Simpson Thacher

Memorandum

PCAOB Adopts Rule Requiring Disclosure of Engagement Partner and Other Audit Participants

January 8, 2016

On December 15, 2015, the Public Company Accounting Oversight Board ("PCAOB") issued a new rule and related amendments to its auditing standards that require accounting firms to disclose, in a new PCAOB form, specified information regarding the engagement partner and other accounting firms that participated in the audit.[1]

I. The PCAOB's New Rule

The PCAOB's final rule requires accounting firms to disclose, on Form AP, *Auditor Reporting of Certain Audit Participants*, the following information for each completed issuer audit:

- **The Name of the Engagement Partner**. While acknowledging that an audit is "often a group effort" and that an audit of a multinational corporation generally involves a large team including more than one partner, the PCAOB notes that the engagement partner – defined in the PCAOB's audit standards as the "member of the engagement team with primary responsibility for the audit" – plays "a unique and critical role in the audit." Accordingly, the PCAOB deems it important for shareholders, who are asked to ratify the issuer's choice of independent auditor, to be informed about the leader of the engagement team that conducted the most recently completed audit.
- **Disclosures Regarding Other Accounting Firms.** The PCAOB recognizes that the auditor signing the auditor's report sometimes uses another accounting firm in a non-U.S. jurisdiction to audit the financial statements of a subsidiary in that country and that, in such cases, "the quality of the audit is dependent, to some degree, on the competence and integrity of the participating accounting firms." Accordingly, the PCAOB's final rule requires certain disclosures with respect to the other accounting firms

[1] *See* Improving the Transparency of Audits: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards, PCAOB Release No. 2015-008 (Dec. 15, 2015).

that participated in the audit.

Under the final rule, an "other accounting firm" is defined as "a registered public accounting firm other than the firm filing Form AP" or "any other person or entity that opines on the compliance of any entity's financial statements with an applicable financial reporting framework." An "other accounting firm" is deemed to have participated in the audit if the accounting firm filing the Form AP assumed responsibility for its work and report, as described in the PCAOB's accounting standards, or if "the other accounting firm or any of its principals or professional employees was subject to supervision" under the PCAOB's accounting standards.

- **Other Accounting Firms Whose Participation Constituted At Least Five Percent of Total Audit Hours.** With regard to other accounting firms whose work constituted at least five percent of total audit hours, the firm completing the Form AP must provide each accounting firm's:
  - legal name;
  - unique five-digit identifier for any firm that has a publicly available PCAOB-assigned number;
  - headquarters office location; and
  - extent of participation in the audit, expressed as a percentage (either as a single number or within a range) of total audit hours.
- **Other Accounting Firms Whose Individual Participation Constituted Less Than Five Percent of Total Audit Hours.** With regard to accounting firms whose individual participation accounted for less than five percent of total audit hours, the auditor filing the Form AP must provide:
  - the number of such other accounting firms, and
  - the "aggregate extent of participation of such other accounting firms, expressed as a percentage of total audit hours."

- **Disclosures Regarding Referred-To Auditors.** Where the auditor makes reference to another accounting firm in the auditor's report, the auditor must disclose, in its Form AP, the name and office location of the referred-to accounting firm, as well as "the magnitude of the portion of the financial statements audited by the referred-to auditor."

The above information is required to be filed with the PCAOB on Form AP 35 days after the auditor's report is first included in a document filed with the Securities and Exchange Commission ("SEC") and will be available in a searchable database on the PCAOB's website.[2]

Additionally, the PCAOB permits, but does not require, auditors to provide in the auditor's report the information disclosed in Form AP regarding the engagement partner, other accounting firms, or both. If disclosure is made in the auditor's report about other accounting firms:

[2] The PCAOB provided a shorter filing deadline of 10 days for initial public offerings.

- "the disclosure must include information about all of the other accounting firms required on Form AP, so that auditors cannot choose to include some other accounting firms and exclude others"; and
- the auditor's report must explicitly state that the principal auditor has responsibility for the work of the other accounting firms "and that it has supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards, to avoid potential confusion about the respective responsibilities of the principal auditor and the other accounting firms."

II. The Effective Date of the Rule

Subject to the rule's approval by the SEC:

- disclosure of the audit engagement partner's identity will be required for auditors' reports issued on or after January 31, 2017, or three months after the SEC's approval of the final rule, whichever is later; and
- disclosure regarding other accounting firms will be required for auditors' reports issued on or after June 30, 2017.

III. Implications of the Rule on Public Companies

In many public companies, the audit committee of the board is involved in the selection of the audit engagement partner. As recognized by the PCAOB, "[i]t is not unusual in audits of large companies for audit committees to interview several candidates for their engagement partner when a new engagement partner is to be chosen because the qualifications and personal characteristics of the engagement partner are viewed by the audit committee and senior management as particularly important." The PCAOB's new rule may place even more emphasis on the importance of the engagement partner selected, as the engagement partner's identity will become public and his or her reputation may impact investors' views regarding the reliability of the company's financial statements. When assessing a potential engagement partner, audit committees may want to consider not only that individual's background, experience, and reputation, but also which other companies, if any, that engagement partner serves.

For the same reason as discussed above, the PCAOB's new rule may also engender heightened sensitivity among audit committees with respect to the other accounting firms the auditor proposes to use in connection with the audit.

If you have any questions or would like additional information, please do not hesitate to contact **Yafit Cohn** at +1-212-455-3815 or yafit.cohn@stblaw.com, any other member of the Firm's Public Company Advisory Practice.

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