



September 11, 2009

Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006-2803

Audit - Tax - Advisory

Grant Thornton LLP  
175 W Jackson Boulevard, 20th Floor  
Chicago, IL 60604-2687

T 312.856.0200

F 312.565.4719

[www.GrantThornton.com](http://www.GrantThornton.com)

Re: PCAOB Rulemaking Docket Matter No. 029, *Concept Release on Requiring the Engagement Partner to Sign the Audit Report*

Dear Board Members and Staff:

We appreciate the opportunity to comment on the *Concept Release on Requiring the Engagement Partner to Sign the Audit Report* ("Concept Release"). We support the practice of issuing a concept release, such as this one, seeking input on high-level issues prior to the issuance of an exposure draft of a proposed standard. We expect you will find the input you receive useful, and encourage you to continue the practice going forward.

We support the goal of increasing accountability and transparency; however, we do not believe requiring the engagement partner to sign the audit report will accomplish that goal. We believe that a requirement to sign the audit report individually will have no effect on the partner's sense of accountability. Partners are held accountable by their own professionalism, supplemented by mechanisms that are in place that allow third parties to hold them accountable. For those partners, it is impossible to be "more" accountable. To the extent that there may be partners who do not feel this deep sense of accountability, it is hard to imagine that the requirement to sign the audit report will influence them if all the mechanisms that are currently in place to hold partners accountable have failed to do so.

With respect to transparency, we believe that a requirement for the engagement partner to sign the audit report would actually reduce transparency in that it obfuscates how an audit is performed. To imply that an individual is solely responsible for performing the audit is misleading. Furthermore, we believe that this requirement may signal to the markets that there has been a fundamental shift in the responsibilities of the audit firm and the engagement partner, which is not the case.

We also believe pursuing this project at this time will distract the Board's resources from more meaningful initiatives to enhance market confidence in audit quality, and the Board risks promulgating a new standard with unproven benefits and unintended consequences.

### Partner's sense of accountability

1. Would requiring the engagement partner to sign the audit report enhance audit quality and investor protection?
2. Would such a requirement improve the engagement partner's focus on his or her existing responsibilities? The Board is particularly interested in any empirical data or other research that commenters can provide.
3. Would disclosure of the engagement partner's name in the report serve the same purpose as a signature requirement, or is the act of signing itself important to promote accountability?

We believe that a requirement to sign the audit report individually will have no effect on investor protection, audit quality or the partner's sense of accountability. Partners are held accountable by their own professionalism, supplemented by mechanisms that are in place that allow third parties to hold them accountable. Such mechanisms include a firm's quality control policies and procedures, such as engagement quality review, a firm's internal inspection process, and partner compensation programs. Other mechanisms include peer review programs and the PCAOB inspection process. Furthermore, the audit committees and other regulators oversee the auditor. Finally, partners have a significant portion of their net worth invested in the firms in which they are partners. A single audit failure can take down a firm, resulting in a significant personal loss to the engagement partner, and all of his or her partners. We do not believe individually signing a report will promote greater accountability.

Furthermore, we are not aware of any studies that have been done to prove or disprove this presumption that individually signing a report drives greater accountability or whether any such requirement impacts investors' perceptions.

We are aware that research has shown that, at the staff-level, personnel will make more conservative materiality assessments and design more testing procedures when they realize that higher-level personnel on the engagement team will know who has performed the procedures.<sup>1</sup> However, we have quality assurance policies and procedures that recognize this characteristic of human behavior by requiring the documentation and review of who has performed which procedures, up through the partner and engagement quality review level. These policies and procedures, and how they are implemented, are reviewed by our internal inspection program, peer review, and PCAOB inspection. We reward and dismiss partners based on the quality of their work. These policies and procedures impose an appropriate level of accountability on all the participants on the audit team, including the engagement partner.

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<sup>1</sup> See DeZoort et al., "Accountability and auditors' materiality judgments: The effects of differential pressure strength," *Accounting, Organizations and Society* 31 (2006) 373–390.

### Transparency

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

The signature of the lead partner on an audit report has been presented as an effort to increase transparency. Increasing transparency implies an underlying process becomes apparent. However, we believe that the signature of the engagement partner on an audit report actually obscures the underlying audit process, which involves firm-level processes, including the firm's methodology, consultation requirements, review processes, and other audit and quality control policies and procedures. The engagement partner is responsible for oversight of the audit, but often specialists and national office partners assume significant responsibilities related to certain technical matters or complex areas. The confidence in the audit opinion is based on the quality of the firm's policies and procedures, not just the abilities of the individual partner. It is for this reason that the partner signs the firm's name on the audit report, not his or her own.

We are very concerned that requiring a partner to individually sign the report will lead to inaccurate conclusions about audit quality under some circumstances. The temptation to rank engagement partners by a simple statistic like number of restatements is too great. However, it must be remembered that the number of restatements is not a pure measure of the quality of a particular partner's body of work. There are many independent and dependent variables that affect any simple statistic of audit quality, only one of which is the identity of the engagement partner.

Finally, we believe that the addition of a requirement for the engagement partner to sign the audit report individually will signal to the markets a fundamental shift in the responsibilities between the audit firm and the engagement partner, which clearly has not occurred.

### Unintended consequences

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

Potential unintended consequences include:

- Shareholders may believe it is appropriate to contact the engagement partner directly to ask questions about the audit, the company's financial statements, or other matters. This would put both auditors and shareholders in a frustrating position, because, of course, the auditor cannot answer such questions due to confidentiality and other legal requirements. Auditors are accountable to the shareholders through the audit committee and the board of directors. This governance structure allows decisions to be made by people with an appropriate level of understanding of the company. We believe that shareholders, operating outside this governance structure, could add

confusion, cost, and frustration to a process that already contains mechanisms in place to hold auditors appropriately accountable to shareholders.

- An increase in real or perceived personal risk and responsibility by engagement partners will result in increased demand for prescriptive auditing and accounting standards, with a resulting decline in the use of professional judgment. Furthermore, costs in general could increase as auditors perform unnecessary procedures, or engage in unnecessary consultations in order to mitigate such perceived increase in personal risk.
  - Engagement partners and their families could be subject to unwarranted and unwelcome communications from shareholders who are unhappy with a particular company's performance in matters that are wholly unrelated to the completeness and accuracy of the financial statements.
  - More highly qualified partners refusing to serve as the engagement partner on more challenging audits because of real or perceived increased legal liability risks or personal security risks associated with particular clients. Furthermore, some auditors may avoid performing riskier audits lest the increased risk of audit failure negatively influences their professional reputations.
  - In the event that a question arises about the sufficiency of an audit of a high-profile company, even before the merits of such a question are validated or debunked, the publication of the engagement partner's name could generate indefensible press coverage that will likely negatively affect his or her reputation even if the audit is later determined to be sufficient.
7. The EU's Eighth Directive requires a natural person to sign the audit report, but provides that "[i]n exceptional circumstances, Member States may provide that this signature does not need to be disclosed to the public if such disclosure could lead to an imminent, significant threat to the personal security of any person." If the Board adopts an engagement partner signature requirement, is a similar exception necessary? If so, under what circumstances should it be available?

We believe that, if the Board adopts an engagement partner signature requirement, an exemption is required for those situations where the engagement partner feels that disclosure of the identity of the engagement partner could lead to an imminent, significant threat to the personal security of any person. The exemption should be available at the discretion of the partner and/or the firm. The need for appropriate guidance for a firm or a partner to use such an exemption would be critical to avoid unnecessary questioning of the professional judgment that would be necessary when using the exemption. However, guidance of this nature would be quite complex. Given that we do not believe a partner individually signing a report enhances audit quality, our belief that this standard is unnecessary is reinforced.

### Legal liability concerns

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

We believe that a signature requirement may cast doubt on an engagement partner's ability to raise important defenses to private claims under Section 10(b) of the Securities Exchange Act of 1934. Therefore, we believe that a signature requirement would likely increase the risk of liability to a partner. We therefore strongly encourage the PCAOB, to the extent it determines to proceed with such a requirement, to perform a thorough analysis on the potential impact an engagement partner's signature may have on litigation.

We expect that a signature requirement could create similar ambiguities under other federal statutes and state laws; the only bounds of the resulting potential liability to engagement partners is the creativity of plaintiffs. Even if resulting claims are ultimately defeated, the perception of increased personal liability of engagement partners will result in additional costs to defend against those claims, and insurance costs.

9. Are there steps the Board could or should take to mitigate the likelihood of increasing an engagement partner's potential liability in private litigation?
10. Some commenters on the ACAP Report who expressed concern about liability suggested that a safe harbor provision accompany any signature requirement. While the Board has no authority to create a safe harbor from private liability, it could, for example, undertake to define the engagement partner's responsibilities more clearly in PCAOB standards. Would such a standard-setting project be appropriate?

In light of the potential for increased litigation against individual engagement partners, we do not believe the Board should implement the signature requirement as long as the Board has no authority to create a safe harbor provision. However, if the Board chooses to go forward with the signature requirement and increased liability of an engagement partner is not intended, the proposed rule should so explicitly state. Further, if an individual signature is not intended to change the liability for the firm as a whole, then the proposed rule should also explicitly state this.

### Effects on other standards

Overall, we recommend making as few changes to the other standards as possible. Additional changes, particularly to the audit report, imply that the partner's signature has a greater meaning than it is possible for it to have.

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

**We do not recommend making changes to any of the other PCAOB standards.**

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

**Unless there has been a change in engagement partner, we do not recommend permitting the firms to add an explanatory paragraph in the report that states that the engagement partner's signature related only to the current year. Such a statement implies that there is a difference in the balance of responsibility between the firm and the partner from year-to-year. In fact, we think that the audit report is equally the firm's responsibility in both years.**

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

**Current standards allow the other auditor to be named, but only with his or her express permission and providing that the other auditor's report is presented together with that of the principal auditor. Assuming that this requirement is maintained, it is unnecessary for the principal auditor to make reference to the other engagement partner, as the other auditor's report, signed by the other engagement partner, will be attached.**

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

**For all of the reasons we do not believe the engagement partner should be required to sign the audit report, we also do not believe the engagement partner should be required to sign a report on interim financial information if the firm issues one.**

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

**We discourage the PCAOB from making any additional changes to the audit report as such changes might be read as attaching more importance to the auditor's signature than is warranted. Any changes in the audit report should be considered carefully and in coordination with other standards setters to avoid the confusion that may be associated with several styles of audit report in the public domain.**

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

We believe that the firm's signature should be the only one on the audit report; however, should the Board decide to impose a requirement for the engagement partner to sign the audit report, then both signatures should be on the report in such a way as to make clear that the firm is responsible for the audit.

We would be pleased to discuss our comments and recommendations with you. If you have any questions, please contact Mr. John L. Archambault, National Managing Partner of Professional Standards, at (312) 602-8701.

Sincerely,

