, in the prior year, another engagement partner (Partner B) was responsible for the audit for the year ended 12/31/20X2, the proposed amendments

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The engagement partner responsible for the audit for the [period] ended [date] was [name].

This statement should succinctly reflect the scope of the engagement partner's responsibility in the most recent period.<sup>23/</sup> In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), i.e., when the engagement partner was the same for all of the periods presented, the disclosure would not include reference to financial reporting periods, as follows:

The engagement partner responsible for the audit resulting in this report was [name].

There may be situations in which an audit report is dual-dated. In such situations, if the firm has changed the engagement partner since the original date of the report, the disclosure would be accomplished by adding the following sentences to the audit report:

The engagement partner responsible for the audit for the [period] ended [date] was [name], except for Note X, for which the engagement partner was [name].

### Questions:

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?
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?

The concept release also noted that the European Union's Eighth Directive requires a natural person to sign the audit report but allows for an exception "if such

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would not require disclosing the name of Partner B in the audit report on the financial statements as of 12/31/20X3 and 12/31/20X2 and for the three years ended 12/31/20X3.

<sup>23/</sup> See Letter from Jo Ann Guattery, Chair, Accounting Principles and Auditing Standards Committee, California Society of Certified Public Accountants, to Secretary, PCAOB (September 9, 2009) (opposing signature or disclosure requirement but stating that "[t]he easiest way to do this is to name the engagement partner for the current year audit, and not require an actual signature").

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disclosure could lead to an imminent and significant threat to the personal security of any person.”<sup>24/</sup> The concept release solicited comment on whether a similar exception should be provided if the Board adopted a signature requirement. Some commenters, generally accounting firms and associations, argued that such an exception would be necessary and two cited incidents that they believed supported that position.<sup>25/</sup> Some commenters believed that an exception would be difficult to craft or would be ineffective because, for example, “[i]t is difficult to imagine all circumstances where there could be a threat to the personal security of the engagement partner, particularly if events causing the threat arise after he or she has already been named.”<sup>26/</sup>

The Board continues to consider this issue, but, after considering the comments it already received, is not including an exception to the proposed disclosure requirement. The names of others involved in the financial reporting process are routinely publicly disclosed.<sup>27/</sup> The Board is not aware that these disclosures have posed significant safety concerns, or that auditors are subject to any greater risk than others who may be publicly associated with their jobs. The Board takes concerns about personal security seriously, however, and accordingly, is seeking additional comment on this issue.

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<sup>24/</sup> Directive 2006/43/EC of the European Parliament and of the Council (May 17, 2006).

<sup>25/</sup> One commenter noted “[a] recent example in the U.K. . . . where animal rights activists carried out an aggressive campaign against [a] company and its advisors, including partners and employees of the company’s audit firm.” See Letter from Katharine E. Bagshaw, Manager, Auditing Standards, Institute of Chartered Accountants in England and Wales, to Office of the Secretary, PCAOB (September 11, 2009). Another referred to the “Rubicon and Young advertising executive who was killed outside his New Jersey home a few years ago.” Letter from Paul Rohan, UHY LLP, to J. Gordon Seymour, Office of the Secretary, PCAOB (September 11, 2009).

<sup>26/</sup> See Letter from Jo Ann Guattery, Chair, Accounting Principles and Auditing Standards Committee, California Society of Certified Public Accountants, to Secretary, PCAOB (September 9, 2009).

<sup>27/</sup> For example, the names of a company’s directors, as well as its CEO and CFO, are contained in its periodic reports. Some commenters also expressed concern that if the partner’s name were disclosed, investors might contact him or her seeking information about the company or audit that the partner could not or would not provide. To the extent it happens, the partner could simply decline to comment.

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### Question:

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?

The Board also sought comment on the liability implications of requiring the engagement partner to sign the audit report. In doing so, the Board stated that its intent with any signature requirement was to increase accountability and to provide for increased transparency in the audit report and not to increase the liability of engagement partners.<sup>28/</sup> In July 2009, when the concept release was issued, the case law with respect to liability in private civil actions brought pursuant to Section 10(b) and Rule 10b-5(b) of the Securities Exchange Act of 1934 varied according to federal judicial circuit. The concept release noted that, under the state of the law at the time, signing the audit report would make it harder, at least in some federal judicial circuits, for an engagement partner to argue that he or she should not be held liable to private parties for fraudulent statements or omissions in the audit report.<sup>29/</sup> The concept release sought comment on (1) what effect, if any, a signature requirement would have on an engagement partner's potential liability in private litigation; (2) whether the signature requirement would lead to an unwarranted increase in private liability; and (3) whether it would affect an engagement partner's potential liability under other provisions of the federal securities laws or under state law.

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<sup>28/</sup> In making its recommendation that the PCAOB undertake a standard-setting initiative to consider requiring the engagement partner to sign the audit report, ACAP stated that "the signature requirement should not impose on any signing partner any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of an auditing firm." ACAP Report at VII:20. According to the ACAP Report, "[t]his language is similar to safe harbor language the SEC promulgated in its rulemaking pursuant to Sarbanes-Oxley's Section 407 for audit committee financial experts." *Id.* at n.87 (referencing Item 407(d)(5)(iv) of Regulation S-K, 17 C.F.R. § 229.407(d)(5)(iv)). Some have understood ACAP's statement to mean that such a requirement would not, given the state of the law at the time, have had an effect on the liability of engagement partners. Others, however, noting ACAP's reference to the audit committee expert safe harbor, have understood it as a recommendation that the PCAOB coordinate with the SEC to ensure that appropriate rulemaking occurs to provide a similar safe harbor for engagement partners.

<sup>29/</sup> As noted in the concept release, engagement partners can be liable in PCAOB and SEC enforcement actions without regard to whether they signed the audit report.

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In response, auditors reiterated what had been noted in the concept release with respect to the state of the Section 10(b) private action case law and argued that the Board should not impose a signature requirement because it would increase engagement partners' liability under Section 10(b). Auditors also expressed concern that the signature requirement would increase liability for engagement partners in actions brought pursuant to Section 11 of the Securities Act of 1933<sup>30/</sup> and possibly under other federal and state securities laws.

Auditors distinguished the litigation environment that exists in the United States from that in European Union ("EU") member states, where the Eighth Directive requires the member states to adopt an engagement partner signature requirement. For example, they noted that United Kingdom law does not allow shareholder class action lawsuits against auditors based on a decline in a company's share price and that the European Commission has called for the EU member states to adopt one of three approaches to limit auditor liability – through contracts with clients, liability caps, or proportionate liability.

Auditors also stated that a signature requirement might increase litigation against engagement partners because they would become more visible to the public. According to these commenters, an increase in litigation, regardless of its merits, would, in turn, increase legal fees and insurance costs for firms and individuals. Auditors also suggested that an increased risk of litigation could impact an engagement partner's behavior, such as by reducing his or her willingness to utilize professional judgment or participate in audits of higher risk companies. One accounting firm also suggested that increased litigation against engagement partners could serve as a disincentive for college graduates to enter the public accounting profession.

In June 2011, the United States Supreme Court issued its decision in Janus Capital Group, Inc. v. First Derivative Traders, 131 S.Ct. 2296 (2011), a Section 10(b) private action involving two separate legal entities – a mutual fund and an investment advisor. In Janus, the Court addressed what it means to “make any untrue statement of a material fact” under Section 10(b) and Rule 10b-5(b). The Court held that, “[f]or

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<sup>30/</sup> Section 11 imposes liability for material misstatements or omissions in a registration statement on “every accountant . . . who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement . . . which purports to have been prepared or certified by him.” Section 7 of the Securities Act requires issuers to file the consent of any accountant who is named as having prepared or certified any part of the registration statement or any valuation or report included in the registration statement.

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purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.”<sup>31/</sup> The Court added that “in the ordinary case, attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by – and only by – the party to whom it is attributed.”<sup>32/</sup>

Few lower courts have yet had occasion to apply the Court’s ruling in Janus and its ultimate implications will not be known for some time. The Board is proposing disclosure of the engagement partner’s name and not a signature requirement and specifically invites comment on the implications of that approach for private liability under Section 10(b).

Commenters also expressed concern that a signature requirement would create potential liability for engagement partners under Section 11 of the Securities Act of 1933. Specifically, commenters were concerned that, if the engagement partner were required to sign the audit report, the engagement partner might be deemed to have prepared and/or certified the audit report, and as a result, the issuer would be required to file not only the consent of the accounting firm that prepared the audit report but also a separate consent of the engagement partner who signed it, which would subject the partner, along with the accounting firm, to potential Section 11 liability.

### Questions:

7. Would the proposed amendments to the auditing standards lead to an increase in private liability of the engagement partner?
8. What are the implications of the proposed disclosure rule for private liability under Section 10(b)?
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?
11. Would a different formulation of the disclosure of the engagement partner ameliorate any effect on liability?

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<sup>31/</sup> Janus, 131 S.Ct. at 2302.

<sup>32/</sup> Id.

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

Pursuant to Rule 2201, each registered firm must file an annual report on Form 2 by June 30 of each year. The report provides basic information about the firm and the firm's issuer-related practice over the most recent 12-month period. Towards that end, Item 4.1 of Form 2 requires the firm to provide, for any audit reports issued during the reporting period, the issuer's name, the issuer's CIK number (if it has one), and the date of the audit report. The Board is proposing to add to Item 4.1 a requirement for firms to disclose the name of the engagement partner.<sup>33/</sup> All of the instructions for completing the form, as well as the other required disclosures, would remain the same.

As discussed above, disclosure of the name of the partner responsible for the audit might increase the partner's sense of accountability and might provide useful transparency. While disclosure in the audit report itself would serve those purposes, it would not provide investors with a convenient mechanism to retrieve information about a firm's engagement partners for all of its audits. The proposed amendment to Form 2 would compile this information in one place that could be easily accessed. Because the relevant information is readily available to firms, the proposed disclosure requirement should not add in any significant way to the time or cost involved in completing Form 2.

#### Questions:

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?
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?
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?

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<sup>33/</sup> In cases in which an audit report is dual-dated and the engagement partner is changed after the original date of the report, the rule would require disclosure of the names of both engagement partners.

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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?

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

In many public company audits, the accounting firm issuing the audit report ("auditor" for purposes of Section III of this release) does not perform 100 percent of the audit procedures. This may be especially common in, but not limited to, audits of companies with operations in more than one country. In these situations, audit procedures on, or audits of the company's foreign operations are performed by other accounting firms or other participants in the audit not employed by the auditor.

Additionally, some accounting firms have begun a practice, known as off-shoring, whereby certain portions of the audit are performed by offices in a country different than the country where the firm is headquartered. For example, an accounting firm could establish an office in a country with a relatively low cost of labor and employ local personnel to perform certain audit procedures on audits of companies located in the country of the accounting firm's headquarters or in a third country.

The Board is proposing amendments that would require the auditor to disclose in the audit report other independent public accounting firms and other persons<sup>34/</sup> not employed by the auditor that took part in the most recent period's audit. The proposed amendments would require disclosure when the auditor (a) assumes responsibility for or supervises the work of another independent public accounting firm or supervises the work of a person that performed audit procedures on the audit; and (b) divides responsibility with another independent public accounting firm. Specifically:

- *Disclosure when assuming responsibility or supervising* – The auditor would be required to disclose the *name, location, and extent of participation in the audit* of (i) independent public accounting firms for whose audit the auditor assumed responsibility pursuant to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, and (ii) independent public accounting firms or other persons not employed by the auditor that performed audit procedures on the most recent period's audit and whose work the auditor was required to

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<sup>34/</sup> As defined by PCAOB Rule 1001(p)(iv), the term "person" means any natural person or any business, legal or governmental entity or association.

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supervise pursuant to Auditing Standard No. 10, *Supervision of the Audit Engagement* (collectively, "other participants in the audit" for purposes of Section III of this release),<sup>35/</sup> and

- *Disclosure when dividing responsibility* – The auditor would be required to disclose the *name* and *location* of another independent public accounting firm that audited the financial statements of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements of the company, to which the auditor makes reference in the audit report on the consolidated financial statements and, when applicable, internal control over financial reporting ("referred-to accounting firms" for purposes of Section III of this release).<sup>36/</sup>

The proposed amendments would affect AU sec. 508, AU sec. 543, and Auditing Standard No. 5. The proposal would require disclosure of all other participants in the audit and referred-to accounting firms regardless of their network affiliation<sup>37/</sup> or registration status with the PCAOB.<sup>38/</sup>

The Board is proposing these amendments to provide investors and other users of the audit report with greater transparency into the other participants in the audit.

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<sup>35/</sup> The auditor's responsibilities with respect to the work of other persons not employed by the auditor are governed by Auditing Standard No. 10. The auditor's responsibilities with respect to the work of other independent public accounting firms are governed by AU sec. 543, when that standard applies, or Auditing Standard No. 10 in all other situations.

<sup>36/</sup> See paragraphs .03 and .06 through .09 of AU sec. 543. Paragraph .07 of AU sec. 543 states that "[w]hen the principal auditor decides that he will make reference to the audit of another auditor, his report should indicate clearly, in both the introductory, scope and opinion paragraphs, the division of responsibility as between that portion of the financial statements covered by his own audit and that covered by the audit of the other auditor."

<sup>37/</sup> Many affiliated accounting firms share a common name but are separate legal entities.

<sup>38/</sup> According to PCAOB Rule 2100, *Registration Requirements for Public Accounting Firms*, public accounting firms that must be registered with the Board are those that (a) prepare or issue any audit report with respect to any issuer; or (b) play a substantial role in the preparation or furnishing of an audit report with respect to any issuer.

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While investors can currently evaluate publicly available information about the auditor, they generally do not know the identities of other participants in the audit. The proposed disclosure would provide investors and other users of the audit report with the ability to evaluate other participants in the audit in the same manner that they evaluate the auditor. For example, the proposed disclosure would enable investors and other users of the audit report to determine whether a disclosed independent public accounting firm is registered with the Board and has been subject to PCAOB inspection,<sup>39/</sup> and whether a disclosed independent public accounting firm or another person has had any publicly available disciplinary history with the Board or other regulators.

Additionally, the proposed amendments would increase the transparency of financial reporting with respect to the referred-to accounting firms. While the audit report prepared by a referred-to firm on a portion of company's operations is required to be filed with the SEC,<sup>40/</sup> the firm's name and location typically are not disclosed in the audit

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<sup>39/</sup> In December 2008, the Board solicited comment on the potential advantages and disadvantages of requiring certain disclosures in the audit report about whether the principal auditor, or any registered firm whose work the principal auditor used, failed to provide information to the PCAOB in respect to an inspection demand on the basis of non-U.S. legal restrictions or sovereignty concerns. See <http://pcaobus.org/Rules/Rulemaking/Pages/Docket027.aspx>. Since 2008, obstacles to conducting PCAOB inspections have been removed in some jurisdictions and progress is being made toward that end in other countries. Nonetheless, the PCAOB remains unable to inspect registered firms in China and some parts of Europe. The Board continues to consider whether requiring disclosures like those described in the 2008 release would advance the public interest. The Board also continues to consider whether additional steps should be taken to protect investors in U.S. public companies that are audited by registered firms located in jurisdictions that do not allow the Board to conduct inspections. In the meantime, the Board publishes on its Web site a list that names every registered firm that has triggered an inspection requirement and notes whether the firm has ever been inspected. See <http://pcaobus.org/Inspections/Pages/InspectedFirms.aspx>. In addition, the Board has published on its Web site a listing of issuer audit clients of non-U.S. registered firms in jurisdictions where the PCAOB had been denied access to conduct inspections. See <http://pcaobus.org/International/Inspections/Pages/IssuerClientsWithoutAccess.aspx>.

<sup>40/</sup> Pursuant to Rule 2-05 of Regulation S-X, "[i]f, with respect to the examination of the financial statements, part of the examination is made by an independent accountant other than the principal accountant and the principal accountant elects to place reliance on the work of the other accountant and makes reference to that effect in his report, the separate report of the other accountant shall be filed. However, notwithstanding the provisions of this section, reports of other

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report on the consolidated financial statements and, if applicable, internal control over financial reporting. Such firms are typically described by the auditor in the audit report as "other auditors."<sup>41/</sup>

Investors have requested greater transparency about who is performing the audit and how much of the audit they have performed. In a March 2010 survey conducted by the Chartered Financial Analysts Institute ("CFA"), "91 percent [of respondents] agree that in cases where there is more than one auditor, the identities and specific roles of other auditors should be disclosed."<sup>42/</sup> Some respondents also thought that "[i]f reliance by one audit team is being placed upon the work conducted by another, we definitely need disclosure of these roles."<sup>43/</sup>

Separately, a task force of the IAG discussed the auditor's reporting model in March 2011.<sup>44/</sup> The task force conducted a survey of investors in investment banks, mutual funds, pension funds, and hedge funds representing over \$8 trillion under management. The survey solicited views regarding various changes to the audit report. Of the investors surveyed who responded to the question regarding disclosure of work performed by other audit firms, 70 percent said they would like to know the level of involvement of the firms that are not signing the audit report.<sup>45/</sup>

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accountants which may otherwise be required in filings need not be presented in annual reports to security holders furnished pursuant to the proxy and information statement rules under the Securities Exchange Act of 1934."

<sup>41/</sup> Paragraph .07 of AU sec. 543.

<sup>42/</sup> CFA Institute, *Independent Auditor's Report Survey Results* (March 2010), available at: [http://www.cfainstitute.org/Survey/independent\\_auditors\\_report\\_survey\\_results.pdf](http://www.cfainstitute.org/Survey/independent_auditors_report_survey_results.pdf).

<sup>43/</sup> *Id.*

<sup>44/</sup> Presentation of the Working Group on Auditor's Report and The Role of the Auditor, IAG meeting (March 16, 2011), available at: [http://pcaobus.org/News/Events/Pages/03162011\\_IAGMeeting.aspx](http://pcaobus.org/News/Events/Pages/03162011_IAGMeeting.aspx).

<sup>45/</sup> *Id.* The response rate for the question regarding disclosing the work performed by other audit firms was approximately 67 percent. Of those who responded, approximately 70 percent (or 47 percent of the total surveyed) would like to know the level of involvement from firms that are not signing the audit report, and approximately 30 percent (or 20 percent of the total surveyed) disagreed with requiring this disclosure.

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Furthermore, the SAG has discussed matters related to providing greater transparency about the audit.<sup>46/</sup> Many SAG members suggested that greater transparency about who performed portions of the audit, including the names of affiliate firms was warranted, since the quality of the services provided by other accounting firms may vary. Some SAG members also suggested that—in situations in which the auditor does not make reference to the audit of another independent public accounting firm—it should be clear that the auditor has assumed responsibility for the work of the other firm. Other SAG members, however, expressed concerns that disclosing the names of the other independent public accounting firms in such situations might give the impression that the responsibility of the auditor was being changed. The Board considered these comments in drafting these proposed amendments.

Sections III.A and III.B of this release contain an overview of the proposed amendments. Appendix C to this release contains the proposed amendments for disclosure of other participants in the audit. The Board seeks comment on all aspects of the proposed amendments and is particularly interested in responses to the specific questions in the following sections.

### A. Disclosure When Assuming Responsibility or Supervising

#### 1. Applicability of the Proposed Disclosure

The proposed amendments regarding the disclosure of other participants in the audit for whose audit the auditor takes responsibility or whose audit procedures the auditor supervises would apply to:

- (a) Independent public accounting firms for whose audit the auditor assumed responsibility pursuant to AU sec. 543,<sup>47/</sup> and
- (b) Independent public accounting firms or other persons not employed by the auditor that performed audit procedures on the most recent period's audit and whose work the auditor was required to supervise pursuant to Auditing Standard No. 10.

The proposed amendments would not require disclosure of:

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<sup>46/</sup> The topic was discussed at SAG meetings in February 2005, April 2010, July 2010, and March 2011. Event details and archived webcast for SAG meetings are available at: <http://pcaobus.org/Standards/SAG/Pages/SAGMeetingArchive.aspx>.

<sup>47/</sup> Paragraphs .03 through .05 of AU sec. 543.

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- Individuals performing the engagement quality review ("EQR");<sup>48/</sup> or
- Persons performing a review pursuant to Appendix K ("Appendix K review");<sup>49/</sup> or
- Persons with specialized skill or knowledge in a particular field other than accounting or auditing;<sup>50/</sup> or
- 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;<sup>51/</sup> or,
  - Internal auditors who provided direct assistance in the audit of the financial statements.<sup>52/</sup>

The Board does not propose disclosing individuals performing the EQR because the EQR is intended to be an objective second look at work performed by the engagement team, and the reviewers' work is not supervised by the auditor in accordance with Auditing Standard No. 10. According to PCAOB standards, "[t]o maintain objectivity, the engagement quality reviewer . . . should not make decisions on behalf of the engagement team or assume any responsibilities of the engagement team."<sup>53/</sup> Unlike the engagement team, the engagement quality reviewer and those

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<sup>48/</sup> See Auditing Standard No. 7, *Engagement Quality Review*.

<sup>49/</sup> See SECPS Section 1000.45 Appendix K, *SECPS Member Firms With Foreign Associated Firms That Audit SEC Registrants*. The Board adopted the requirements of the Securities and Exchange Commission Practice Section ("SECPS") of the AICPA as part of its interim standards.

<sup>50/</sup> AU sec. 336, *Using the Work of a Specialist*.

<sup>51/</sup> See paragraph 17 of Auditing Standard No. 5.

<sup>52/</sup> See paragraph .27 of AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*.

<sup>53/</sup> Paragraph 7 of Auditing Standard No. 7.

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assisting the reviewer do not perform substantive procedures or obtain sufficient evidence to support an opinion on the financial statements or internal control over financial reporting. EQRs could be performed by individuals from the same accounting firm issuing the audit report or individuals outside of the accounting firm issuing the audit report. Similarly, the Board does not propose disclosing persons performing the Appendix K review because the auditor does not supervise or assume responsibility for the Appendix K review.

The Board does not propose disclosing persons with specialized skill or knowledge in a particular field other than accounting or auditing because AU sec. 336, *Using the Work of a Specialist*, (rather than Auditing Standard No. 10) applies to situations in which the auditor engages a specialist in an area other than accounting or auditing and uses the work of that specialist as audit evidence.

The Board does not propose disclosing persons employed or engaged by the company who provided direct assistance to the auditor because determining the extent of their participation in the audit may be impractical. Such persons also may perform other tasks for the company not related to providing direct assistance to the auditor or may not track time spent on providing the direct assistance.

With respect to “off-shoring” arrangements, (as defined on page 18 of this release), the proposed amendments would not result in disclosure of such arrangements to the extent that the off-shored work is performed by another office of the same accounting firm (even though that office may be located in a country different from the country where the firm is headquartered). The Board is interested in comments regarding whether any disclosure of off-shoring arrangements should be required and whether there are any other types of arrangements to perform audit procedures that should be disclosed.

### Questions:

16. Is it sufficiently clear who the disclosure would apply to? If not, how could this be made clear?
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?
18. Is it appropriate not to require disclosure of the person that performed the Appendix K review?

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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. 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?

### 2. Details of the Disclosure Requirements

The proposed amendments would require the auditor to disclose in an explanatory paragraph to the audit report:

- The names of other participants in the audit (including the financial statement audit and, when applicable, the audit of internal control over financial reporting, and reviews pursuant to AU sec. 722, *Interim Financial Information*);
- The location of other participants in the audit (the country of headquarters' office location for a firm and the country of residence or headquarters' office location for another person); and
- The percentage of hours attributable to the audits or audit procedures performed by the other participants in the audit in relation to the total hours in the most recent period's audit, excluding the hours attributable to the performance of the EQR and Appendix K review ("the percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review").<sup>54/</sup>

The explanatory paragraph would be presented in the audit report after the opinion on the financial statements and, when applicable, the opinion on the effectiveness of internal control over financial reporting<sup>55/</sup> and any other explanatory paragraphs. The proposed amendments would allow the auditor to include in the

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<sup>54/</sup> The total hours in the most recent period's audit are comprised of hours attributable to the financial statement audit and, when applicable, the audit of internal control over financial reporting, and reviews pursuant to AU sec. 722, *Interim Financial Information*.

<sup>55/</sup> Paragraphs 86 through 88 of Auditing Standard No. 5.

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explanatory paragraph a reference to an appendix to the audit report, immediately following the report, that would include the required disclosure information about the other firms and persons. Some auditors may prefer this alternative in audits where there is more than one other participant in the audit. If the auditor issues separate reports on the financial statement audit and the audit of the effectiveness of internal control over financial reporting, the explanatory paragraph in each separate report would include reference to the same appendix.

The proposed amendments would require the disclosure of the name of the independent public accounting firms and the country of their headquarters' office location and the name of persons not employed by the auditor along with their country of residence or headquarters' office location. For purposes of this disclosure, the name of any independent public accounting firm or person with whom the auditor has the contractual relationship should be disclosed. For example, if the auditor contracted with an entity specializing in tax preparation services to perform audit procedures on the income tax provision, the auditor would disclose the name of the entity, instead of the names of the individuals from the entity, who performed the audit procedures. However, if the auditor contracted directly with an individual employed by the entity, the auditor would disclose the name of the individual who performed the audit procedures and not the name of the entity.

The disclosure of the names of other participants in the audit would include the names of all independent public accounting firms that participated in the audit, which may or may not be affiliated with the accounting firm issuing the audit report. The names of these firms may be similar to the name of the accounting firm issuing the audit report, as is the case with many of the larger public accounting firms. In the case of smaller public accounting firms, such firms may not be part of a network of firms or the network firms may not have names similar to the name of the accounting firm issuing the audit report. The Board is interested in comments on whether the proposed disclosure would have any effects on competition.

The proposed amendments also would require including a statement in the audit report that the auditor (a) is responsible for the audits of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or audit procedures performed by other participants in the audit and (b) has supervised the work of other participants in the audit or performed procedures to assume responsibility for the work of the other participants in accordance with PCAOB standards. Because this statement would clarify who is responsible for the audit procedures performed, the Board has proposed to delete language in AU sec. 543 that prohibits independent public accounting firms from making reference to another firm unless the firm is dividing responsibility with the other firm.

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Under the Board's proposal, disclosing other participants in the audit would not represent a qualification of the auditor's opinion nor would it change the responsibility of the auditor for the performance of the audit. The proposed disclosure would not constitute making reference pursuant to paragraphs .06 through .09 of AU sec. 543 and would not suggest that the auditor has divided responsibility with another independent public accounting firm. Furthermore, the proposed amendments would not change the requirements regarding the auditor's determination of whether the auditor's extent of participation in the audit is sufficient to serve as principal auditor pursuant to paragraph .02 of AU sec. 543.

### Questions:

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

The proposed amendments would require the auditor to state the percentage of hours attributable to the audits or audit procedures performed by other participants in

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the audit in relation to the total hours in the most recent period's audit,<sup>56/</sup> excluding EQR and Appendix K review. The percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review would be determined as of the date of the audit report for each other firm or person participating in the audit. In calculating this percentage, the auditor may estimate the total hours for the audit and the portion of hours attributable to each participant in the audit in situations when the actual number of hours have not been reported.

The audit report includes an opinion on all periods presented in the financial statements and, when applicable, an opinion on the effectiveness of internal control over financial reporting as of the end of the most recent period. The disclosure requirement would apply only to the most recent period under audit, and, if applicable, the audit of internal control over financial reporting as of the end of the most recent period. This requirement is consistent with the proposed requirement to disclose the name of the engagement partner in the audit report for the most recent period's audit.

In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), the disclosure would state the percentage of audit hours attributable to the audits or audit procedures performed by other participants in the audit in relation to the total audit hours, excluding EQR and Appendix K review, for all periods presented. In these circumstances, the auditor should indicate that the percentages are aggregations of multiple periods by modifying the first sentence of the explanatory paragraph and, if applicable, in the introductory paragraph in the appendix to the audit report to include all relevant periods.

There may be situations in which an audit report is dual-dated. In these circumstances, the proposed amendments would require that the auditor: (a) repeat in the audit report the most recent disclosure before the dual-dating and (b) supplement it by stating, separately, the percentage of hours attributable to the work performed subsequent to the original report date.

The percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review, is included in the proposed requirement because it appears to be the most appropriate quantitative measure of the other participants' relative participation in the audit. Other metrics were considered to reflect the audit procedures performed by other participants in the audit. For instance, fees incurred in

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<sup>56/</sup> The total hours in the most recent period's audit are comprised of hours attributable to the financial statement audit and, when applicable, the audit of internal control over financial reporting; and reviews pursuant to AU sec. 722.

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the most recent period's audit incurred by other participants in the audit as a percentage of audit fees in the issuer's proxy disclosure were considered. However, this measure may not be representative of the extent of other participants' participation in the audit because audit fees in the proxy disclosure may include fees for other services (e.g., other regulatory and statutory filings) and also may exclude fees paid directly to other participants rather than to the auditor.

The Board also considered requiring a disclosure of percentages of revenues or assets, which would be similar to the disclosure required when making reference pursuant to AU sec. 543.<sup>57/</sup> However, percentages of revenues or assets tested may not be appropriate in the context of assuming responsibility for or supervising the work of other participants because the level of procedures applied to the accounts can vary significantly and different participants can apply procedures to the same account. For instance, other participants in the audit might perform an inventory observation to test the existence of the inventory at a particular location, and the auditor might test the valuation of the inventory at all locations including the one tested by the other firms and persons.

The percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review, quantitatively represents the extent of participation of each other participant in the audit. The Board believes that auditors routinely record and collect time spent on the audit. Therefore, the incremental effort to comply with the proposed disclosure should be limited to calculating the percentage of time incurred as required by this proposal.<sup>58/</sup>

For reasons stated above, the percentage of the total hours in the most recent period's audit, excluding EQR and Appendix K review, appears to be the most relevant and practical metric of the extent of other participants' participation in the audit. The proposed amendments include an example of the proposed disclosure.

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<sup>57/</sup> Paragraph .07 of AU sec. 543. The Board does not propose to change this requirement. See detailed discussion of the proposed requirements when making reference pursuant to AU sec. 543 in Section III.B later in this release.

<sup>58/</sup> The Board seeks comment on situations in which auditors do not routinely record or collect time spent on performing audits of particular entities (e.g., audits of equity-method investees) and whether such information could be obtained with reasonable effort (see Question 27).

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### Questions:

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

#### 4. Thresholds

The proposed amendments would apply to all other participants in the audit. In preparing these amendments the Board's intention was to provide the most meaningful information to investors and other users of the financial statements about participants in the audit and therefore the Board considered whether there should be a threshold below which firms or persons would not be required to be disclosed. The thresholds considered by the Board included:

- The "substantial role" threshold – The role played by other participants in preparing or furnishing the audit report was not substantial, as defined in PCAOB Rule 1001;<sup>59/</sup>

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<sup>59/</sup> According to paragraph (p)(ii), "Play a Substantial Role in the Preparation or Furnishing of an Audit Report," of PCAOB Rule 1001, *Definitions of Terms Employed in Rules*, "[t]he phrase "play a substantial role in the preparation or furnishing of an audit report" means – (1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer, or (2) to perform the majority of the audit procedures with respect to a subsidiary or component

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- A minimum percentage threshold – A certain minimum percentage of the total hours in the most recent period's audit attributable to other participants individually or as a group (e.g., 1 percent, 3 percent, 5 percent); and,
- The registration threshold – Other firms not registered with the PCAOB.

Given the various considerations regarding each of these possible thresholds, the Board decided to propose a 3% threshold for disclosing other participants in the audit. Specifically, the Board proposes requiring that other participants in the audit whose individual extent of participation is 3% or more of total hours in the most recent period's audit be disclosed individually with their respective percentage of total hours in the most recent period's audit. Those other participants in the audit whose individual extent of participation is less than 3% of the total hours in the most recent period's audit should be disclosed either individually with their respective percentage of total hours in the most recent period's audit or as a group titled "other participants" with the percentage of total hours attributable to the audit procedures performed by the group.

### Questions:

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?
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?

## **B. Disclosure When Dividing Responsibility**

In situations in which another independent public accounting firm has audited the financial statements and, if applicable, internal control over financial reporting of one or more subsidiaries, divisions, branches, components, or investments included in the financial statements, and certain conditions are met, PCAOB standards allow the auditor to make reference in the audit report to the report of the other firm. This

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of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer." Under PCAOB Rule 2100, each public accounting firm that "plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer must be registered with the Board."

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reference is an indication of the divided responsibility between the auditor and the referred-to accounting firm that conducted the audit of various components of the consolidated financial statements. Under existing PCAOB standards, the auditor is not required to name the referred-to accounting firm and should not disclose the name of a referred-to firm without obtaining that firm's express permission.<sup>60/</sup>

The proposed amendments to AU sec. 543 would require the auditor to disclose in the audit report the name of the referred-to accounting firm and the country of its headquarters' office location. Additionally, the proposed amendments to AU sec. 543 would remove the existing requirement to obtain express permission of the referred-to firm when disclosing the firm's name. The SEC rules already include a requirement that the audit report of a referred-to firm should be filed with the SEC, so the name of the firm is already made public.<sup>61/</sup> However, including the name of referred-to firm in the audit report on the consolidated financial statements would make it more transparent for investors and other users of the audit report.

The proposed amendments would not change the existing requirement to disclose the magnitude of the portion of the financial statements audited by the referred-to firm by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly reveals the portion of the financial statements audited by the referred-to accounting firm.<sup>62/</sup>

### Questions:

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

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<sup>60/</sup> Paragraphs .03 and .06 through .09 of AU sec. 543.

<sup>61/</sup> See Rule 2-05 of Regulation S-X.

<sup>62/</sup> Paragraph .07 of AU sec. 543.

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confusion? If so, what should the disclosure requirements be in such situations?

### IV. Opportunity for Public Comment

The Board will seek comment for a 90-day period. Interested persons are encouraged to submit their views to the Board. Written 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](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 29 in the subject or reference line and should be received by the Board no later than 5:00 PM EDT on January 9, 2012. The Board will consider all comments received.

On the 11th day of October, in the year 2011, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour  
Secretary

October 11, 2011

APPENDIX A – Proposed Amendments to PCAOB Auditing Standards for Disclosure of the Engagement Partner

APPENDIX B – Proposed Amendment to Form 2

APPENDIX C – Proposed Amendments to PCAOB Auditing Standards for Disclosure of Other Participants in the Audit

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### Appendix A

#### ***Proposed Amendments to PCAOB Auditing Standards for Disclosure of the Engagement Partner***

##### AU sec. 508, "Reports on Audited Financial Statements"

SAS No. 58, "Reports on Audited Financial Statements" (AU sec. 508, "Reports on Audited Financial Statements"), as amended, is amended as follows:

- a. In paragraph .08, subparagraph c-1 is added, as follows:

The name of the engagement partner responsible for the most recent period's audit, except that:

- (1) In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit) i.e., when the engagement partner was responsible for the audit for all of the periods presented, the name of the engagement partner for all periods presented should be disclosed, and
  - (2) In cases in which an audit report is dual-dated and the engagement partner is changed after the original date of the report, the names of both engagement partners.
- b. In paragraph .08, at the end of the first paragraph of the example report on financial statements covering a single year, the following new sentence is added:

The engagement partner responsible for the audit resulting in this report was [name].

- c. In paragraph .08, at the end of the first paragraph of the example report on comparative financial statements, the following new sentences are added:

The engagement partner responsible for the audit for the [period] ended [date] was [name]. *[[When the financial statements for all periods presented were audited during one audit engagement]* The engagement

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partner responsible for the audit resulting in this report was [name]. [*When the report is dual-dated and the firm changes the engagement partner after the original date of the report*] The engagement partner responsible for the audit for the period ended December 31, 20X2 was Partner A, except for Note X, for which the engagement partner was Partner B.]

- d. In paragraph .13, between the third and fourth sentences of the first paragraph of the example report indicating a division of responsibility, the following new sentence is inserted:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

- e. In paragraph .34, at the end of the first paragraph of the example report on the balance sheet only, the following new sentence is added:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

- f. In paragraph .44, at the end of the first paragraph of the example of a qualified report, the following new sentence is added:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

- g. In paragraph .63, at the end of the first paragraph of the example of a report disclaiming an opinion, the following new sentence is added:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

- h. In paragraph .74, between the third and fourth sentences of the first paragraph of the example of a successor auditor's report, the following new sentence is inserted:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

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### AU sec. 9508, "Reports on Audited Financial Statements: Auditing Interpretations of Section 508"

AU sec. 9508, "Reports on Audited Financial Statements: Auditing Interpretations of Section 508," as amended, is amended as follows:

- a. In paragraph .36, at the end of the first paragraph of the example Report on Single Year Financial Statements in Year of Adoption of Liquidation Basis, the following new sentence is added:

The engagement partner responsible for the audit resulting in this report was [name].

- b. In paragraph .36, at the end of the first paragraph of the example report on Comparative Financial Statements in Year of Adoption of Liquidation Basis, the following new sentence is added:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

### AU sec. 543, "Part of Audit Performed by Other Independent Auditors"

SAS No. 1, "Codification of Auditing Standards and Procedures," section 543 "Part of Audit Performed by Other Independent Auditors" (AU sec. 543, "Part of Audit Performed by Other Independent Auditors"), as amended, is amended as follows:

In paragraph .09, between the third and fourth sentences of the first paragraph of the example report indicating a division of responsibility, the following new sentence is inserted:

The engagement partner responsible for the audit for the [period] ended [date] was [name].

### Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board*

Auditing Standard No. 1 is amended as follows:

In paragraph 1 of the Appendix, at the end of the first paragraph of the illustrative report on an audit of financial statements, the following new sentence is added:

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The engagement partner responsible for the audit for the [period] ended [date] was [name].

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

Auditing Standard No. 5 is amended as follows:

- a. In paragraph 85, subparagraph d-1 is added, as follows:

The name of the engagement partner responsible for the engagement resulting in the audit report on internal control over financial reporting.

- b. In paragraph 87, at the end of the first paragraph of the example report, the following new sentences are added:

The engagement partner responsible for the audit for the [period] ended [date] was [name]. *[[When the financial statements for all periods presented were audited during one audit engagement] The engagement partner responsible for the audit resulting in this report was [name]. [When the report is dual-dated and the firm changes the engagement partner after the original date of the report] The engagement partner responsible for the audit for the period ended December 31, 20X8 was Partner A, except for Note X, for which the engagement partner was Partner B.]*

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**Appendix B**

***Proposed Amendment to Form 2***

**Form 2 – Annual Report Form**

- a. Item 4.1a is amended by adding the following new subparagraph:
  - 4. The name of the engagement partner responsible for the engagement resulting in the audit report.
- b. Item 4.1.a is amended by adding the following new note:

Note: In responding to Items 4.1.a.4, in cases in which an audit report is dual-dated and the engagement partner is changed after the original date of the report provide the names of both engagement partners.

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### Appendix C

#### ***Proposed Amendments to PCAOB Auditing Standards for Disclosure of Other Participants in the Audit***

##### AU sec. 508, Reports on Audited Financial Statements

SAS No. 58, "Reports on Audited Financial Statements" (AU sec. 508, "Reports on Audited Financial Statements"), as amended, is amended as follows:

- a. In subparagraph .11a, the text is replaced with the following:

The auditor's opinion is based, in part, on the report of another auditor, and the auditor makes reference to the audit of the other auditor pursuant to AU sec. 543, *Part of Audit Performed by Other Independent Auditors* (paragraphs .12 and .13).

- b. In paragraph .11, subparagraph a-1 is added, as follows:

Other independent public accounting firms perform an audit of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments, or other independent public accounting firms or persons<sup>10a</sup> not employed by the auditor perform audit procedures in the most recent reporting period's audit, other than in the circumstance described in paragraph 11.a (paragraphs .14A through .14C).

<sup>10a</sup> PCAOB Rule 1001(p)(iv) defines the term "person" to mean any natural person or any business, legal or governmental entity or association.

- c. In paragraph .12, delete the title "*Part of Audit Performed by Other Independent Auditors*" from the parentheses.
- d. In paragraph .13, in the example of a report indicating a division of responsibility,
- The last sentence of the first paragraph is replaced with the following:

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Those statements were audited by [name of other auditors and country of their headquarters' office location] whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of [name of other auditors].

- The last sentence of the second paragraph is replaced with the following:

We believe that our audits and the report of [name of other auditors] provide a reasonable basis for our opinion.

- In the first sentence of the third paragraph, the phrase "other auditors" is replaced with "[name of other auditors]."

- e. The following section header is inserted after the amended paragraph .13:

**Other Independent Public Accounting Firms or Persons Not Employed By the Auditor Perform an Audit or Audit Procedures in the Most Recent Period's Audit**

- f. Paragraph .14A is inserted, as follows:

When another independent public accounting firm performs an audit of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or another independent public accounting firm or person not employed by the auditor performs audit procedures in the most recent period's audit, other than an independent auditor whose audit is referred to pursuant to paragraphs .06 through .09 of AU sec. 543 and other than as provided by paragraph .14B, the following items should be disclosed in the audit report through the addition of an explanatory paragraph following the opinion paragraph and any other explanatory paragraphs: (1) the name(s) and country(ies) of headquarters' office location of such firm(s) and/or (2) the name(s) and country(ies) of residence or headquarters' office location of such person(s), and (3) the percentage of the hours attributable to audits or audit procedures performed by the firm(s) or person(s) in relation to the total hours in the most recent period's audit, which include the hours incurred in performing reviews pursuant to AU sec. 722, *Interim Financial Information*, as of the date of the audit report. The explanatory paragraph

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also should include a statement that the auditor is responsible for the audits or audit procedures performed by the firm(s) or person(s) and has supervised or performed procedures to assume responsibility for the work in accordance with PCAOB standards.

Note: The explanatory paragraph can refer to an appendix immediately following the audit report that includes the required disclosure.

Note: For purposes of this disclosure, the auditor should disclose the name of the firm or person with whom the auditor has the contractual relationship.

Note: In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), the disclosure should state the percentage of audit hours attributable to the audits or audit procedures performed by independent public accounting firms other than the firm issuing the audit report and other persons participating in the audit in relation to the total audit hours for all periods presented.

Note: In cases in which an audit report is dual-dated, the auditor should: (a) repeat in the audit report the most recent disclosure before the dual-dating and (b) supplement it by stating, separately, the percentage of hours attributable to the work performed subsequent to the original report date.

Note: Independent public accounting firms other than the firm issuing the audit report and other persons participating in the audit whose individual extent of participation is 3% or more of total hours in the most recent period's audit should be disclosed individually with their respective percentage of total hours. Other firms and persons participating in the audit whose individual extent of participation is less than 3% of the total hours in the most recent period's audit should be disclosed either individually, with their respective percentage of total hours in the most recent period's audit, or as a group titled "other participants," with the percentage

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of total hours attributable to the audit or audit procedures performed by the group.

Note: The disclosure required by this paragraph does not constitute making reference pursuant to paragraphs .06 through .09 of AU sec. 543 or suggest that the auditor has divided responsibility for the performance of the audit with another auditor.

g. Paragraph .14B is inserted, as follows:

Excluded from the disclosures required by paragraph .14A is the name of the individual who performed the engagement quality review ("EQR") and the name of persons that performed the filing review pursuant to SECPS Section 1000.45 Appendix K ("Appendix K review") and the hours attributable to the EQR and Appendix K review. Also excluded from the disclosures required by paragraph .14A are (1) persons with specialized skill or knowledge in a particular field other than accounting or auditing, (2) 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 (3) internal auditors who provide direct assistance in the audit of the financial statements.

h. Paragraph .14C is inserted, as follows:

Examples of the explanatory paragraph described in paragraph .14A follow:

*An example of the explanatory paragraph for situations in which another independent accounting firm performed certain audit procedures – In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2, ABC Audit Firm (country of headquarters' office location) performed certain audit procedures. We are responsible for the audit procedures performed by ABC Audit Firm and, accordingly, have supervised their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit was X%.*

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*An example or the explanatory paragraph for situations in which another independent accounting firm performed an audit of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments* – In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2, ABC Audit Firm (country of headquarters' office location) performed an audit of the financial statements of one of XYZ Company's subsidiaries. We are responsible for the audit performed by ABC Audit Firm, insofar as that audit relates to our expression of an opinion on the financial statements taken as a whole and, accordingly, have performed procedures to assume responsibility for their work in accordance with PCAOB standards. The portion of the total audit hours attributable to the audit performed by ABC Audit Firm in our audit was X%.

- i. Paragraph .14D is inserted, as follows:

An example of the explanatory paragraph using an appendix described in paragraph .14A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2, the other independent public accounting firms listed in the Appendix to this report performed [*choose applicable*: audits of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or certain audit procedures], and persons listed in the Appendix performed certain audit procedures. We are responsible for the audits and audit procedures performed by the other independent public accounting firms and persons listed in the Appendix to this report and, accordingly, have supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards.

## APPENDIX

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2, the other independent public accounting firms listed below performed [*choose applicable*: audits of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or certain audit

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procedures], and persons listed below performed certain audit procedures. The portion of the total audit hours attributable to audits and audit procedures performed by these other independent public accounting firms and persons in our audit follows:

<b>Other participants in the audit</b>	<b>Percentage of total audit hours for the [period] ended [date]</b>
ABC Audit Firm (country of headquarters' office location)	21 %
DEF Audit Firm (country of headquarters' office location)	12
GHI Consulting Business (country of headquarters' office location)	5
JKL Audit Firm (country of headquarters' office location)	4
Mr. Person Y (country of residence)	3
Other participants, all individually less than 3% of total audit hours	15

j. Paragraph .14E is inserted, as follows:

In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), an example of the explanatory paragraph described in paragraph .14A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period(s)] ended [date(s)], ABC Audit Firm (country of headquarters' office location) performed certain audit procedures. We are responsible for the audit procedures performed by ABC Audit Firm and, accordingly, have supervised their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit was X%.

k. Paragraph .14F is inserted, as follows:

In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering,

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single-period audit, or re-audit), an example of the explanatory paragraph using an appendix described in paragraph .14A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period(s)] ended [date(s)], the other independent public accounting firms and persons listed in the Appendix to this report performed certain audit procedures. We are responsible for the audit procedures performed by the other independent public accounting firms and persons listed in the Appendix to this report and, accordingly, have supervised their work in accordance with PCAOB standards.

## APPENDIX

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period(s)] ended [date(s)], the other independent public accounting firms and persons listed below performed certain audit procedures. The portion of the total audit hours attributable to audit procedures performed by these other independent public accounting firms and persons in our audit follows:

<b>Other participants in the audit</b>	<b>Percentage of total audit hours for the [period(s)] ended [date(s)]</b>
ABC Audit Firm (country of headquarters' office location)	21 %
DEF Audit Firm (country of headquarters' office location)	12
GHI Consulting Business (country of headquarters' office location)	5
JKL Audit Firm (country of headquarters' office location)	4
Mr. Person Y (country of residence)	3
Other participants, all individually less than 3% of total audit hours	15

I. Paragraph .14G is inserted, as follows:

In cases in which an auditor dual-dates the audit report (e.g., the company restates its financial statements before the end of the next annual

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reporting period), an example of the explanatory paragraph described in paragraph .14A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period] ended [date], ABC Audit Firm (country of headquarters' office location) performed certain audit procedures. We are responsible for the audit procedures performed by ABC Audit Firm and, accordingly, have supervised their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit was X%. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit procedures performed subsequent to [date of original audit report] was Y%.

m. Paragraph .14H is inserted, as follows:

In cases in which an auditor dual-dates the audit report (e.g., the company restates its financial statements before the end of the next annual reporting period), an example of the explanatory paragraph using an appendix described in paragraph .14A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period] ended [date], the other independent public accounting firms and persons listed in the Appendix to this report performed certain audit procedures. We are responsible for the audit procedures performed by the other independent public accounting firms and persons listed in the Appendix to this report and, accordingly, have supervised their work in accordance with PCAOB standards.

## APPENDIX

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period] ended [date], the other independent public accounting firms and persons listed below performed certain audit procedures. The portion of the total audit hours attributable to audit procedures performed by these other independent public accounting firms and persons in our audit follows:

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<b>Other participants in the audit</b>	<b>Percentage of total audit hours for the [period] ended [date]</b>	
	<b>Up to [date of original report]</b>	<b>Subsequent to [date of original report]</b>
ABC Audit Firm (country of headquarters' office location)	21 %	10 %
DEF Audit Firm (country of headquarters' office location)	12	8
GHI Consulting Business (country of headquarters' office location)	5	–
JKL Audit Firm (country of headquarters' office location)	4	–
Mr. Person Y (country of residence)	3	–
Other participants, all individually less than 3% of total audit hours	15	3

AU sec. 543, "Part of Audit Performed by Other Independent Auditors"

SAS No. 1, "Codification of Auditing Standards and Procedures" section 543, "Part of Audit Performed by Other Independent Auditors" (AU sec. 543, "Part of Audit Performed by Other Independent Auditors"), as amended, is amended as follows:

a. In paragraph .04, the last sentence is replaced with the following:

If the principal auditor decides to take this position, he should not make reference to the audit of the other auditor in the audit report, as described in paragraphs .06 through .09.

b. The following note is added after paragraph .04:

Note: When the principal auditor does not make reference to the audit of the other auditor, paragraph .14A of AU sec. 508, *Reports on Audited Financial Statements*, requires disclosure of the other auditor.

c. In paragraph .07,

- The second and third sentences are replaced with the following:

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The report should disclose the name of the other auditor, the country of headquarters' office location of the other auditor, and the magnitude of the portion of the financial statements audited by the other auditor. Disclosing the magnitude of the portion of the financial statements audited by the other auditor may be accomplished by stating the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, whichever most clearly reveals the portion of the financial statements audited by the other auditor.

- The last sentence and footnote 3 are deleted.

d. In paragraph .09,

- The last sentence of the first paragraph of the example report is replaced with the following:

Those statements were audited by [name of other auditors and country of headquarters' office location] whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of [name of other auditors].

- The last sentence of the second paragraph of the example report is replaced with the following:

We believe that our audit and the report of [name of other auditors] provide a reasonable basis for our opinion.

- In the first sentence of the third paragraph of the example report, the phrase "the other auditors" is replaced with "[name of other auditors]."

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*

Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements*, is amended, as follows:

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- a. In paragraph C1, subparagraph c-1 is added, as follows:

Other independent public accounting firms perform an audit of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments, or other independent public accounting firms or persons<sup>0a</sup> not employed by the auditor perform audit procedures in the most recent period's audit, other than in the circumstance described in paragraph C1.c.

<sup>0a</sup> PCAOB Rule 1001(p)(iv) defines the term "person" to mean any natural person or any business, legal or governmental entity or association.

- b. Paragraph C11-A is added, as follows:

*Other Independent Public Accounting Firms or Persons Not Employed by the Auditor Perform an Audit or Audit Procedures in the Most Recent Period's Audit.*

When another independent public accounting firm performs an audit of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or another independent public accounting firm or a person who is not employed by the auditor performs audit procedures in the audit of the company's internal control over financial reporting, other than an independent auditor whose audit is referred to pursuant to paragraphs .06 through .09 of AU sec. 543 and other than as provided by paragraph C11-B, the following items should be disclosed in the combined audit report for the most recent reporting period under audit through the addition of an explanatory paragraph following the opinion paragraph and any other explanatory paragraphs: (1) the name(s) and country(ies) of headquarters' office location of such firm(s) and/or (2) the name(s) and country(ies) of residence or headquarters' office location of such person(s), and (3) the percentage of the hours attributable to audits or audit procedures performed by the firm(s) or person(s) in relation to the total hours in the most recent period's audit, which include the hours incurred in performing reviews pursuant to AU sec. 722, *Interim Financial Information*, as of the date of the audit report. When the auditor chooses to issue a separate report on internal control over financial reporting, this paragraph should follow the paragraph required by paragraph 88 in each

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separate report. The explanatory paragraph also should include a statement that the auditor is responsible for the audits or audit procedures performed by the firm(s) or person(s) and has supervised or performed procedures to assume responsibility for the work in accordance with PCAOB standards.

Note: The explanatory paragraph can refer to an appendix immediately following the audit report that includes the required disclosure.

Note: For purposes of this disclosure, the auditor should disclose the name of the firm or person with whom the auditor has the contractual relationship.

Note: In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), the disclosure should state the percentage of audit hours attributable to the audits or audit procedures performed by independent public accounting firms other than the firm issuing the audit report and other persons participating in the audit in relation to the total audit hours for all periods presented.

Note: In cases in which an audit report is dual-dated, the auditor should: (a) repeat in the audit report the most recent disclosure before the dual-dating and (b) supplement it by stating, separately, the percentage of hours attributable to the work performed subsequent to the original report date.

Note: Independent public accounting firms other than the firm issuing the audit report and other persons participating in the audit whose individual extent of participation is 3% or more of total hours in the most recent period's audit should be disclosed individually with their respective percentage of total hours. Other firms and persons participating in the audit whose individual extent of participation is less than 3% of the total hours in the most recent period's audit should be disclosed either individually, with their respective percentage of total hours in the most recent period's audit, or as a group titled "other participants," with the percentage

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of total hours attributable to the audit or audit procedures performed by the group.

Note: The disclosure required by this paragraph does not constitute making reference pursuant to paragraphs .06 through .09 of AU sec. 543 or suggest that the auditor has divided responsibility for the performance of the audit with another auditor.

c. Paragraph C11-B is inserted, as follows:

Excluded from the disclosures required by paragraph C11-A is the name of the individual who performed the engagement quality review ("EQR") and the name of persons that performed the filing review pursuant to SECPS Section 1000.45 Appendix K ("Appendix K review") and the hours attributable to the EQR and Appendix K review. Also excluded from the disclosures required by paragraph C11-A are (1) persons with specialized skill or knowledge in a particular field other than accounting or auditing, (2) 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 (3) internal auditors who provide direct assistance in the audit of the financial statements.

d. Paragraph C11-C is inserted, as follows:

Examples of the explanatory paragraph described in paragraph C11-A follow:

*An example of the explanatory paragraph for situations in which another independent accounting firm performed certain audit procedures – In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2 and of the effectiveness of internal control over financial reporting as of December 31, 20x2, ABC Audit Firm (country of headquarters' office location) performed certain audit procedures. We are responsible for the audit procedures performed by ABC Audit Firm and, accordingly, have supervised their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit was X%.*

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*An example of the explanatory paragraph for situations in which another independent accounting firm performed an audit of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments* – In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2 and of the effectiveness of internal control over financial reporting as of December 31, 20x2, ABC Audit Firm (country of headquarters' office location) performed an audit of the financial statements of one of XYZ Company's subsidiaries. We are responsible for the audit performed by ABC Audit Firm, insofar as that audit relates to our expression of an opinion on the financial statements taken as a whole and, accordingly, have performed procedures to assume responsibility for their work in accordance with PCAOB standards. The portion of the total audit hours attributable to the audit performed by ABC Audit Firm in our audit was X%.

- e. Paragraph C11-D is inserted, as follows:

An example of the explanatory paragraph using an appendix described in paragraph C11-A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2 and of the effectiveness of internal control over financial reporting as of December 31, 20x2, the other independent public accounting firms listed in the Appendix to this report performed [*choose applicable*: audits of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or certain audit procedures], and persons listed in the Appendix performed certain audit procedures. We are responsible for the audits and audit procedures performed by the other independent public accounting firms and persons listed in the Appendix to this report and accordingly, have supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards.

## APPENDIX

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the year ended December 31, 20x2 and of the effectiveness

**RELEASE**

of internal control over financial reporting as of December 31, 20x2, the other independent public accounting firms listed below performed [*choose applicable*: audits of the financial statements of one or more of the company's subsidiaries, divisions, branches, components, or investments or certain audit procedures], and persons listed below performed certain audit procedures. The portion of the total audit attributable to audits and audit procedures performed by these other independent public accounting firms and persons in our audit follows:

<b>Other participants in the audit</b>	<b>Percentage of total audit hours for the [period] ended [date]</b>
ABC Audit Firm (country of headquarters' office location)	21 %
DEF Audit Firm (country of headquarters' office location)	12
GHI Consulting Business (country of headquarters' office location)	5
JKL Audit Firm (country of headquarters' office location)	4
Mr. Person Y (country of residence)	3
Other participants, all individually less than 3% of total audit hours	15

f. Paragraph C11-E is inserted, as follows:

In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), an example of the explanatory paragraph described in paragraph C11-A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period(s)] ended [date(s)] and of the effectiveness of internal control over financial reporting as of [date], ABC Audit Firm (country of headquarters' office location) performed certain audit procedures. We are responsible for the audit procedures performed by ABC Audit Firm and, accordingly, have supervised their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit was X%.

## **RELEASE**

g. Paragraph C11-F is inserted, as follows:

In cases in which the financial statements for all periods presented were audited during one audit engagement (e.g., in an initial public offering, single-period audit, or re-audit), an example of the explanatory paragraph using an appendix described in paragraph C11-A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period(s)] ended [date(s)] and of the effectiveness of internal control over financial reporting as of [date], the other independent public accounting firms and persons listed in the Appendix to this report performed certain audit procedures. We are responsible for the audit procedures performed by the other independent public accounting firms and persons listed in the Appendix to this report and, accordingly, have supervised their work in accordance with PCAOB standards.

### **APPENDIX**

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period(s)] ended [date(s)] and of the effectiveness of internal control over financial reporting as of [date], the other independent public accounting firms and persons listed below performed certain audit procedures. The portion of the total audit hours attributable to audit procedures performed by these other independent public accounting firms and persons in our audit follows:

**RELEASE**

<b>Other participants in the audit</b>	<b>Percentage of total audit hours for the [period(s)] ended [date(s)]</b>
ABC Audit Firm (country of headquarters' office location)	21 %
DEF Audit Firm (country of headquarters' office location)	12
GHI Consulting Business (country of headquarters' office location)	5
JKL Audit Firm (country of headquarters' office location)	4
Mr. Person Y (country of residence)	3
Other participants, all individually less than 3% of total audit hours	15

h. Paragraph C11-G is inserted, as follows:

In cases in which an auditor dual-dates the audit report (e.g., the company restates its financial statements before the end of the next annual reporting period), an example of the explanatory paragraph described in paragraph C11-A follows:

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period] ended [date] and of the effectiveness of internal control over financial reporting as of [date], ABC Audit Firm (country of headquarters' office location) performed certain audit procedures. We are responsible for the audit procedures performed by ABC Audit Firm and, accordingly, have supervised their work in accordance with PCAOB standards. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit was X%. The portion of the total audit hours attributable to audit procedures performed by ABC Audit Firm in our audit procedures subsequent to [date of original audit report] was Y%.

i. Paragraph C11-H is inserted, as follows:

In cases in which an auditor dual-dates the audit report (e.g., the company restates its financial statements before the end of the next annual reporting period), an example of the explanatory paragraph using an appendix described in paragraph C11-A follows:

**RELEASE**

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period] ended [date] and of the effectiveness of internal control over financial reporting as of [date], the other independent public accounting firms and persons listed in the Appendix to this report performed certain audit procedures. We are responsible for the audit procedures performed by the other independent public accounting firms and persons listed in the Appendix to this report and, accordingly, have supervised their work in accordance with PCAOB standards.

**APPENDIX**

In our audit of the financial statements of XYZ Company and subsidiaries as of and for the [period] ended [date] and of the effectiveness of internal control over financial reporting as of [date], the other independent public accounting firms and persons listed below performed certain audit procedures. The portion of the total audit hours attributable to audit procedures performed by these other independent public accounting firms and persons in our audit follows:

<b>Other participants in the audit</b>	<b>Percentage of total audit hours for the [period] ended [date]</b>	
	<b>Up to [date of original report]</b>	<b>Subsequent to [date of original report]</b>
ABC Audit Firm (country of headquarters' office location)	21 %	10 %
DEF Audit Firm (country of headquarters' office location)	12	8
GHI Consulting Business (country of headquarters' office location)	5	–
JKL Audit Firm (country of headquarters' office location)	4	–
Mr. Person Y (country of residence)	3	–
Other participants, all individually less than 3% of total audit hours	15	3