
STANDING ADVISORY GROUP MEETING

PANEL DISCUSSION – SIGNING THE AUDITOR'S REPORT

OCTOBER 22 - 23, 2008

Introduction

At the October 2008 meeting of the Standing Advisory Group ("SAG"), a panel, consisting of an investor, an academic, and a representative from a large accounting firm, will discuss a recommendation of the Department of the Treasury's ("Treasury") Advisory Committee on the Auditing Profession ("Advisory Committee" or "Committee") that the PCAOB should consider mandating the engagement partner's signature on the auditor's report. The Treasury established the Committee in October 2007 to "examine auditing industry concentration, financial soundness, audit quality, employee recruitment and retention, in addition to other topics."^{1/}

In February 2005, the SAG discussed various issues regarding the audit reporting model, including whether to include the engagement partner's and the second or concurring partner's signatures on the audit report.^{2/} At that time, some SAG members expressed support for inclusion of the signatures, and other members expressed opposition to that idea. Given the feedback received from that meeting, along with the Treasury's recommendation plus other recent developments, such as the European Union's Eighth Directive that requires that

^{1/} U.S. Department of the Treasury, "Paulson Announces Auditing Committee Members to Make Recommendations for a More Sustainable, Transparent Industry," Treasury Press Release No. hp 585 (October. 2, 2007), available at <http://www.treas.gov/press/releases/hp585.htm>.

^{2/} See SAG Briefing Paper at www.pcaobus.org/News/Events/Documents/02162005_SAGMeeting/Auditors%20Reporting%20Model.pdf

This paper was developed by the staff of the Office of the Chief Auditor to foster discussion among the members of the Standing Advisory Group. It is not a statement of the Board; nor does it necessarily reflect the views of the Board or staff.

the engagement partner sign the auditor's report^{3/}, the PCAOB staff believes it is appropriate for the SAG to reconsider the topic.

This paper provides SAG members with background information on the recommendation from the Advisory Committee and on the current U.S. reporting requirement related to audit engagements. In addition, it includes discussion of recent developments in other countries related to required signatures and also highlights views that have been expressed on whether the individual auditors should sign the audit report.

Recommendation from the Advisory Committee

On October 6, 2008, the Committee released its Final Report ("Committee's Final Report"), which included a recommendation relating to the engagement partner's signature on the auditor's report.^{4/} Specifically, the Committee's Final Report included the following recommendation:

Chapter V. Firm Structure and Finance

Recommendation 6: Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report.^{5/}

The Committee's Final Report states that the Committee believes that the engagement partner's signature on the auditor's report would increase transparency and accountability. The Committee's Final Report "notes the signature requirement should not impose on any signing partner any duties,

^{3/} European Union, Directive 2006/43/EC of the European Parliament and of the Council of 17 May on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC ("EU Eighth Directive"), Article 28, Audit Reporting. For the implementation status of the EC Eighth Directive, see the section of the briefing paper below on "U.S. and International Reporting Requirements."

^{4/} U. S. Department of the Treasury, *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury* ("Committee's Final Report") (October 6, 2008), pp. VII:19 - VII:20; available at <http://www.treas.gov/offices/domestic-finance/acap/docs/final-report.pdf>.

^{5/} *Ibid.*, p. VII:19. The Appendix provides an excerpt of the Committee's Final Report.

obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of an auditing firm."^{6/}

U.S. and International Reporting Requirements

The reporting requirements in the United States and internationally vary regarding whether the auditor's signature is required as part of the audit report. For example, U.S. Securities and Exchange Commission ("SEC") Rule 2-02(a) of Regulation S-X states that "[t]he accountant's report (1) shall be dated; (2) shall be signed manually; (3) shall indicate the city and state where issued; and (4) shall identify without detailed enumeration the financial statements covered by the report."^{7/} At the same time, PCAOB interim standards state that the audit report should include the "manual or printed signature of the auditor's firm."^{8/} The signatures of the engagement partner and the second or concurring partner are not required to be included in the audit report under PCAOB interim standards.

Internationally, practice is varied, although the most common form of reporting includes the signature of the firm and not the individual signing the report. The International Federation of Accountants has acknowledged these differences in its International Auditing and Assurance Standards Board's ("IAASB") International Standard on Auditing 700 ("ISA 700"), *The Independent Auditor's Report on a Complete Set of General Purpose Financial Statements*, which requires that the auditor's report should be signed. However, ISA 700

^{6/} *Committee's Final Report*, pp. VII:20. The Committee's Final Report also includes a related recommendation on annual shareholder ratification of public company auditors by all public companies. More specifically, the Committee recommends that "disclosure in the company proxy statement regarding shareholder ratification include the name(s) of the senior auditing partner(s) staffed on the engagement." (See *Committee's Final Report*, pp. VIII:20.) Proxy rules are determined by the U.S. Securities and Exchange Commission.

^{7/} 17 C.F.R. § 210.2-02(a); see also Rule 2-02(f) of Regulation S-X, 17 C.F.R. § 210.2-02(f) (requiring the auditor's report on internal control over financial reporting to "be dated, signed manually, identify the period covered by the report and indicate that the accountant has audited the effectiveness of internal control over financial reporting").

^{8/} See paragraph .08(i) of AU 508, *Reports on Audited Financial Statements*; see paragraph 85 of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements*.

acknowledges that the "auditor's signature is either in the name of the audit firm, the personal name of the auditor or both, as appropriate for the particular jurisdiction."^{9/}

In May 2006, the European Parliament passed the Eighth Directive on Statutory Audits, which requires, among other things, that the engagement partner sign the auditor's report. Specifically, Article 28, Audit Reporting, of the Eighth Directive states:^{10/}

Where an audit firm carries out the statutory audit, the audit report shall be signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm. In exceptional circumstances Member States may provide that this signature need not be disclosed to the public if such disclosure could lead to an imminent and significant threat to the personal security of any person. In any case the name(s) of the person(s) involved shall be known to the relevant competent authorities.

Member states of the European Union were required to adopt Article 28 of the Eighth Directive by June 29, 2008; therefore, those member states now follow the Eighth Directive instead of ISA 700, which does not require that the auditor sign the audit report. Since the Eighth Directive went into effect only recently, there is limited information about the results of such reporting, including how frequently the exception from individual reporting is used because of an "imminent and significant threat to the personal security of any person."

Views on Signatures of Individual Auditors on the Audit Report

The topic of whether the signatures of the individual auditors should be included in the audit report has been discussed in a variety of forums, including the Advisory Committee, the SAG, and the Institute of Chartered Accountants of England and Wales. A common theme among all of these discussions has been that the inclusion of the auditor's signature should not result in a shift in responsibility from the accounting firm to the engagement partner or other partners.

^{9/} International Federation of Accountants, *Handbook of International Standards on Auditing, Assurance, and Ethics Pronouncements*, 2008 edition, Part I.

^{10/} European Union, EU Eighth Directive, Article 28, Audit Reporting.

Advisory Committee

The Committee's Final Report states that -

- "Advocates believe that such signatures will foster greater accountability of the individuals signing the auditor's report, will enhance transparency, and may improve audit quality... "^{11/}
- "[S]upporters analogize the signatures to the chief executive officer and chief financial officer certifications under Section 302 of Sarbanes-Oxley and directors' signatures on public company annual reports."^{12/}
- "Opponents of such signatures argue that the audit firm operates as a team and takes responsibility for the audit, but not individual partners" and that "no improvement in audit quality will result from such a signature."^{13/}

Standing Advisory Group

At the February 2005 SAG meeting, SAG members expressed different views about whether individual partners should sign the audit report, although SAG members expressing support generally were investors and issuers and SAG members expressing opposition generally were auditors.

SAG members expressing support for the signature of individual partners on the audit report provided the following views –

- Since chief executive officers and chief financial officers have to certify to the accuracy of the financial statements, an auditor may feel more responsibility for the audit if he or she similarly includes his or her personal signature.
- A person exhibits a different behavior when they sign their name to something.

^{11/} *Committee's Final Report*, p. VII:19.

^{12/} Ibid.

^{13/} Ibid.

- Including the lead partner's signature on the audit report shows professional commitment to more accountability after the Sarbanes-Oxley Act and also would help to restore investor confidence and public trust in financial reporting.
- Since investors want to see the signature of the lead partner, such information should be provided.

SAG members expressing opposition to the signature of individual partners on the audit report provided the following views –

- Board and audit committee members are aware of the individual partners, and they have responsibility for oversight of the audit.
- The entire firm stands behind the report.
- The analogy to Section 302 certifications is not appropriate, because such certifications are not signed by the company in addition to the individuals. The certifications are only signed by individuals.
- Such disclosures should be optional and left to the firms' discretion.

There was no significant, focused discussion at the February 2005 SAG meeting on the specific issue of whether the second or concurring partners' signatures should be included on the audit report. The only comment specific to this issue came from a SAG member who expressed opposition to including the signature of the audit partner. That individual said that the concurring reviewer's responsibilities are not at the same level as that of the lead audit partner.

Institute of Chartered Accountants of England and Wales

The Institute of Chartered Accountants of England and Wales ("ICAEW") issued a report^{14/} in 2005 that addressed the issue of whether individual partners should sign the audit report. The report outlines benefits as well as concerns and issues with the practice.

The report describes the following benefits of including signatures of individual partners –

^{14/} Institute of Chartered Accountants of England and Wales, *Shareholder involvement – Identifying the audit partner* (2005).

- Aid transparency
- Provide motivation to the individual partner to take even more care in performing the audit if their name is visible and their personal reputation is at stake
- Demonstrate that rotation of the audit engagement partner is taking place
- Provide more transparency that the audit has been carried out for and on behalf of the firm
- Highlight the specific responsibilities that the audit engagement partner has for the quality of the audit

The concerns expressed in the paper about including signatures of individual partners are –

- Could have a potentially misleading effect by suggesting that only the named individual has full responsibility for the engagement
- Will have no impact on the nature of access that shareholders have to the auditor, since shareholders will need to approach the auditor via the client
- Could reduce the number of firms that are available for audits that are considered to be high risk
- Could reduce the number of professional accountants willing to enter the audit profession
- Risk to personal safety

After considering the requirements relating to including signatures of individual partners on the audit report, the ICAEW's report recommended that the wording in the legislation needed to be clarified to reflect the need for the key/lead audit engagement partner to sign in his/her own name on behalf of the firm. Additionally, the ICAEW's report recommended that the auditing standards be amended to clarify that the audit report should be signed in the personal name of the audit engagement partner, on behalf of the firm.

Discussion Topics –

The purpose of the SAG discussion is to hear from panelists and provide an opportunity for discussion about the Advisory Committee's recommendation regarding the engagement partner's signature on the auditor's report as well as whether to include the signatures of other members of the engagement team or accounting firm. The presentations and discussion will address the following topics:

- Pros and cons of including the signature of the engagement partner on the auditor's report
- Pros and cons of including the signatures of other members of the engagement team or accounting firm (such as the second or concurring partner, quality control partner, consultation partner, industry expert partner, accounting firm Chief Executive Officer) on the auditor's report

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The PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002, to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

APPENDIX

Excerpt from

FINAL REPORT

**of the
ADVISORY COMMITTEE
on the AUDITING PROFESSION**

**to the
DEPARTMENT OF THE TREASURY**

October 6, 2008

Recommendation 6: Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report.

SEC regulations require that the auditor's report be signed.⁷⁹ Under current requirements, the auditor's report signature block shows the auditing firm's name, not the engagement partner's. In 2005, the PCAOB's SAG considered whether the audit partner and a concurring partner should sign the auditor's report in their own names.⁸⁰ The Committee has received testimony and commentary regarding the benefits and complexities of engagement partner signatures.⁸¹ The Committee has also discussed and debated the merits of the senior engagement partner signing the auditor's report.⁸² Advocates believe that such signatures will foster greater accountability of the individuals signing the auditor's report, will enhance transparency, and may improve audit quality, and they also note the signature will create no additional liability concerns for the engagement partner.⁸³ These supporters analogize the signatures to the chief

⁷⁹ SEC Regulation S-X, Rule 2-02a.

⁸⁰ Public Company Accounting Oversight Board, Standing Advisory Group Meeting: Auditor's Reporting Model 7-8 (Feb. 16, 2005).

⁸¹ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga, Jr., Vice Chairman, Capital Research and Management Company, 2), *available at* <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf> (stating that signatures could improve audit quality and enhance accountability).

⁸² See, e.g., Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Donald T. Nicolaisen, Board Member, Morgan Stanley, 228-230) (stating his belief that the engagement partner should sign the auditor's report); Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Mary K. Bush, Board Member, Discover Financial Services, 231) (endorsing the engagement partner signature on the auditor's report).

⁸³ See, e.g., Donald Chapin, Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 9, 2008), *available at* http://comments.treas.gov/_files/TreasuryAdvisoryCommittee.doc (suggesting that if the engagement partner and concurring partner sign the auditor's report separately, some type of liability limitations should be received if the firm is not complicit in the audit failure); Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 13, 2008), *available at*

executive officer and chief financial officer certifications under Section 302 of Sarbanes-Oxley and directors' signatures on public company annual reports. The signature will also enhance the status of the engagement partner, putting the partner on the same level as the chief executive officer and chief financial officer. Opponents of such signatures argue that the auditing firm operates as a team and takes responsibility for the audit, but not individual partners. They also argue that no improvement in audit quality will result from such a signature.⁸⁴

http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (supporting the Recommendation); Paul Lee, Director, Hermes Equity Ownership Services Limited, Comment Letter Regarding Draft Report and Draft Report Addendum 4, (June 13, 2008), *available at* http://comments.treas.gov/_files/ACAPresponse13Jun08.pdf (noting that the signatures would increase accountability and professionalism).

⁸⁴ See, e.g., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 21 (June 27, 2008), *available at* http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (arguing that regulators and others can already identify those involved in audits); Arnold Hanish, Financial Executives International, Chair, Committee on Corporate Reporting, Comment Letter Regarding Draft Report and Draft Report Addendum 5 (July 3, 2008), *available at* http://comments.treas.gov/_files/FEICCRTreasuryACAPCommentLetterFiled73080.pdf (stating that partners could become excessively conservative and seek multiple opinions from the national office before signing their name); Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 14-15, (June 27, 2008) *available at* http://comments.treas.gov/_files/ResponsetoAdvisoryCommittee0627final.PDF (noting that an audit is a team effort and focusing on one partner may reduce other engagement staff's sense of responsibility); Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 17, 2008), *available at* http://comments.treas.gov/_files/MayerHoffmanMcCannCommentLetter.pdf (stating that the Recommendation "may be counterproductive since large audits require many partners in various part of the country or world"); PricewaterhouseCoopers LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 11-12, (June 30, 2008), *available at* http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (discerning no clear benefit from the Recommendation).

The Committee notes that engagement partner signatures are required in other jurisdictions. The European Union's (EU) Eighth Directive requires that the engagement partner sign the auditor's report.⁸⁵ Even prior to the Eighth Directive, several European countries, including France, Germany, and Luxembourg, required engagement partner signatures for a number of years.⁸⁶

The Committee notes that in Chapter VIII of this Report, the Committee is recommending disclosure of the name(s) of the senior audit partner(s) staffed on the engagement in the proxy statement to increase transparency and affirm the accountability of the auditor.

The Committee believes that the engagement partner's signature on the auditor's report would increase transparency and accountability. Therefore, the Committee recommends that the PCAOB undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report. The Committee notes 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.⁸⁷

⁸⁵ Directive 2006/43/EC of the European Parliament and of the Council Art. 28 (May 17, 2006).

⁸⁶ The Institute of Chartered Accountants in England and Wales, Shareholder Involvement-Identifying The Audit Partner (2005) (noting that Germany, France, and Luxembourg currently require audit partner signatures and European Member states must adopt such a requirement under Article 28 of the Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts).

⁸⁷ This 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. See, SEC, Final Rule: Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Release No. 33-8177 (Jan. 23, 2003).