

*Arden House
Coppice Lane
Disley
Stockport
Cheshire
United Kingdom
SK12 2LT*

Telephone - +44 1663 763566

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington DC 20006-2803
USA

Dear Sirs,

PCAOB Rulemaking Docket Matter No 29
PCAOB Rulemaking Docket Matter No 34

As a recently appointed member of the PCAOB Standing Advisory Group I am writing in support of the PCAOB in their proposal to improve audit quality and transparency by requiring registered public accounting firms to disclose the name of the partner responsible for signing the audit report (Docket No 29) and the proposal to revise the auditing standard regarding the Auditor's Report and the Auditor's responsibilities regarding other information.

In 2011, I delivered the annual Aileen Beattie memorial lecture for the Institute of Chartered Accountants of Scotland (ICAS), an honour also bestowed on your chairman, James Doty, in 2013. My lecture contained a number of matters which I felt needed to be considered if our profession is to deliver a service to publically quoted companies that is relevant in today's (and future) global and local market places. I indicated that the "stool" of corporate reporting needed three strong legs in order to stand the weight of expectation from the investor community. It needs a robust financial reporting framework, quality auditing and reporting and effective, transparent, corporate governance, this latter part being partly delivered through the report of the audit committee. Without these three legs there is always scope for deficiencies in the information provided within financial statements all of which is relied upon by the investor community. It is also true that there is a need for all three legs to make their own contribution and one leg should not take on the task of rectifying any deficiencies in the other two. The audited financial statements underpin all other corporate reporting, whether it is quarterly and half yearly trading updates, preliminary announcements or analyst briefings, so it is essential that they contain sufficient,

balanced and relevant information for the investor and the wider stakeholder community to understand the risks within the company.

My lecture notes contained a number of messages, all of which were designed to facilitate change in the auditor, company and stakeholder relationship and to ensure the information reported in the financial statements is helpful in commenting on the risks within the business. Only in this way will we ensure that we were continually developing the relevance of the work we do and be recognised as working in the public interest.. The audit model and auditor reporting has not changed very much in the 150 years that ICAS (the oldest accounting institute in the world) has been in existence. Techniques have changed and the scope has, to a degree, changed but the fundamentals of auditor engagement and reporting have not. As a result of more focus being put on company and auditor reporting following the financial crisis it has become evident that now is the right time to change.

The conclusions I drew in 2011, and therefore the basis for my support for the PCAOB proposals, were contained in the following extract from the lecture:

“So how can we or should we be delivering on the mission to always undertake our work in the public interest? As I have said throughout this lecture, there is a need for the profession to do more in order to meet the ever increasing needs of the various stakeholders.

- ***Firstly, let us get company reporting right.*** *The need for the corporate report to tell the story of the business in a much more concise manner, focusing on the business model, the strategy, the key business risks and the rationale for believing the company is a going concern, both in the short and medium to long term, is an absolute necessity. The responsibility for this lies, primarily, with the preparer but the auditor also has a role.*
- ***Let us deepen our role of the auditor.*** *There is potentially a need for auditors to do more in relation to going concern but how far should this go? As stated earlier, the auditor should opine on information provided but if the company does not disclose matters then the auditor is likely to be asked to provide that information.*
- ***Let us expand the role of the auditor beyond the numbers and the statutory disclosures.*** *The desire of users for some form of assurance over the front half of the Annual Report is evident - auditors will need to adapt to meet that demand.*
- ***Let us expand the auditor’s reporting.*** *The need for greater insight to be given publicly as to what happens behind closed doors in the audit process. The auditors’ engagement with the audit committee and with management is crucial. The big debate is how should this information be conveyed externally – should it be through the audit report or through the report of the audit committee. This is fundamentally important to the whole question of auditor communication not only to users but also to supervisors and regulators. In my view, the audit committee report is the right vehicle.*
- ***Let us accept the need for more professional scepticism*** *and ensure that we build this into our day to day activities,*
- ***Let us contribute to better Company Stewardship.*** *There is a need for greater engagement with the investor community but as yet it is undecided how this could be best achieved. This is very important but if we get our mission ‘right’ by dealing with the points I have just made then perhaps this would, in essence, already have been taken care of.*

And, during this whole debate we must ensure that the auditors' independence and integrity is not impaired or compromised."

When I look back on these conclusions it is evident that we have come a long way in many jurisdictions around the world to plug what I call "the information gap"; a better description than the "expectation gap" which is a term so often used when considering what the investor community wants and the company and the auditor provides. We cannot provide all the information the various stakeholders seek but the current reporting model does need improvement and there is still a long way to go in most jurisdictions, including the United States.

We do need more work on corporate reporting as in some areas it is too complicated and does not always identify the key risks being, or likely to be, experienced by the company. This applies to all national and international accounting standard setters. The financial crisis has shown that there are areas where more is required from the financial reporting framework and this should be addressed by the accounting standard setters and not leave it to the audit standard setters to "plug the holes".

There is more to do on going concern by the company, and this is where the financial reporting framework could again help by having more requirements put onto company management to report formally within the financial statements. Additional requirements under auditing standards will help change the work the auditors do and how they report on this crucial area. In the UK this is now required and has been a positive move forward.

I think that the information in the front half of financial statements is extremely important both in relation to the present condition and the future prospects of the business and therefore there is more that the company and the auditor can do in relation to this information. It is appreciated that opining on future events is both difficult and dangerous for the auditor. Having said that, there are other judgements that need to be made throughout the audit of the financial statements so, as long as the auditor ensures that the reporting by the company is consistent with their knowledge of the company which is obtained during the course of the audit, why not say so in the audit opinion?

Expanding auditor reporting in my view is an essential part of the move to better quality auditing and more meaningful financial reporting. As I stated in one of my bullet points above, the information on the risks within the business should be provided by the company through its business review and through the audit committee report, however, the work undertaken by the auditor to mitigate the impact of those risks to ensure that there is no material error within the financial statements is also extremely important and useful to external stakeholders. This information forms the basis of audit committee / auditor discussion so should be pertinent to the investor community. Clearly, some matters are commercially sensitive but this should not be used as an excuse to withhold information that is critical to understanding the company's financial position.

During 2010, 2011 and 2012, I was very active in Europe on matters relating to the audit market, corporate governance and financial reporting as President of the Federation of European Accountants (FEE). In addition I was a member of the International Auditing and Assurance Standards Board (IAASB) Consultative Advisory Group (CAG). Consequently, I was heavily involved with the proposals put forward by the European Commission and the European Parliament primarily relating to changes within the audit profession. It became clear very early in 2010 that change was required and demanded. It was at this point I

requested that auditor reporting should be much higher up on the agenda of the IAASB whose standards were being used throughout almost all of Europe in one form or other. The IAASB did take this, and other input, into account when formulating their future work plan and fast tracked the revision of the auditing standard on audit reports (ISA 700). At the same time there were discussions taking place in the UK where they too were moving in the same direction. Both these were positive moves in my eyes and the proposals being put forward by the PCAOB by the release of these two rulemaking dockets are equally seen as a positive move for the global economy.

Turning to the two areas currently being debated in the US in relation to these matters.

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In my view the inclusion of the name of the partner responsible for the audit engagement and for signing the audit opinion on behalf of audit firm improves accountability and transparency. I do not, however, believe that other firms or individuals should also be disclosed. The auditor who signs the report is the one responsible for the whole engagement and the inclusion of other names has the potential to dilute the perception as to who is ultimately responsible. If a large amount of the work undertaken is performed by firms or individuals not under the direct control of the audit engagement partner then additional procedures are required to enable the engagement partner to sign the opinion as he/she has this ultimate responsibility. As is the practice in Europe, I suggest that the name is disclosed at the end of the report where the opinion is signed and that the signature is that of the person responsible not the name of the firm.

There are numerous reasons why the naming of the engagement partner enhances transparency and quality, many of which are included in other comment letters received by the PCAOB. Consequently, I do not intend to recite them here. One important effect, however, is to more easily identify and evaluate the engagement audit partner's experience within the sector in which the client operates and the extent of his/her workload on publicly quoted companies within the audit firm. These are particularly important when assessing the quality of the work being undertaken and the time availability of the individual auditor.

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The work undertaken by IAASB, the European Commission and the Financial Reporting Council (FRC) in the UK is moving the reporting framework for auditors in one direction and that is towards providing more detail of what an audit is, enhancing the information provided on audit performance and moving away from just a pass / fail model. The pass / fail model will still exist but the reasons behind the pass or fail will be more transparent.

Given the global nature of business it is therefore important that the US keeps itself aligned with the rest of the world. The PCAOB proposals go a long way towards closing this gap and should be encouraged but alignment would be preferable. Convergence in auditor reporting across the globe will improve understanding and enable comparison to be made from one jurisdiction to another. The opinion should use the same terminology, definitions and criteria if confusion is to be avoided.

The answer to most of the questions raised in the first public consultation on Rulemaking Docket 34 is "yes" but I consider one omission which should be included is specific reference in the audit report to the going concern basis of accounting adopted by the company and

the auditor's conclusion on this issue. The comments on this aspect could be included as a critical audit matter as in the majority of cases it is relevant to many of the judgements being made. Much of this information should already be contained in the MD&A so it is not a significant move to link all the disclosures.

Regarding critical audit matters, these should be kept to a few rather than many. Depending on the complexity of the company / group I would expect these to be between five and ten each year. They are not the identified risks of material misstatement contained in the initial audit plan but those which required most consideration by the company and the auditor and which were critical in the understanding of the company's financial position and its internal control assessment. The proposed "Auditors Discussion and Analysis" will in my view lead to too much information being included and could detract from the important areas of judgement being made. In this regard the enhanced audit opinion should provide better information to the reader and not focus on just providing more information.

Disclosure of critical audit matters has many benefits. Comparison of critical audit matters reported from one year to the next provides the reader with useful information on whether there is a changing profile to the risks within the business. This is an important element in order to understand the shifting nature of corporate risk and is, once again, an important indicator to stakeholders.

As I mentioned during the Aileen Beattie lecture, I believe that the reporting by the audit committee should also be enhanced as it is here that information on the company should be addressed and not provided by the auditor. This is addressed in the second public consultation document and the answer here is "yes". The role of the auditor is to opine on the information provided by the company and only supply the information if there are shortcomings in the company's reporting. This is a clear dividing line and one that should continue. It is primarily management's responsibility to provide company specific information not the auditor's.

Personal experience of changes to audit committee and auditor reporting

In the UK, September 2013 saw a change in the FRC requirements on reporting to shareholders by both the audit committee and the auditor. As the chair of one audit committee and a member of another, the reporting in the 2013 financial statements saw a significant change in this regard. Reflecting on the positives coming out of this experience there was certainly greater engagement between the audit committee and the auditor. The audit committee focussed heavily on the key matters within the financial statements and were far more engaged with management and the auditor to ensure appropriate judgements were being made and that the reporting of these judgements was appropriate. There was also more detail provided by the auditor to the audit committee as to how they had addressed key matters and how they had satisfied themselves as to the key judgements. Altogether it was a positive experience with few, if any, negative comments from audit committee members or auditor. At the end of the process I believe that both parties benefitted from the new reporting model. There was robust debate but no differences of opinion as to what should be reported in the financial statements. The requirement in the UK to ensure that the financial statements, as a whole, must be fair, balanced and understandable also helped when drafting the disclosures.

From an auditor perspective, it was reported that the new requirements had increased the awareness of the whole audit team regarding the importance of the work being undertaken

and also increased the level of scepticism being exercised. They felt that their work was having a more direct impact on the audit opinion itself. They also felt that they were providing useful information to the wider stakeholder community that required a higher degree of evidence to be obtained in order for it to be included in the auditor's report. Consequently, more engagement by the audit team in the audit and more evidence collected during the course of the audit.

Overall there was certainly better reporting by the audit committee and, I am sure, an improvement in audit quality as a consequence of the changes made.

I trust that my observations will be of use to the Board when it deliberates over the next steps to be taken in relation to this very important subject.

Yours sincerely

Philip Johnson