
SUPPLEMENTAL REQUEST FOR COMMENT:) PCAOB Release No. 2015-004
RULES TO REQUIRE DISCLOSURE OF) June 30, 2015
CERTAIN AUDIT PARTICIPANTS ON A NEW)
PCAOB FORM) PCAOB Rulemaking
) Docket Matter No. 029
)
)

Summary: The Public Company Accounting Oversight Board ("PCAOB" or "Board") is issuing this supplemental request for comment on its 2013 reproposal to require auditors to disclose in the auditor's report the name of the engagement partner and information about certain other participants in the audit. The Board is considering an alternative to disclosure of this information in the auditor's report, whereby the information would be required to be disclosed on a new PCAOB form. This supplemental request for comment seeks commenters' views on disclosure on a new PCAOB form.

Public Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, NW, Washington, DC 20006-2803. Comments also may be submitted via e-mail to comments@pcaobus.org or through the Board's website at <http://www.pcaobus.org>. All comments should refer to PCAOB Rulemaking Docket Matter No. 029 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EDT on August 31, 2015.

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I. Summary

The Board is issuing this release to solicit comment on an alternative to its 2013 reproposal to require disclosure in the auditor's report of the name of the engagement partner and information about certain other participants in the audit.¹ The new alternative would mandate disclosure of this information on a new PCAOB form, Form AP, *Auditor Reporting of Certain Audit Participants* ("Form AP"). This alternative could provide information about participants in the audit, which investors have consistently sought throughout the Board's rulemaking process, while responding to concerns raised by accounting firms and other commenters about the potential for increased auditor liability or litigation risk. Information filed on Form AP would be available in a searchable database on the Board's website.

The Board continues to consider whether to mandate auditor disclosure regarding certain audit participants and, if so, whether disclosure should be made in the auditor's report or on Form AP. The Board is considering trade-offs as it evaluates the potential of these two different disclosure mechanisms to achieve the benefits of disclosure—transparency and an increased sense of accountability. This supplemental request for comment presents the new PCAOB rule that would be necessary for the Board to implement this alternative, along with instructions for Form AP. The Board is seeking commenters' views on this approach as an alternative to mandated disclosure in the auditor's report.

This supplemental request for comment should be read in conjunction with the 2013 Release, which describes the proposal to mandate disclosure in the auditor's report.

Studies, memoranda, or other substantive items may be added by the Board or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Board's website. To ensure direct electronic receipt of such notifications via e-mail, subscribe to PCAOB updates at <http://pcaobus.org/About/Pages/PCAOBUpdates.aspx>.

II. Background

For several years, the Board has been considering requiring auditors to provide more information about key participants in audits that are subject to PCAOB standards. Providing such information would provide additional transparency about who is

¹ *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit*, PCAOB Release No. 2013-009 (December 4, 2013) ("2013 Release").

responsible for performing an audit for the benefit and use of investors and other market participants.

The Board began this rulemaking process in 2009, in response to a recommendation of the U.S. Department of the Treasury's Advisory Committee on the Auditing Profession ("ACAP"),² by seeking comment on whether the engagement partner should be required to sign the auditor's report.³ In 2011, after considering commenters' views on a signature requirement, the Board proposed rules that would have required disclosure in the auditor's report of the name of the engagement partner. The Board proposed a disclosure approach instead of a signature requirement primarily in response to commenters' concerns regarding liability and to better reflect the roles of both the firm as a whole and the engagement partner. In addition, the Board proposed rules that would have required disclosures of certain information about accounting firms and other participants in the audit to provide investors and other financial statement users with greater transparency into the other participants in the audit.⁴

In December 2013, the Board repropoed amendments to its standards that would require disclosure in the auditor's report of: (1) the name of the engagement partner; (2) the names, locations, and extent of participation of other independent public accounting firms that took part in the audit; and (3) the locations and extent of participation, on an aggregate basis by country, of certain nonaccounting firm participants in the audit.⁵

² ACAP, *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury* (October 6, 2008), at VII:20 (recommending that the PCAOB undertake a standard-setting initiative to consider mandating the engagement partner's signature on the audit report).

³ *Concept Release on Requiring the Engagement Partner to Sign the Audit Report*, PCAOB Release No. 2009-005 (July 28, 2009) ("2009 Release").

⁴ *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2*, PCAOB Release No. 2011-007 (October 11, 2011) ("2011 Release"). The proposal would also have required accounting firms to name the engagement partner on the public Form 2, *Annual Report Form*, which is the reporting form registered firms are required to file to fulfill their annual reporting obligation to the Board regarding basic information about the firm and the firm's issuer-, broker-, and dealer-related practices over the most recent 12-month period.

⁵ See 2013 Release.

Throughout this process, the Board has sought to balance the potential benefits of such disclosure with concerns expressed by some commenters about the potential for an increase in auditors' private liability and litigation risk. Toward that end, the Board has looked for ways to achieve the stated goals of the rulemaking while minimizing, to the extent it can, these potential unintended consequences.

III. Comments on the 2013 Release About the Method and Location of Disclosures

The Board received 69 comment letters on the 2013 Release.⁶ While the Board continues to consider all comments received on the 2013 Release, and will more fully discuss its responses upon adoption of any final rules, this supplemental request for comment responds to the principal comments received regarding the consequences of disclosure in the auditor's report and other potential locations for the disclosure.

Some commenters on the 2013 Release expressed concern that identifying the engagement partner and the other participants in the audit in the auditor's report could create both legal and practical issues under the federal securities laws by increasing the named parties' potential liability and by requiring their consent if the auditors' reports naming them were included in, or incorporated by reference into, registration statements under the Securities Act of 1933 ("Securities Act").⁷ In addition, some commenters expressed concerns about the possible effects of the engagement partner's name appearing in the auditor's report on litigation risk under Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder. In their view, identification in the auditor's report could make it more likely that identified persons would be named in a lawsuit or could affect their liability position. Many commenters on the 2013 Release urged the Board to proceed with the new disclosure requirements, if it

⁶ The Board also received 43 comment letters on its 2011 Release and 23 comment letters on its 2009 Release. As noted in the 2013 Release, this topic has also been discussed at several meetings of the Board's advisory groups, beginning in 2005. All of the comments and transcripts of the relevant portions of the meetings are available on the Board's website. See Docket 029, *Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits*.

⁷ Section 11 of the Securities Act imposes liability on certain participants in a securities offering, including every accountant who, with his or her consent, has been named as having prepared or certified any part of the registration statement or any report used in connection with the registration statement. Section 7 of the Securities Act requires that the consent of every accountant so named in a registration statement must be filed with the registration statement.

determined to do so, by mandating disclosure on an amended PCAOB Form 2⁸ or on a newly created PCAOB form as a means of responding to liability concerns.

Other commenters stated that, in view of the PCAOB's investor protection mission, the 2013 Release gave too much weight to commenters' concerns about liability. These commenters asserted that naming the engagement partner, in itself, would not affect the basis on which liability could be founded.

Some commenters suggested that the audit committee report in the company's proxy statement would be a more appropriate place for these disclosures, as the audit committee is responsible for engaging the auditor.⁹

IV. Disclosure on Form AP

Form AP—Auditor Reporting of Certain Audit Participants

As an alternative to disclosure in the auditor's report, the Board is considering requiring disclosures regarding the engagement partner and other accounting firms participating in the audit to be made on a new PCAOB form, Form AP. Auditors would not be required to include the information in the auditor's report but could choose to do so in addition to filing the form.¹⁰ To implement this alternative, the Board could adopt a

⁸ Form 2 is due no later than June 30 of each year covering the 12-month period from April 1 to March 31. The purpose of Form 2 reporting is principally to provide a profile of the firm at a point in time, based on its activity related to issuers, brokers, and dealers. The Board collects information reflecting the extent and nature of the firm's audit practice related to issuers, brokers, and dealers in order to facilitate analysis and planning related to the Board's inspection responsibilities and to inform other Board functions.

⁹ The Board understands that staff at the U.S. Securities and Exchange Commission ("SEC" or "Commission") are working on a recommendation to the Commission for a potential concept release on audit committee disclosures. See, e.g., Mary Jo White, Chair, U.S. Securities and Exchange Commission, Remarks at the Society of Corporate Secretaries and Governance Professionals 69th National Conference (June 25, 2015), available at <http://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html>; and James Schnurr, SEC Chief Accountant, Remarks at the 34th Annual SEC and Financial Reporting Institute Conference (June 5, 2015), available at <http://www.sec.gov/news/speech/remarks-34th-sec-financial-reporting-institute-conference.html>.

¹⁰ If the Board adopts this alternative, paragraph .04 of AU sec. 543, *Part of the Audit Performed by Other Independent Auditors*, would be amended substantially as

rule requiring firms to file Form AP in connection with each issuance of an auditor's report. As discussed in more detail below, Form AP would be filed in a similar way as other PCAOB forms, and the data reported on Form AP would be accessible through a searchable database on the Board's website.

In its consideration of this standard-setting project, the Board has noted that its purpose was not to expose auditors to additional private liability; rather, it was to provide information about certain participants in the audit. The Board understands, however, that disclosure in the auditor's report could trigger the consent requirement of Section 7 and subject the named parties to potential liability under Section 11 of the Securities Act. As commenters suggested, disclosure on a form filed with the PCAOB should not raise those concerns because the engagement partner and other firms would not be named in a registration statement or in any document incorporated by reference into one.¹¹ Commenters also raised concerns that disclosure in the auditor's report would increase the risk of potential liability in private actions under Exchange Act Section 10(b) in light of the Supreme Court's *Janus* decision.¹² The Board is seeking comment on whether disclosure on Form AP would address concerns about this liability risk.

The Board believes that Form AP could serve the same purpose as disclosure in the auditor's report. Its intended audience would be the same as the audience for the auditor's report—investors and other financial statement users—and its filing would be tied to the issuance of an auditor's report. In that respect, it would differ from the PCAOB's existing forms,¹³ which are intended primarily to elicit information for the

proposed in the 2013 Release to permit reference to other accounting firms that participated in the audit to the extent contemplated by the amendment to AU sec. 508, *Reports on Audited Financial Statements*, included in Appendix 1.

¹¹ While the requirement to file Form AP would be triggered by the issuance of an auditor's report, the form would not be incorporated by reference into or otherwise made part of the auditor's report.

¹² *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). As noted in the 2013 Release, while any form of public identification of the engagement partner might, at least in some circuits, make it easier for a private plaintiff to plead reliance, the plaintiff would still have to meet all the other elements of Section 10(b) liability, including, with respect to claims based on Rule 10b-5(b), that the engagement partner was the maker of the statement under the *Janus* standard.

¹³ Existing PCAOB reporting forms have been developed for the purpose of registration with the Board and reporting to the Board about a firm's issuer, broker, and dealer audit practice. These forms are: (1) Form 1, *Application for Registration*; (2) Form

Board's use in connection with its oversight activities, with a secondary benefit of making as much reported information as possible available to the public as soon as possible after filing with the Board.¹⁴ Form AP would be primarily intended as a vehicle for public disclosure, much like the auditor's report itself.¹⁵ While information on Form AP could also benefit the Board's oversight activities, that is ancillary to the primary goal of public disclosure.

In addition to the required filing of Form AP, auditors may decide to voluntarily provide the same disclosures in the auditor's report. Since this would not be mandatory, however, fewer disclosures in the auditor's report would be expected than under the requirements proposed in the 2013 Release. The Form AP approach may, therefore, require more effort for investors to find the information, and it thereby could impose higher search costs in some instances, given that the auditor's report is the existing vehicle by which the auditor communicates with investors and is the place where other information about the audit is already found. Form AP would require a user to visit the PCAOB website to find information disclosed on the form. However, the use of Form AP may in other circumstances result in lower search costs than disclosure in the auditor's report because investors and other financial statement users would be able to find all of the required disclosures regarding engagement partners and other audit participants in a searchable database on the Board's website. As a result, search costs would likely be lower, for example, for persons seeking information about a single engagement partner across multiple audits or about multiple audit participants.

1-WD, *Request to Withdraw from Registration*; (3) Form 2, *Annual Report*; (4) Form 3, *Special Report*; and (5) Form 4, *Succeeding to Registration Status of Predecessor*.

¹⁴ *Periodic Reporting by Registered Public Accounting Firms*, PCAOB Release No. 2008-004 (June 10, 2008), at 28.

¹⁵ The Board has authority under Section 103 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") to adopt, by rule, audit standards "to be used by registered public accounting firms in the preparation and issuance of audit reports . . . as may be necessary or appropriate in the public interest or for the protection of investors." In addition, under Section 102 of Sarbanes-Oxley, the Board has authority to require registered public accounting firms to submit periodic and special reports, which are publicly available unless certain conditions are met. If a firm requests confidential treatment of information under Section 102(e) of Sarbanes-Oxley, the information is not publicly disclosed unless there is a final determination that it does not meet the conditions for confidentiality. Because of the intended purpose of Form AP and the Board's related authority under Section 103 of Sarbanes-Oxley, the Board does not believe it would be appropriate to provide for confidential treatment of the information filed on Form AP as it does for certain information filed on other PCAOB forms.

In the 2013 Release, the Board observed that requiring disclosure on a PCAOB form rather than in the auditor's report could impose additional compliance costs on accounting firms, which would have to develop systems for compiling and reporting the required information. The commenters that addressed that issue—primarily large accounting firms—argued, however, that the cost of compliance with a new PCAOB form filing requirement would be significantly less than the overall costs of disclosure in the auditor's report.

Filing Requirements

The use of Form AP would afford the Board flexibility in establishing the timing of disclosure versus a requirement to disclose in the auditor's report. While the Board believes the information should be made available promptly, some time could be allowed for firms to compile the necessary information, particularly for firms that choose to submit multiple forms at the same time. The Board is considering a basic filing deadline of 30 days after the date the auditor's report is first included in a document filed with the SEC, with a shorter deadline of 10 days for initial public offerings ("IPOs") to ensure that the information would be available before any IPO road show.¹⁶ This time period takes into account recommendations made by the commenters that suggested disclosure on a reporting form. Some of these commenters suggested a periodic filing requirement, such as quarterly reporting; others suggested filing within a specified time after the completion of the audit, such as 4 days, 30 days (consistent with Form 3), or 45 days (consistent with audit documentation requirements). Another commenter suggested that the required information should be reported prior to the filing of the definitive proxy statement. The Board is soliciting comment on the filing deadline.

Form AP would provide information only about completed audits, so there would be no requirement to file in connection with interim reviews.¹⁷ Form AP would be

¹⁶ In the context of an IPO, an emerging growth company ("EGC") may confidentially submit to the SEC a draft registration statement for confidential nonpublic review by the staff of the SEC prior to public filing. For auditor's reports initially issued in connection with such a draft submission, Form AP would be required to be filed within the 10 days after the registration statement is publicly filed with the SEC. Under Securities Act Section 6(e)(1), this public filing must occur not later than 21 days before the date on which the issuer conducts a road show. The 10-day deadline the Board is considering would ensure that investors had access to the information disclosed on Form AP before the commencement of a road show.

¹⁷ In addition, Form AP would not be required to be filed in connection with attestation engagements, for example, compliance with servicing criteria pursuant to SEC Rule 13a-18—Regulation AB. However, for audits of brokers and dealers, the total audit hours used to determine the extent of participation of other participants in the audit

required to be amended only when there was an error or omission in the original submission. Changes from one year to the next (for example, a change in engagement partner) would not necessitate an amendment and would be reflected on a Form AP that would be filed when the next auditor's report was issued. Since the obligation to file Form AP would be tied to the issuance of the auditor's report, if the auditor's report is reissued and dual-dated, a new Form AP would be required even when no other information on the form changed.

To ease compliance, firms would file Form AP through the PCAOB's existing web-based Registration, Annual, and Special Reporting system using the username and password they were issued in connection with the registration process.¹⁸ The system requirements for filing Form AP would be similar to the system requirements for filing annual and special reports with the PCAOB. The Board would develop a template, also known as a schema, that would allow firms to submit multiple forms simultaneously using an extensible markup language ("XML").

Forms AP filed with the Board would be available on the Board's website. The Board's website would allow users to search Forms AP by engagement partner, to find the audits of companies (*i.e.*, issuers, brokers, and dealers) that he or she led (after the requirement's effective date), and by company, to find the engagement partner and other firms that worked on its audit. Over time, the PCAOB could enhance the search functionality as needed and could allow users to download the search results. It is anticipated that the information filed on Form AP would be available on the Board's website indefinitely.

V. Other Participants in the Audit

In addition to the method of disclosure, the Board is considering narrowing the disclosure requirements regarding other participants in the audit. In the 2013 Release, the Board proposed disclosure of: (1) the names, locations, and extent of participation of other independent public accounting firms that took part in the audit and (2) the locations and extent of participation, on an aggregate basis by country, of other nonaccounting firm participants that took part in the audit. The requirements to disclose other accounting firm participants in the audit are reflected in Appendix 1 substantially

would include hours incurred in the performance of the required attestation procedures. See Section VIII.

¹⁸ Firms that are not registered with the Board would not be required to file Form AP, even when conducting audits in accordance with PCAOB standards. While not required, these firms could still voluntarily include this information in the auditor's report.

as repropoed. However, in light of comments received, the Board is reexamining the proposed requirements to disclose information about nonaccounting firm participants and engaged specialists.

Nonaccounting Firm Participants

As proposed in the 2013 Release, the category of nonaccounting firm participants might include, among others, certain "offshore" service centers, consultants, and entities that provide accounting firms with leased employees. The disclosures would permit investors to determine how much of the audit was performed by nonaccounting firm participants in a particular jurisdiction but not whether those nonaccounting firm participants were, for example, offshore service centers, consultants, or another type of entity that worked on the audit.

Under the 2013 Release, disclosure of the names of nonaccounting firm participants would not have been required. Rather, these participants would have been identified in the auditor's report as "persons in [country] not employed by our firm." Commenters' reactions to the repropoed disclosure requirements were mixed. Some commenters argued for uniform treatment of accounting firm participants and nonaccounting firm participants, either to make disclosure easier to understand or to avoid the creation of incentives to engage nonaccounting firm participants rather than other accounting firms. Other commenters questioned the value of the disclosures or suggested that the disclosures could be confusing or subject to misinterpretation.

After considering these comments, the Board is reconsidering the appropriateness of the disclosures regarding nonaccounting firm participants. As such, Appendix 1 does not include proposed requirements to disclose information regarding nonaccounting firm participants. The Board is, however, continuing to seek additional comment on whether it should adopt disclosure requirements concerning nonaccounting firm participants at this time.¹⁹

If, after considering the comments, the Board were to require disclosure regarding nonaccounting firm participants, the Board is also considering a more tailored approach than proposed in the 2013 Release. The more tailored approach, recommended by a commenter, would not require reporting if the nonaccounting firm participants were controlled by or under common control with the accounting firm issuing the auditor's report. The commenter suggested that disclosure of such situations

¹⁹ The proposed disclosure requirements regarding nonaccounting firm participants can be found in Appendix 2 of the 2013 Release at A2-1. If the Board were to adopt a disclosure requirement with regard to nonaccounting firm participants in Form AP, the instructions to Form AP would be revised for that disclosure.

would not provide useful information because such entities function as an "office" of the registered firm, and the fact that they are formed as separate legal entities would not impact the work performed.

Under this more tailored approach, disclosure of certain information about nonaccounting firm participants in the audit could be required if, in the current period, the auditor was required to supervise²⁰ other persons that are not: (1) other accounting firms; (2) the auditor's own employees; or (3) entities that are controlled by or are under common control with the auditor, or employees of such entities. Control could be defined for that purpose as the power to direct or cause the direction of management and policies of the participant, whether through the ownership of voting securities, by contract, or otherwise.²¹

The Board is seeking comment on retaining disclosures of nonaccounting firm participants and this more tailored approach to disclosure of nonaccounting firm participants to the extent the disclosures are retained.²²

Engaged Specialists

The disclosure requirements and computation of total audit hours presented in Appendix 1 have been modified to exclude specialists engaged, not employed, by the auditor. This change responds to commenters' concerns that smaller firms, which are more likely to use engaged specialists, would have to disclose other participants more frequently than larger firms that employ specialists, which could place a disproportionate burden on smaller firms.

VI. Economic Considerations

The 2013 Release described the need for the disclosure requirements, as well as the alternatives the Board had considered to meet that need, and discussed potential benefits and costs of the proposed disclosure requirements, including potential indirect costs related to any increase in private liability.²³ Appendix 2 to this release includes

²⁰ See Auditing Standard No. 10, *Supervision of the Audit Engagement*.

²¹ This would mirror the definition of "control" in some Securities Act and Exchange Act rules. See, e.g., 17 CFR § 230.405 and § 240.12b-2.

²² Regardless of the determination as to disclosure requirements, the hours of such persons would continue to be included in total audit hours.

²³ 2013 Release at 25, 31. The Board continues to consider comments on the economic analysis included in the 2013 Release.

further discussion on the economic considerations related to the disclosure requirements the Board is considering. This release seeks comment on economic considerations related to disclosure on Form AP as compared to disclosure in the auditor's report, as discussed in Section IV, and on the potential changes to disclosure about other participants in the audit, as discussed in Section V.

Disclosure on Form AP Compared to Disclosure in the Auditor's Report

The Board is considering trade-offs as it evaluates the potential of these two different disclosure mechanisms to achieve the benefits of disclosure—transparency and an increased sense of accountability. Disclosure would publicly associate the engagement partner with the work performed. Accounting firms would similarly be publicly associated with their choices of engagement partners and their choices of other firms participating in the audit. These benefits depend, in part, on the extent to which the information would be made available and accessible so that market participants could use it. The Board is soliciting comment on the extent to which the form-based alternative discussed in this release would achieve these benefits compared to mandatory disclosure in the auditor's report as proposed in the 2013 Release.

As explained in Section III, the Board is considering a form-based alternative because of concerns expressed by some commenters about private liability. The Form AP alternative responds to those concerns by providing for disclosure outside the auditor's report. Since auditors would not be required to make the disclosure in the auditor's report, no auditor would be required to incur costs related to obtaining consents or to the increased risk of private liability under Section 11 of the Securities Act that might come with disclosure in the auditor's report. Such costs would presumably be incurred only if the auditor expected disclosure in the auditor's report in addition to Form AP to produce a net benefit.

The Form AP approach may involve higher direct costs than disclosure in the auditor's report, particularly when first implemented. Registered firms would presumably incur substantially the same direct costs to gather the necessary information, whether disclosure was made in the auditor's report or on the form. Those costs are described in the 2013 Release and Appendix 2 of this supplemental request for comment. However, use of Form AP would entail some additional costs to fill out the form and file it with the Board, and it could also result in the need for firms to develop a system to gather the required information from each engagement team. As described in Section III, however, commenters suggested that the cost of compliance with a new PCAOB filing requirement would not be significant.

Regardless of whether the information is disclosed in the auditor's report as previously proposed or on Form AP, data providers may develop methodologies to

compile the information,²⁴ and investors that are interested in analyzing the information should be able to find it regardless of where it is disclosed.²⁵ The Board is seeking comments on whether there are cost-effective ways, including search criteria or functionalities, to make this disclosure more broadly accessible to investors who may not be familiar with filings by firms on forms available on the Board's website.

Nonaccounting Firm Participants in the Audit and Engaged Specialists

In considering whether to eliminate or narrow proposed disclosure requirements regarding nonaccounting firm participants in the audit and engaged specialists as described in Section V, the Board is considering trade-offs and seeks to strike an appropriate balance between the potential value to investors and other financial statement users of the proposed disclosures and the costs of compliance. For example, one commenter suggested that requiring less disclosure for nonaccounting firm participants than for other accounting firms may create an incentive for auditors to engage nonaccounting firms in order to avoid disclosure, which could negatively affect audit quality. On the other hand, other commenters stated that disclosures regarding nonaccounting firm participants could be distracting or subject to misinterpretation. With respect to engaged specialists, commenters have expressed concern that the proposed disclosure requirements may impose a disproportionate burden on smaller firms, which are more likely than larger firms to engage rather than employ specialists. The Board is seeking comment on these issues.

VII. Considerations for Audits of Emerging Growth Companies

Pursuant to Section 104 of the Jumpstart Our Business Startups ("JOBS") Act, any rules adopted by the Board subsequent to April 5, 2012, do not apply to the audits of EGCs (as defined in Section 3(a)(80) of the Exchange Act) unless the SEC "determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and

²⁴ Some data providers sell subscriptions or charge a fee, while others make information available free of charge.

²⁵ It is not uncommon for market participants to look to multiple sources for information required to be disclosed pursuant to the federal securities laws. For example, information may be incorporated by reference from one SEC filing to another. Also, some SEC rules allow issuers a choice of disclosure location for certain information. See, e.g., Item 406 of Regulation S-K, CFR § 229.406 (choice of location for disclosure regarding the company's code of ethics).

whether the action will promote efficiency, competition, and capital formation."²⁶ As a result of the JOBS Act, the amendments to PCAOB rules and standards that are included in this supplemental request for comment, if adopted by the Board, would be subject to a separate determination by the SEC regarding their applicability to audits of EGCs.

Generally, the costs of making disclosure on Form AP, which are discussed in Section VI, would be equally applicable to all auditors, including auditors of EGCs. As noted above, the Form AP approach may involve more direct costs than disclosure in the auditor's report, such as costs associated with preparing and filing the form, but disclosure in the auditor's report may have more indirect costs, such as potential liability that could arise if the auditor's report is included in a Securities Act registration statement. Such direct costs would be borne with respect to audits of all companies, but such indirect costs may have less impact for auditors of companies that do not regularly conduct registered offerings of securities (including auditors of EGCs that do not regularly conduct such offerings).

In the 2013 Release, the Board discussed and sought comment on the applicability of the proposed disclosure requirements to audits of EGCs. The Board continues to consider comments received in response to the 2013 Release. In addition, the Board seeks further comment, including any available empirical data, on how disclosure on Form AP would affect EGCs and on whether it would protect investors and promote efficiency, competition, and capital formation.

VIII. Application to Audits of Brokers and Dealers

Pursuant to Exchange Act Rule 17a-5, brokers and dealers are generally required to file annual reports with the SEC and other regulators.²⁷ The annual reports include a financial report, either a compliance report or exemption report, and reports by the auditor covering the financial report and the compliance report or exemption report. The annual reports are public, except that if the statement of financial condition in the financial report is bound separately from the balance of the annual report, the balance of the annual report is deemed confidential and nonpublic.²⁸ Therefore, in situations in which the broker or dealer binds the statement of financial condition separately from the balance of the annual report, the auditor generally would issue two separate auditor's

²⁶ Pub. L. No. 112-106 (April 5, 2012). See Section 103(a)(3)(C) of Sarbanes-Oxley, (15 U.S.C. §7213(a)(3)), as added by Section 104 of the JOBS Act.

²⁷ See 17 CFR § 240.17a-5.

²⁸ See Exchange Act Rule 17a-5(e), 17 CFR § 240.17a-5(e).

reports that would have different content: (1) an auditor's report on the statement of financial condition that would be available to the public and (2) an auditor's report on the complete annual report that, except as provided in paragraph (c)(2)(iv) of Exchange Act Rule 17a-5, would be confidential and not available to the public.²⁹

In such cases, only one Form AP would be required. The audit hours used to determine the extent of participation of other accounting firms participating in the audit would include hours incurred in the performance of: (1) the audit of the financial statements; (2) audit procedures performed on supplemental information; and (3) attestation procedures performed in accordance with Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, or Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*.

The Board solicited comment regarding the applicability of the requirements to audits of brokers and dealers in the 2013 Release. Some commenters indicated that the requirements should apply equally to all audits performed in accordance with PCAOB standards, while others opposed the requirements for audits of nonissuer brokers or dealers.

The Board continues to consider these comments. The Board is also seeking comment on whether Form AP presents specific issues with respect to audits of brokers and dealers.

IX. Appendices

This supplemental request for comment includes this release and its appendices:

- Appendix 1 contains the proposed amendments to the Board's rules and PCAOB auditing standards related to disclosure of the name of the engagement partner and certain information about other accounting firms on Form AP and proposed form instructions.
- Appendix 2 contains economic considerations related to the disclosure requirements.

²⁹ See also Exchange Act Rule 17a-5(c)(2), 17 CFR § 240.17a-5(c)(2), regarding audited statements required to be provided to customers.

X. Effective Date

At this time, the Board is considering making the requirements effective for auditors' reports issued or reissued on or after June 30, 2016, or three months after approval of the requirements by the SEC, whichever occurs later.

XI. Opportunity for Public Comment

The Board is seeking comment on all aspects of the Form AP alternative, including how Form AP compares to the disclosure in the auditor's report proposed in the 2013 Release, its economic implications, and whether there are any special considerations relevant to audits of EGCs, brokers and dealers, and other entities. The Board is also interested in any issues related to the Form AP instructions and filing process and how the Board might address them. In addition, the Board seeks comments on the following more specific questions:

1. Would disclosure on Form AP as described in this release achieve the same potential benefits of transparency and an increased sense of accountability as mandatory disclosure in the auditor's report? How do they compare? Would providing the disclosures on Form AP change how investors or other users would use the information?
2. Are there special considerations relating to the Form AP approach that have not been addressed in this supplemental request for comment? If so, what are the considerations? How might the Board address them? What are the costs of Form AP compared to the costs of disclosure in the auditor's report?
3. Would disclosure on Form AP mitigate commenters' concerns about liability? Are there potential unintended consequences, including liability-related consequences under federal or state law, of the Form AP approach? If so, what are the consequences? How might the Board address them?
4. In addition to the required filing of the Form AP, auditors may decide to voluntarily provide the same disclosures in the auditor's report. Are there any special considerations or unintended consequences regarding voluntary disclosure in the auditor's report? If so, what are those considerations or consequences? How might the Board address them?
5. What search criteria and functionality would users want for information filed on Form AP? What additional criteria and functionality beyond what is described in Section IV of this release would be useful? Would third-party

vendors provide additional functionality if the Board does not? Are there cost-effective ways to make the disclosure more broadly accessible to investors who may not be familiar with PCAOB forms?

6. Is 30 calendar days after the filing of the auditor's report (and 10 calendar days in the case of an IPO) an appropriate amount of time for firms to file Forms AP? Should the deadline be shorter or longer? Why? Are there circumstances that might necessitate a different filing deadline? For example, should there be a longer deadline (e.g., 60 days) in the first year of implementation? Should the 10-day deadline apply whenever the auditor's report is included in a Securities Act registration statement, not just in the case of an IPO?
7. This supplemental request for comment contemplates not requiring disclosure of nonaccounting firm participants in the audit as previously proposed. Is it an appropriate approach to not require disclosure of nonaccounting firm audit participants? If not, should the Board adopt the requirements as proposed in the 2013 Release or the narrower, more tailored approach described in Section V of this supplemental request, which would not require disclosure of information about nonaccounting firm participants controlled by or under common control with the accounting firm issuing the auditor's report, with control as defined in Section V? If the Board were to adopt this narrower, more tailored approach, is the description of the scope of a potential requirement sufficiently clear? Why or why not? Is the definition of control in Section V appropriate? Why or why not?
8. Does Form AP pose any specific issues for EGCs? Would disclosure of the required information on Form AP promote efficiency, competition, and capital formation if applied to EGCs? If so, how? How does disclosure on Form AP compare to disclosure in the auditor's report proposed in the 2013 Release in that regard? Would creating an exemption for audits of EGCs benefit or harm EGCs or their investors? Why?
9. Does Form AP pose any specific issues for brokers, dealers, or other entities? If so, what are those issues? How does disclosure on Form AP compare to disclosure in the auditor's report proposed in the 2013 Release in that regard?
10. Are the rule to implement Form AP, the instructions to Form AP, and the amendments to AU sec. 508 included in Appendix 1 clear and appropriate? Why or why not?

11. Are there additional economic considerations associated with mandated disclosure, either in the auditor's report or on Form AP, that the Board should consider? If so, what are those considerations? The Board is particularly interested in hearing from academics and in receiving any available empirical data commenters can provide.
12. Assuming the Board adopts a rule during 2015, would it be feasible to make the requirement, either in the auditor's report or on Form AP, effective for auditors' reports issued or reissued on or after June 30, 2016, or three months after the SEC approves the requirements, whichever is later? How much time following SEC approval would firms need to implement the requirement either in the auditor's report or on Form AP?

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, NW, Washington, DC 20006-2803. Comments also may be submitted by e-mail to comments@pcaobus.org or through the Board's website at <http://www.pcaobus.org>. All comments should refer to PCAOB Rulemaking Docket Matter No. 029 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EDT on August 31, 2015. The Board will consider comments received.

On the 30th day of June, in the year 2015, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ Phoebe W. Brown

Phoebe W. Brown
Secretary

June 30, 2015

APPENDIX 1

Amendments to Rules of the Board to Require Disclosure of Certain Participants in the Audit on Form AP

Section 3. Auditing and Related Professional Practice Standards

* * * * *

Rule 3210. Signatures and Amendments

The provisions of Rule 2204 concerning signatures and Rule 2205 concerning amendments shall apply to any form filed pursuant to this Part of the Rules of the Board as if the submission were a report on Form 3.

Rule 3211. Auditor Reporting of Certain Audit Participants

- (a) For each audit report issued pursuant to PCAOB standards for the audit of an issuer or broker or dealer, each registered public accounting firm must file with the Board a report on Form AP in accordance with the instructions to that form.

Note: Form AP is not required to be filed by a public accounting firm that is another auditor pursuant to AU sec. 543, *Part of Audit Performed by Other Independent Auditors*, whose audit report is issued in accordance with PCAOB standards and is referred to by the registered public accounting firm in accordance with AU sec. 543.07.

- (b) Form AP is deemed to be timely filed if—
1. The form is filed by the 30th day after the date the audit report is first included in a document filed with the Commission; or
 2. In circumstances where the company had no obligation to file, and did not file, periodic or other reports or registration statements with the Commission as of the auditor's report date, the registered public accounting firm files the form by the 10th day after the date the auditor's report is first included in a document filed with the Commission.

- (c) Unless directed otherwise by the Board, a registered public accounting firm must file such report electronically with the Board through the Board's web-based system.
- (d) A report on information about the audit of an issuer or broker or dealer on Form AP shall be deemed to be filed on the date that the registered public accounting firm submits a Form AP in accordance with this Rule that includes the signed certification in Part VI of Form AP.

* * * * *

FORM AP—AUDITOR REPORTING OF CERTAIN AUDIT PARTICIPANTS

GENERAL INSTRUCTIONS

1. Submission of This Report. Effective **[insert effective date of Rule 3211]**, a *registered public accounting firm* must use this Form to file with the *Board* information about the audit of an *issuer or broker or dealer* required by Rule 3211 and to file any amendments to this Form. Unless otherwise directed by the *Board*, the *registered public accounting firm* must file this Form electronically with the *Board* through the *Board's* web-based system.
2. Defined Terms. The definitions in the *Board's rules* apply to this Form. Italicized terms in the instructions to this Form are defined in the *Board's rules*. In addition, as used in the instructions to this Form, the term "the Firm" means the *registered public accounting firm* that is filing this Form with the *Board*.
3. When This Report is Considered Filed. A report on information about the *audit of an issuer or broker or dealer* is considered filed when the Firm has submitted to the *Board* a Form AP in accordance with Rule 3211 that includes the signed certification required by Part VI of Form AP.
4. Amendments to This Report. Amendments shall not be filed to update information in a filed Form AP that was correct at the time the Form was filed, but only to correct information that was incorrect at the time the Form was filed or to provide information that was omitted from the Form and was required to be provided at the time the Form was filed. When filing a Form AP to amend an earlier filed Form AP, the Firm must supply not only the corrected or supplemental information, but it must include in the amended Form AP all information, affirmations, and certifications that were required to be included in the original Form AP. The Firm may access the originally filed Form AP through

the *Board's* web-based system and make the appropriate amendments without needing to reenter all other information.

Note: The *Board* will designate an amendment to a report on information about the audit of an *issuer* or *broker* or *dealer* as a report on "Form AP/A."

5. Rules Governing This Report. In addition to these instructions, the *rules* contained in Part 1 of Section 3 of the *Board's rules* govern this Form. Read these *rules* and the instructions carefully before completing this Form.
6. Language. Information submitted as part of this Form, must be in the English language.

PART I—IDENTITY OF THE FIRM

In Part I, the Firm should provide information that is current as of the date of the certification in Part VI.

Item 1.1 Name of the Firm

- a. State the legal name of the Firm.
- b. If different than its legal name, state the name under which the Firm issued this *audit report*.

Item 1.2 Location of the Firm's Office

- a. City and state (or, if outside the United States, city and country) of the office of the Firm issuing the *audit report*.

PART II—GENERAL INFORMATION CONCERNING THE FILING OF THIS FORM

Item 2.1 Amendments

If this is an amendment to a report previously filed with the *Board*:

- a. Indicate, by checking the box corresponding to this item, that this is an amendment.
- b. Identify the specific Part or Item number(s) in this Form (other than this Item 2.1) as to which the Firm's response has changed from that provided in the most recent Form AP or amended Form AP filed by the Firm with respect to an *audit report* related to the *issuer* or *broker* or *dealer* named in Item 3.1.a.1.

PART III—AUDIT CLIENT AND AUDIT REPORT

Item 3.1 *Audit Report*

- a. Provide the following information concerning the *issuer* or *broker* or *dealer* for which the Firm issued the *audit report* –
 1. Indicate, by checking the box corresponding to this item, if the *audit* client is an *issuer*, other than an employee benefit plan or investment company; a *broker* or *dealer*; an employee benefit plan; or an investment company;

2. The Central Index Key (CIK) number, if any, or *broker's* or *dealer's* Central Registration Depository (CRD) number, or Series identifier, if any;
 3. The name of the *issuer* or *broker* or *dealer* whose financial statements were audited;
 4. The date of the *audit report*;
 5. The end date of the current period's financial statements identified in the *audit report*; and
 6. Name (that is, first and last name and any middle name(s) and suffix) of the engagement partner on the current period's *audit*.
- b. Indicate, by checking the box corresponding to this item, if the current period and one or more other periods presented in the financial statements identified in Item 3.1.a.5 were audited during a single *audit* engagement.
- c. In the event of an affirmative response to Item 3.1.b, indicate the periods audited during the single *audit* engagement for which the individual named in Item 3.1.a.6 served as engagement partner (for example, as of and for the two years ended December 31, 20XX).
- d. Indicate, by checking the box corresponding to this item, if the *audit report* was dual-dated.
- e. In the event of an affirmative response to Item 3.1.d, indicate the date of the dual-dated information and if different from the engagement partner named in Item 3.1.a.6, the name of the engagement partner who audited the information within the financial statements to which the dual-dated opinion applies.
- f. Indicate, by checking the box corresponding to this item, if other *public accounting firm(s)* took part in the *audit*. If this item is checked, complete Part IV. By checking this box, the Firm is stating that it is responsible for the *audits* or *audit* procedures performed by the other *public accounting firm(s)* identified in Part IV and has supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards.

g. Indicate, by checking the box corresponding to this item, if the Firm divided responsibility for the *audit* pursuant to PCAOB standards, with one or more other *public accounting firm(s)*. If this item is checked, complete Part V.

Note: In responding to Item 3.1.e, the Firm should provide each date of any dual-dated *audit report*.

Note: In responding to Item 3.1.f, other *public accounting firms* that took part in the *audit* do not include the *public accounting firm(s)* with which the Firm divided responsibility for the *audit* and whose report the Firm made reference to pursuant to PCAOB standards.

PART IV—RESPONSIBILITY FOR THE *AUDIT* IS NOT DIVIDED

In responding to Part IV, total *audit* hours in the current period's *audit* should be comprised of hours attributable to: (1) the financial statement *audit*; (2) reviews pursuant to AU sec. 722, *Interim Financial Information*; (3) the *audit* of internal control over financial reporting pursuant to Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements*; (4) audit procedures performed on supplemental information, pursuant to Auditing Standard No. 17, *Auditing Supplemental Information Accompanying Audited Financial Statements*; and (5) attestation procedures performed in accordance with Attestation Standard No. 1, *Examination Engagements Regarding Compliance Reports of Brokers and Dealers*, or Attestation Standard No. 2, *Review Engagements Regarding Exemption Reports of Brokers and Dealers*. Excluded from the disclosure and from total *audit* hours in the current period's *audit* are: (1) the engagement quality reviewer; (2) the person who performed the review pursuant to Securities and Exchange Commission Practice Section 1000.45 Appendix K; (3) specialists engaged, not employed, by the Firm; (4) 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 (5) internal auditors who provided direct assistance in the *audit* of the financial statements.

In responding to Part IV, if the financial statements for the current period and one or more other periods covered by the *audit report* identified in Item 3.1.a.4 were audited during a single *audit* engagement (for example, in a reaudit of a prior period(s)), the calculation should be based on the percentage of audit hours attributable to the *audits* or *audit* procedures performed by such firms in relation to the total *audit* hours for the periods identified in Item 3.1.c.

Indicate, by checking the box, if the extent of participation in Part IV will be presented within ranges.

Item 4.1 Other *Public Accounting Firm(s)* Individually 5% or Greater of Total *Audit* Hours

a. State the legal name of other *public accounting firms* and the extent of participation in the *audit*—as a single number or within the appropriate range of the percentage of hours, according to the following list—attributable to the *audits* or audit procedures performed by such *public accounting firm* in relation to the total hours in the current period's *audit*.

90%-or-more of total *audit* hours;
80% to less than 90% of total *audit* hours;
70% to less than 80% of total *audit* hours;
60% to less than 70% of total *audit* hours;
50% to less than 60% of total *audit* hours;
40% to less than 50% of total *audit* hours;
30% to less than 40% of total *audit* hours;
20% to less than 30% of total *audit* hours;
10% to less than 20% of total *audit* hours; and
5% to less than 10% of total *audit* hours.

b. For each *public accounting firm* named, state the country of the headquarters' office.

Note: In responding to Items 4.1 and 4.2, percentage of hours attributable to other firms should be calculated individually for each firm. If the individual participation of one or more other *public accounting firm(s)* is less than 5%, the Firm should complete Item 4.2.

Item 4.2 Other *Public Accounting Firm(s)* Individually Less Than 5% of Total *Audit* Hours

a. State the number of other *public accounting firm(s)* individually representing less than 5% of total *audit* hours.

b. Indicate the aggregate percentage of participation of the other *public accounting firm(s)* that individually represented less than 5% of total *audit* hours by—filling in a single number or by selecting the appropriate range as follows:

90%-or-more of total *audit* hours;
80% to less than 90% of total *audit* hours;
70% to less than 80% of total *audit* hours;

60% to less than 70% of total *audit* hours;
50% to less than 60% of total *audit* hours;
40% to less than 50% of total *audit* hours;
30% to less than 40% of total *audit* hours;
20% to less than 30% of total *audit* hours;
10% to less than 20% of total *audit* hours;
5% to less than 10% of total *audit* hours; and
Less-than-5% of total *audit* hours.

PART V—RESPONSIBILITY FOR THE *AUDIT* IS DIVIDED

Item 5.1 Identity of the Other *Auditor(s)*

- a. Provide the following information concerning each other *auditor* the Firm divided responsibility with in the *audit*—
1. State the legal name of the other *auditor*.
 2. State the country of headquarters' office location of the other *auditor*.
 3. State the magnitude of the portion of the financial statements audited by the other *auditor*.

Note: In responding to Item 5.1.a.3, the Firm should state the dollar amounts or percentages of one or more of the following: total assets, total revenues, or other appropriate criteria, as it is described in the *audit report*.

PART VI—CERTIFICATION OF THE FIRM

Item 6.1 Signature of Partner or Authorized Officer

This Form must be signed on behalf of the Firm by an authorized partner or officer of the Firm including, in accordance with Rule 3210, both a signature that appears in typed form within the electronic submission and a corresponding manual signature retained by the Firm. The signer must certify that:

- a. The signer is authorized to sign this Form on behalf of the Firm;
- b. The signer has reviewed this Form;

c. Based on the signer's knowledge, this Form does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading; and

d. Based on the signer's knowledge, the Firm has not failed to include in this Form any information or affirmation that is required by the instructions to this Form.

The signature must be accompanied by the signer's title, the capacity in which the signer signed the Form, the date of signature, and the signer's business mailing address, business telephone number, and business e-mail address.

* * * * *

Amendments to PCAOB Auditing Standards for Optional Disclosure of Certain Audit Participants in the Auditor's Report

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. Paragraph .09A is added, as follows:

The auditor may include in the auditor's report the information regarding the engagement partner and other participants in the audit that is required to be reported to the PCAOB pursuant to Rule 3211, *Auditor Reporting of Certain Audit Participants*. If the auditor chooses to do so, the auditor's report must include the same information as is reported on Form AP. If disclosure is included regarding other participants in the audit, the auditor also should include a statement that the auditor is responsible for the audits or audit procedures performed by the other firms and has supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards.

APPENDIX 2

Economic Considerations

The Public Company Accounting Oversight Board ("PCAOB" or "Board") is mindful of the economic impacts of its standard setting. The following discussion addresses in detail the potential economic impacts, including potential benefits and costs, most recently considered by the Board.

The Board has requested input from commenters several times over the course of the rulemaking. Commenters provided views on a wide range of issues pertinent to economic considerations, including potential benefits and costs, but did not provide empirical data. The potential benefits and costs considered by the Board are difficult to quantify reliably, so the Board's economic discussion is therefore qualitative in nature. This appendix describes the Board's current analysis about the likely economic impacts of the disclosure requirements under consideration. The Board continues to solicit input from commenters about how the disclosure requirements under consideration may impact the audit profession and financial markets, as well as input specifically related to the Board's economic analysis.

A. Need for Disclosure

Users of financial statements are generally not in a position to observe the quality of the audit of a public company or the factors that drive audit quality. Instead, they rely on proxies such as the reputation of the accounting firm issuing the auditor's report, measures of auditor expertise, or information about the geographic location of the office where the auditor's report was signed as a signal for audit quality.¹ The Board is considering a number of ways to provide a more precise signal of audit quality. In addition to the disclosures discussed in this supplemental request for comment and the 2013 Release, these efforts include formulation of a series of audit quality indicators, a portfolio of quantitative measures that may provide new insights into how quality audits are achieved.² The Board intends that, over time, these and other efforts may provide additional information that may allow investors and other financial statement users to

¹ See, e.g., Linda Elizabeth DeAngelo, *Auditor Size and Audit Quality*, 3 *Journal of Accounting and Economics* 183 *passim* (1981); and Jere R. Francis, *What Do We Know About Audit Quality?*, 36 *The British Accounting Review* 345 *passim* (2004).

² See *Concept Release on Audit Quality Indicators*, PCAOB Release No. 2015-005 (June 30, 2015).

better evaluate audit quality. When used in conjunction with other publicly available data and potential audit quality indicators, the name of the engagement partner and information about other participants in the audit, collectively, could provide a more precise signal of audit quality.³ For example, users of financial statements could seek to reduce the asymmetric information⁴ about audit quality by gathering information about the skills, expertise, and independence of the specific individuals and firms that participate in the audit.

PCAOB oversight activities show that audit quality varies among engagement partners within the same firm. PCAOB oversight activities also reveal variations in audit quality within the global networks established by large accounting firms. In addition to a number of other factors, the PCAOB uses information about engagement partners and other participants in the audit to identify audit engagements for risk-based selections in its inspections program. Academic research also documents variations in audit quality at both the firm and engagement partner levels.⁵ These findings suggest that firm reputation is an imprecise signal of audit quality because engagement partners and other audit participants differ in the quality of their audit work.

The difficulty that investors and other financial statement users have in evaluating audit quality may have important effects for accounting firms and the

³ Information economics frequently treats information as consisting of two components: a signal that conveys information and noise, which inhibits the interpretation of the signal. Precision is the inverse of noise so that decreased noise results in increased precision and a more readily interpretable signal. See, e.g., Robert E. Verrecchia, *The Use of Mathematical Models in Financial Accounting*, 20 *Journal of Accounting Research* 1 *passim* (1982).

⁴ Economists often describe information asymmetry as an imbalance, where one party has more or better information than another party.

⁵ See, e.g., W. Robert Knechel, Ann Vanstraelen, and Mikko Zerni, *Does the Identity of Engagement Partners Matter? An Analysis of Audit Partner Reporting Decisions*, *Contemporary Accounting Research* (forthcoming 2015); Daniel Aobdia, Chan-Jane Lin, and Reining Petacchi, *Capital Market Consequences of Audit Partner Quality*, *The Accounting Review* (forthcoming 2015); and Carol Callaway Dee, Ayalew Lulseged, and Tianming Zhang, *Who Did the Audit? Audit Quality and Disclosures of Other Audit Participants in PCAOB Filings*, *The Accounting Review* (forthcoming 2015). Professors Dee and Aobdia are research fellows at the PCAOB. Their research cited above was undertaken prior to joining the PCAOB.

functioning of the audit profession and capital markets.⁶ The capacity to differentiate between alternative products is a fundamental requirement of competitive markets.⁷ One way to improve the functioning of a market is to provide mechanisms that enable market participants to better evaluate quality, thereby reducing the degree of information asymmetry.

Mandatory disclosure provides financial markets with information that may have otherwise been more costly or difficult to obtain. This information may influence investors' decisions and allow them to make better informed investment decisions. The disclosure of information may also lead identified parties to change their behavior because they know their performance can be more easily observed and evaluated. In general, an important feature of accountability is identifiability.⁸ In the context of the audit, transparency about audit participants may lead to increased accountability because decision makers can use the disclosed information to identify participants separately from the accounting firm signing the auditor's report. The ability for outsiders to identify and evaluate the performance of individual audit participants may induce these individuals to change their behavior.

Because of the influence that engagement partners and other audit participants can exert over the audit process, more specific information about who actually performed the audit of a particular company could be a useful addition to the mix of information that investors can use to assess audit quality and financial reporting risk. As identifying information becomes publicly available, it could also provide a further incentive to engagement partners and other accounting firms that participate in the audit

⁶ There is a long stream of research regarding the effects that information asymmetry about product features, such as quality, and disclosure have on markets. See, e.g., George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 *The Quarterly Journal of Economics* 488 *passim* (1970); and Robert E. Verrecchia, *Essays on Disclosure*, 32 *Journal of Accounting and Economics* 97 (2001).

⁷ See, e.g., George J. Stigler, *Perfect Competition, Historically Contemplated*, 65 *The Journal of Political Economy* 1 *passim* (1957).

⁸ Academic research finds accountability is a complex phenomenon and is affected by numerous factors. See, e.g., Jennifer Lerner & Philip Tetlock, *Accounting for the Effects of Accountability*, 125 *Psychological Bulletin* 255 *passim* (1999). See also Todd DeZoort, Paul Harrison, and Mark Taylor, *Accountability and Auditors' Materiality Judgments: The Effects of Differential Pressure Strength on Conservatism, Variability, and Effort*, 31 *Accounting, Organizations and Society* 373 (2006).

to develop and enhance a personal reputation for providing reliable audits and to avoid being associated with adverse audit outcomes that could be attributed to deficiencies in their audit work.⁹

Under the disclosures considered by the Board, investors would gain additional information that could help them assess the reputation of not only the firm, but also of the engagement partner on the audits of companies in which they invest, which they can use as a signal for audit quality. Likewise, investors would have visibility into the extent of the audit work being performed by other accounting firms that participated in the audit, including accounting firms in jurisdictions where the PCAOB has been unable to conduct inspections. Collectively, the disclosures can facilitate the investor's ability to assess audit quality and financial reporting risk by providing investors with information about who conducted the audit and the extent to which the accounting firm signing the auditor's report relied on audit work performed by other accounting firms.¹⁰

Although the disclosure of the name of the engagement partner might provide limited information initially, the experiences in other countries suggest that over time the disclosures would allow databases to be developed that could link the engagement partner to other data points,¹¹ including:

- Number of other public company, broker, and dealer engagements in which the partner is the engagement partner;
- Industry experience of the engagement partner;
- Number and nature of restatements of financial statements for which he or she was the engagement partner;

⁹ Adverse audit outcomes may include financial statement restatements for errors, nontimely reporting of internal control weaknesses, and nontimely reporting of going concern issues, among others.

¹⁰ As discussed in previous releases, PCAOB oversight activities have revealed instances in which the accounting firm signing the auditor's report may have exercised undue reliance on the audit work of other accounting firms.

¹¹ For example, the Taiwan Economic Journal collects data that covers all public companies in Taiwan and includes, among other things, the names of the engagement partners, the accounting firms issuing auditors' reports, the regulatory sanction history of the partners, and the audit opinions. For more information, refer to <http://www.finasia.biz/ensite/Database/tabid/92/language/en-US/Default.aspx>.

- Number and nature of going concern report modifications on financial statements for which he or she was the engagement partner;
- Number of auditors' reports citing a material weakness in internal control over financial reporting for which he or she was the engagement partner;
- Number of years as the engagement partner of a particular company;
- Disciplinary proceedings and litigation in which the engagement partner was involved; and
- Other information about the engagement partner in the public domain, such as education, professional titles and qualifications, and association memberships.

Additional information sources may also develop about other firms that participate in public company audits, and additional data points should add to the mix of information that investors would be able to use, such as:

- The extent of the audit performed by the firm signing the auditor's report;
- The extent of participation in the audit by other firms in other jurisdictions, including jurisdictions in which the PCAOB cannot currently conduct inspections;¹²
- Whether the other firms are registered with the PCAOB, have been inspected, and the inspection results, if any;
- Industry experience of the other firms;
- Whether the other firms belong to a global network;
- Trends and changes in the level of participation of other firms in the audit work; and
- Disciplinary proceedings and litigation involving the other firms.

¹² See *Non-U.S. Firm Inspections* on the PCAOB's website for information about firms in non-U.S. jurisdictions that deny PCAOB inspection access.

These data points, when analyzed together with the audited financial statements, potential audit quality indicators, and information provided in the auditor's report or on Form AP, could provide investors with a more precise signal about the quality of the audit and, therefore, the reliability of the financial statements. This signal should reduce the level of information asymmetry about audit quality between company management and investors.

Providing investors with data at this level of specificity would add to the mix of information that they can use. This could induce changes in the market dynamics for audit services because investors should be able to identify engagement partners and other firms that took part in the audit in whom they have confidence. The companies audited by these engagement partners and other firms should benefit from a lower cost of capital relative to those companies whose auditor's performance record suggests a higher risk.¹³

As some engagement partners and other accounting firms that participated in the audit develop a public reputation for performing reliable audits, a further incentive may develop for others to attract similarly favorable attention. Conversely, as some engagement partners and other accounting firms are associated with adverse audit outcomes, others may have additional incentives to perform audits that comply with applicable standards in order to avoid similar association. The disclosures may also create additional incentives for audit committees to engage auditors with a reputation for performing reliable audits. As a result, the disclosures under consideration may also promote increased competition based on audit quality.

1. *Baseline*

Current PCAOB rules and standards do not require registered firms to publicly disclose the name of the engagement partner or information about other accounting firms participating in the audit and nonaccounting firm participants. However, company management and the audit committee interact directly with the engagement partner.

¹³ There is an emerging body of academic research analyzing market reactions to disclosure of the engagement partner and the firms participating in audits. See Knechel et al., *Does the Identity of Engagement Partners Matter? An Analysis of Audit Partner Reporting Decisions*; Aobdia et al., *Capital Market Consequences of Audit Partner Quality*; and Dee et al., *Who Did the Audit? Audit Quality and Disclosures of Other Audit Participants in PCAOB Filings*.

Additionally, auditors are required to communicate to the audit committee certain information about other accounting firms and other participants in the audit.¹⁴

Today, the name of the engagement partner is disclosed in auditors' reports filed with the U.S. Securities and Exchange Commission ("SEC" or "Commission") in only a small percentage of cases, such as when the audit is conducted by a firm having only one certified public accountant whose name appears in the firm's name or by a foreign firm in a jurisdiction in which local requirements or practice norms dictate identification of the engagement partner. The identity of the engagement partner is sometimes made available, for example to investors attending an annual shareholders' meeting or to members of the audit committee in a proposal for audit services, but there is no uniform disclosure. Further, the process of acquiring this information may be costly. For example, investors could incur significant transaction costs¹⁵ to attend annual meetings and the usefulness of the information they could gather would still be lower relative to the existence of a database that covers audits across time and is available to all interested users. As a result, it is difficult for most investors and other financial statement users to identify the engagement partner in the current environment.

With respect to other firms participating in the audit, paragraph .04 of AU sec. 543, *Part of the Audit Performed by Other Independent Auditors*, has prohibited principal auditors from disclosing in the auditor's report the identities of other firms that participated in the audit unless it is a divided-responsibility opinion.¹⁶ However, investors

¹⁴ See Auditing Standard No. 16, *Communications with Audit Committees*.

¹⁵ These transaction costs could include, among other costs, travel costs, and the costs of gaining access to the annual meeting which may be restricted to shareholders entitled to vote and thus may exclude other types of investors, such as bondholders, as well as prospective investors.

¹⁶ The sentence in AU sec. 543.04 that states that if the principal auditor decides not to make reference to the work of other auditors, the principal auditor "should not state in his report that part of the audit was made by another auditor because to do so may cause a reader to misinterpret the degree of responsibility being assumed" would be deleted under the proposed amendments in the 2013 Release. In the Board's view, the language included under both alternatives—in the auditor's report and on Form AP—clearly states the auditor's responsibility regarding the work of other participants in the audit and should not cause financial statement users to misinterpret or be confused about the degree of responsibility being assumed by the accounting firm signing the auditor's report.

and other financial statement users have been able to obtain information about a limited subset of other firms from PCAOB Form 2.¹⁷

There are no current requirements under which information would be provided publicly about other participants in the audit and, to the Board's knowledge, firms generally do not make this information public.

B. The Impact of Disclosure

The disclosure requirements under consideration would impact certain participants in the audit, financial statement users, and companies to the extent that this information is currently not publicly available. As discussed below, not all of these market participants would be affected in the same ways or to the same degree.

1. The Benefits of Disclosure

The disclosure requirements under consideration, whether in the auditor's report or on Form AP, aim to provide investors and other financial statement users with information that could add to the information available when evaluating the quality of individual audits. Among other things, the disclosures would allow investors to research whether engagement partners have been associated with adverse audit outcomes that could be attributed to deficiencies in their audit work or have been sanctioned by the PCAOB or SEC, and to understand how much of the audit was performed by the firm issuing the report and how much was performed by other firms, including those in jurisdictions where the PCAOB has been unable to conduct inspections. Moreover, as the disclosed information accumulates and is aggregated and analyzed in conjunction with other publicly available information, investors and financial intermediaries (for example, research analysts and credit rating agencies) would have a basis to evaluate additional data points, together with the information disclosed in the auditor's report or on Form AP, that may give them insight into individual audits. While this information may not be useful in every instance or meaningful to every investor, as discussed in more detail below, academic research suggests that, overall, financial markets would respond to it.¹⁸

¹⁷ PCAOB Form 2 requires independent public accounting firms that audited no issuers during the applicable reporting period to provide information on each issuer for which they "play[ed] a substantial role in the preparation or furnishing of an audit report," as defined by PCAOB Rule 1001 (p)(ii).

¹⁸ See, e.g., Knechel et al., *Does the Identity of Engagement Partners Matter? An Analysis of Audit Partner Reporting Decisions*; Aobdia et al., *Capital Market*

Disclosures regarding the engagement partner and the other accounting firms that participated in the audit would allow investors and other financial statement users to supplement the accounting firm's name with more granular information when forming an opinion about the audit. The disclosed information may provide a more precise signal of audit quality in accounting firms that conduct a large number of public company audits. This information should be particularly valuable to investors where there is a greater degree of information asymmetry, as may be the case for smaller and less seasoned public companies. The new disclosures should also increase accountability for auditors who are not operating at an appropriate level of accountability, because they would now be publicly associated with the audit. However, the effect of the disclosures on accountability is not expected to have a uniform effect on all auditors.

a. Transparency

The PCAOB uses various data, including information about engagement partners and other accounting firms, to identify audit engagements for its risk-based inspections program. While some commenters argued that the information would not be useful or could be confusing, others stated that, over time, financial statement users would be able to combine the disclosed information with other financial information, including whether any previous adverse audit outcomes could be attributed to deficient audit work, which would allow them to better assess the quality of individual audits. For example, investors and other financial statement users would be able to observe whether financial statements audited by the engagement partner have been restated or whether the engagement partner has been sanctioned by the PCAOB or SEC, and investors and other financial statement users could also research other publicly available information. Commenters indicated that this information may be useful for investment decisions and decisions about whether to ratify the appointment of an accounting firm.

i. Disclosure Regarding the Engagement Partner

Other countries have adopted or may soon adopt requirements to disclose the name of the engagement partner.¹⁹ Experiences from the countries with similar disclosure requirements are important in assessing possible consequences, intended or not, of any changes in this area. Academic research studying those jurisdictions documents how investors and other financial statement users may use the information

Consequences of Audit Partner Quality, and Dee et al., *Who Did the Audit? Audit Quality and Disclosures of Other Audit Participants in PCAOB Filings*.

¹⁹ See *infra* footnotes 47 and 48.

to form an opinion about audit quality, as well as financial reporting quality. In general, economic theory argues that these disclosures should be useful to investors and other financial statement users, and studies using data from the jurisdictions where the disclosures are available appear to support the theory. However, in considering the implications of these studies for the audits under the Board's jurisdiction, the Board has been mindful, as some commenters suggested, of the specific characteristics of the U.S.-issuer and broker-dealer audit market, which may make it difficult to generalize observations made in other markets. For example, results from non-U.S. studies may depend on different baseline conditions (e.g., market efficiency, affected parties, policy choices, legal environment, or regulatory oversight) than those prevailing in the United States.

Several studies have examined whether engagement partner disclosure requirements affect the prices of securities, leading to more efficient markets. Knechel et al. found "considerable evidence that similar audit reporting failures persist for individual partners over time" and that, in Sweden, where engagement partners' names are disclosed, "the market recognizes and prices differences in audit reporting style among engagement partners" of public companies.²⁰

A similar study conducted by Aobdia et al. used data from Taiwan and also found that both debt and equity markets react to the performance characteristics of engagement partners as measured by abnormal accruals.²¹ Although estimates of abnormal accruals are an imperfect proxy for audit quality, the authors continue to find evidence that engagement partner histories matter to capital markets when they use regulatory sanctions history as an alternate measure of engagement partner performance. The results of two other studies also conducted using data from foreign jurisdictions are consistent with these results.²²

²⁰ See Knechel et al., *Does the Identity of Engagement Partners Matter? An Analysis of Audit Partner Reporting Decisions*.

²¹ See Aobdia et al., *Capital Market Consequences of Audit Partner Quality*.

²² See Wuchun Chi, Linda A. Myers, Thomas C. Omer, and Hong Xie, *The Effects of Audit Partner Pre-Client and Client-Specific Experience on Audit Quality and on Perceptions of Audit Quality* (January 2015) (working paper, on file with Social Science Research Network) (auditor experience is an important factor in determining audit quality and the perceived level of audit quality as measured by the cost of debt funding); see also Ferdinand A. Gul, Donghui Wu, and Zhifeng Yang, *Do Individual Auditors Affect Audit Quality? Evidence from Archival Data*, 88 *The Accounting Review* 1993 *passim* (2013) (effects of individual auditors on audit quality both economically

The limited research on engagement partner identification in the United States provides some support that the name of the engagement partner may be used as a signal of audit quality. Using data collected from SEC comment letters, Laurion et al. are able to identify engagement partners who are copied on correspondence between issuers and the SEC's Division of Corporation Finance. The authors find that newly rotated engagement partners are responsible for substantial increases in the number of material restatements of previously issued financial statements and write-downs of impaired assets.²³ While the authors do not explicitly analyze potential benefits related to engagement partner disclosure, they argue that engagement partner disclosure would provide useful information to investors because it would allow them to determine who was ultimately responsible for the audit of the financial statements that were misstated.

While empirical evidence suggests that disclosure of the name of the engagement partner could be beneficial, one experimental study pointed out by commenters raises the potential for unintended negative consequences. Lambert et al. used an experimental framework to examine how investors react to disclosure of the engagement partner.²⁴ They found that prospective investors were less likely to invest in a company that has been linked via the disclosure of the name of the engagement partner to another company that had to restate its financial statements, although the findings were only statistically significant for less-experienced investors. The authors conclude that disclosing the name of the engagement partner may align partner

and statistically significant; effects pronounced in both large and small accounting firms). The authors of these papers use multiple proxies for audit quality, including "audit reporting aggressiveness" (*i.e.*, individual auditors' willingness to rely on management's disclosures and representations), clients' abnormal accruals and noncore earnings, the presence of a small profit, and bank loan pricing.

²³ See Henry Laurion, Alastair Lawrence, and James Ryans, *U.S. Audit Partner Rotations* (April 10, 2015) (working paper, on file with Social Science Research Network). The authors note that such increases in restatements and write-downs of impaired assets "suggest that new partners may help address the complacency of the former audit partner by bringing a renewed sense of skepticism as well as additional insights and expertise." *Id.* at 5.

²⁴ See Tamara A. Lambert, Benjamin L. Luippold, and Chad M. Stefaniak, *Audit Partner Disclosure: An Experimental Exploration of Accounting Information Contagion* (October 14, 2014) (working paper, on file with Social Science Research Network).

incentives more closely with those of client management, which could have negative effects on independence.

While individual responses to the disclosed information would vary, it does not necessarily follow that linking an engagement partner's reputation to the results of an audit would align the incentives of engagement partners with those of management and impair auditor independence. Rather, as discussed below, being publicly associated with an audit may result in an incentive to improve audit quality, for instance by enhancing the engagement partner's incentive to exercise an appropriate level of professional skepticism.

In addition, empirical evidence suggests that investors may be rational in believing that engagement partners associated with a previous financial statement restatement have an increased risk of misstatement going forward. Using data from Taiwan, Chi et al. found that recent financial statement restatements disclosed by an engagement partner's client are associated with a higher likelihood of that engagement partner's other clients misstating in the current year.²⁵ Although this result is based on evidence from a non-U.S. jurisdiction, it suggests that the disclosures could provide investors with useful information about the reliability of other financial statements audited by individual engagement partners who have been associated with a recent financial statement restatement.

ii. Disclosure Regarding Other Participants in the Audit

Empirical evidence also suggests that the market values information about other participants in the audit. Dee et al. examined the effect on issuers' stock prices²⁶ when investors learn (from participating auditors' Form 2 filings) that these issuers' audits included the substantial use of other accounting firms that do not audit other issuers. Using event study methodology, the authors find that, when accounting firms disclosed in Form 2 the identity of issuer audits in which they substantially participated, the stock prices of these issuers were negatively affected. The authors also find that earnings surprises for these issuers are less informative to the stock market after these disclosures in Form 2 are made, meaning that investors use these issuers' accounting

²⁵ See Wuchun Chi, Ling Lei Lisic, Linda A. Myers, and Mikhail Pevzner, *Information in Financial Statement Misstatements at the Engagement Partner Level: A Case for Engagement Partner Name Disclosure?* (January 2015) (working paper, on file with Social Science Research Network).

²⁶ See Dee et al., *Who Did the Audit? Audit Quality and Disclosures of Other Audit Participants in PCAOB Filings*.

information less when pricing their securities.²⁷ The authors concluded that the results of the study suggested "that PCAOB mandated disclosures by auditors of their significant participation in the audits of issuers provides new information, and investors behave as if they perceive such audits in which other participating auditors are involved negatively."²⁸

To the extent that investors and other financial statement users are better able to assess the level of audit risk stemming from multi-location engagements, it should incent the accounting firm signing the auditor's report to use higher-quality, less risky firms as other audit participants. It may also encourage the accounting firm signing the auditor's report to enhance their supervision and risk management practices with respect to audit participants in jurisdictions perceived as posing increased audit risk. It should also provide other firms incentives to increase the quality of their audit work to help ensure that they can continue to receive referred audit work.

b. Accountability

Public disclosure of the name of the engagement partner and certain other accounting firms that participated in the audit may also create incentives for the engagement partner and other firms to take voluntary steps that could result in improved audit quality. As discussed above, the Board expects that external sources would develop a body of information about the histories of engagement partners and other firms. The public nature of this information, through which audit outcomes would be publicly associated with the engagement partners and other firms involved, should provide them with additional incentives to develop a reputation for consistently performing reliable audits. While this would not affect all engagement partners and all

²⁷ Academic research suggests that the financial markets' reaction to earnings surprises depends, among other things, upon the extent to which the disclosed earnings are perceived to be reliable. Thus, if markets react less to earnings surprises after an event, it could suggest that the earnings are perceived to be less reliable after the event. Academic researchers often interpret this as an indication of a reduction in perceived audit quality by investors.

²⁸ The negative market reaction in this instance may, at least to some extent, reflect the fact that the other participants in the study were auditors that have no issuer clients themselves but play a substantial role (*i.e.*, participate at least 20%) in an audit of an issuer. The disclosures being considered would also apply to other auditors that take a smaller role in the audit and/or may have more experience in the application of PCAOB standards to audits of issuers. Market reaction to disclosures regarding these types of participants may differ.

other firms participating in audits to the same degree, as some already operate with a high sense of accountability, others may respond to the additional incentives to deliver high quality audits.

i. Disclosure Regarding the Engagement Partner

Many investors, as well as some other commenters, believe that scrutiny of the engagement partner may result in increased accountability, which could prompt voluntary changes in behavior. However, other commenters, primarily accounting firms, asserted that disclosure of engagement partners would not affect accountability. If engagement partner behavior were to change, such changes could include increased professional skepticism, which could, in turn, result in better supervision of the engagement team and lower reliance on management's assertions. The auditor may have greater willingness to challenge management's assertions in the auditor's consideration of the substance and quality of management's financial statement disclosures. In addition, public disclosure of the name of the engagement partner may make that person less willing to accept an inappropriate position taken by a previous engagement partner because of the potential effects on his or her personal reputation.²⁹ For example, an academic study found evidence that engagement partner disclosure could increase the effectiveness of engagement partner rotation in promoting audit quality.³⁰

Academic research also analyzed whether engagement partner disclosures could have an effect on accountability.³¹ For example, a recent study examined the

²⁹ See Letter from Carl Levin, Chairman, Senate Permanent Subcommittee on Investigations, and Tom Coburn, Ranking Minority Member, Senate Committee on Homeland Security and Governmental Affairs, to the Office of the Secretary, PCAOB (February 3, 2014) ("Public accountability, in which specific audit partners are recognized for high quality audits, as well as audit failures, can be a powerful antidote to internal pressures.")

³⁰ As discussed previously, academic research documents an increased rate of financial statement restatements following the rotation of engagement partners. This result may become more salient if the identity of the engagement partner is publicly available because engagement partners will have additional incentives to scrutinize their colleagues' work more closely so as to mitigate the possibility that a restatement will arise from financial statements audited during their tenure. See Laurion, et. al., *U.S. Audit Partner Rotations*.

³¹ See, e.g., Joseph V. Carcello and Chan Li, *Costs and Benefits of Requiring an Engagement Partner Signature: Recent Experience in the United*

impact of the European Union's audit engagement partner signature requirement on audits in the United Kingdom and found improvements in several proxies for audit quality,³² as well as an increase in risk-adjusted audit fees. Although the authors did not find evidence that audit fees actually increased following the implementation of the signature requirement, their model indicates that audit fees increased on a risk-adjusted basis in the year following the implementation of the requirement.³³ It is worth highlighting that this study evaluated a policy alternative (a signature requirement) that may have a more pronounced effect than the disclosure requirements being considered, since just disclosing the partner's name in the auditor's report or in a form on the PCAOB's website may not affect accountability to the same extent as a signature. In addition, the authors note that there were several other audit and financial reporting requirements implemented in the United Kingdom contemporaneously with the signature requirement and, accordingly, it is not possible for the authors to rule out the possibility that these other requirements may have driven their results. Furthermore, the study was conducted during the recent financial crisis, which may also have affected the results.

Kingdom, 88 *The Accounting Review* 1511 *passim* (2013); Allen D. Blay, Matthew Notbohm, Caren Schelleman, and Adrian Valencia, *Audit Quality Effects of an Individual Audit Engagement Partner Signature Mandate*, 18 *International Journal of Auditing* 172 (2014); and Ronald R. King, Shawn M. Davis, and Natalia M. Mintchik, *Mandatory Disclosure of the Engagement Partner's Identity: Potential Benefits and Unintended Consequences*, 26 *Accounting Horizons* 533 *passim* (2012).

³² Specifically, Carcello and Li found a significant decline in abnormal accruals, a decrease in the propensity to meet an earnings threshold, an increase in the incidence of qualified auditors' reports, and an increase in a measure of earnings informativeness. Some commenters criticized the use of one of these metrics, abnormal accruals, as a proxy for audit quality. While, as noted in Section B.1.a.i., abnormal accruals are an imperfect proxy for audit quality, the results were corroborated using alternate proxies.

³³ Based on the size and risk characteristics of publicly traded companies in the United Kingdom, the model Carcello and Li estimate suggested that audit fees should have decreased following the engagement partner signature requirement. However, audit fees remained relatively stable, whether due to contractual reasons or otherwise. Therefore, the results of their model indicate that audit fees increased on a risk-adjusted basis, even though the audit fees actually paid remained relatively stable.

This contrasts with another study suggesting that disclosure requirements could produce limited or no observable improvement in audit quality.³⁴ Blay et al. analyzed data from the Netherlands and were unable to document any statistically significant changes in audit quality as measured by estimates of earnings quality. The authors concluded that the lack of findings may be attributable to sufficiently high levels of accountability and audit quality in the Netherlands.

As previously noted, the baseline conditions in other jurisdictions may differ from those in the United States, which could affect the extent to which these findings can be generalized to the United States.

ii. Disclosure Regarding Other Participants in the Audit

While some commenters questioned the value of disclosures regarding other participants in the audit, others argued that the disclosure of the extent of the audit work performed by other participants in the audit could increase accountability for accounting firms that are named. Other commenters indicated that, as with disclosure of the name of the engagement partner, information sources would likely develop over time. This may increase scrutiny of the overall reputation of such firms. This increased reputational risk should incent other accounting firms participating in an audit to perform high-quality audits for all engagements. Further, if another accounting firm performs a substantial portion of the audit, then its reputation would be closely tied to the overall results of the audit. This may help align the interests of the other firms participating in the audit with investors and other financial statement users and thus enhance audit quality.

The disclosure requirement may also incent global network firms to increase accountability for all of the firms in their networks. The audit process for many multinational companies currently depends on the affiliated firms within a global network to audit company subsidiaries in their respective countries. This introduces vulnerabilities to the audit if quality varies across the network. To counter this risk, the global network firm may be incented to increase its efforts to maintain uniform quality control standards and accountability across the global network. The global network firm may also improve its monitoring of other audit participants to ensure audit quality as well. This increased accountability of the other accounting firms that participated in the audit to the accounting firm signing the auditor's report could improve audit quality.

³⁴ See Blay et. al., *Audit Quality Effects of an Individual Audit Engagement Partner Signature Mandate*.

For principal auditors that are not part of a global network, disclosures regarding other firms participating in the audit would provide an additional incentive for the principal auditor to choose firms that have a good reputation for quality.

2. *The Costs and Other Possible Consequences of Disclosure*

Over the course of the rulemaking, the Board was mindful of concerns voiced by commenters about potential compliance and other costs associated with public disclosure. In particular, many commenters on the 2013 Release argued that naming the engagement partner and other audit participants in the auditor's report, as contemplated by the 2013 Release, may create both legal and practical issues under the federal securities laws and therefore increase the cost of performing audits compared to the costs in the current environment. Some commenters suggested that an increase in costs would be passed on to companies through higher audit fees. Some commenters urged the Board to proceed with the new transparency requirements, if it determined to do so, by mandating disclosure in an amended Form 2 or in a newly created PCAOB form. As discussed in Section IV of the release, some commenters suggested that disclosure on a form may not raise the same concerns about Section 11 liability or consent requirements as disclosure in the auditor's report.

As discussed more fully in Section VI of the release, there are trade-offs associated with each of these disclosure locations. For example, if the disclosures are made in the auditor's report, accounting firms may incur incremental costs to obtain consents and potential additional costs associated with any increase in liability. However, if disclosure in the auditor's report is not mandatory, any such costs would presumably only be incurred in situations where the auditor expects disclosure in the auditor's report to produce a net benefit. Lastly, a requirement to file Form AP on the PCAOB's website would increase the costs of compliance for accounting firms that would otherwise prefer to provide disclosure in the auditor's report. These may include, for example, accounting firms that are not concerned with potential securities law liability and sole proprietorships that already disclose the name of the engagement partner in the auditor's report. The Board is seeking input from commenters as it evaluates these trade-offs.

a. *Direct Costs*

Under both the 2013 reproposal and the Form AP approach, the direct costs for auditors would include the costs of compiling information about the engagement partner and other participants in the audit and calculating the percentage of audit work completed by other participants in the audit. In general, costs should be lower for audits not involving other participants because the only required disclosure would be the engagement partner's name.

Compliance with the 2013 reproposal would also entail the cost of adding these specific disclosures in the auditor's report. By comparison, compliance with the Form AP approach would entail initial costs of implementation—which could include creating systems to gather the required information from each engagement team—and ongoing costs associated with aggregating the information and filling out and filing Form AP.

A number of commenters observed that administrative effort would be required to compile data for, prepare, and review the required disclosures, both initially and on an ongoing basis. Accounting firms that commented on this issue asserted that the administrative efforts and related costs would not be significant.

b. Indirect Costs and Possible Unintended Consequences

In addition to the direct costs, there may be indirect costs and unintended consequences associated with the disclosures under consideration, some of which could be more significant than the direct compliance costs.

i. Differential Demand Based on Reputation

The disclosures aim to provide investors and other financial statement users with additional information they can use to evaluate audit quality at the engagement level, as opposed to the accounting firm level. This may result in some degree of differentiation in stature and reputation of individual auditors who serve as engagement partners and in other firms that participate in audits.

Currently, accounting firms are primarily differentiated based on proxies for reputation or experience.³⁵ Some commenters suggested that the new requirements could be detrimental to smaller and less well-known accounting firms, even when they perform audit work in accordance with PCAOB standards. Others raised concerns that public identification of the engagement partner could lead to a rating, or "star," system resulting in particular individuals and entities being in high demand, to the unfair disadvantage of other equally qualified engagement partners. It is also possible that engagement partners may be unfairly disadvantaged because of association with an adverse audit outcome, which could be particularly damaging to their professional development and future opportunities if it occurred at the outset of their career. Unwarranted attribution of an adverse audit outcome to an engagement partner could also adversely affect other public companies whose audits were led by the same

³⁵ See DeAngelo, *Auditor Size and Audit Quality*, and Francis, *What Do We Know About Audit Quality?*

engagement partner. While commenters did not raise similar concerns related to other accounting firms participating in audits, the implications of identification could be similar.

Differential demand based on reputation could be a cost of the disclosures under consideration to the extent the reputation (whether good or bad) was undeserved. It may be reasonable, however, to expect that financial markets would be discerning in considering information about the engagement partner and other firms participating in the audit. As one commenter stated, "investors are accustomed to weighing a variety of factors when assessing performance. . . . This approach can be seen in the careful analysis investors and proxy advisors do when they are asked to withhold support from directors standing for election. There is no reason to believe they will do otherwise with respect to auditors."³⁶ Academic research also suggests that financial markets do not treat all restatements and going concern opinions equally. Instead, financial markets respond to the facts and circumstances related to an individual restatement or going concern modification.³⁷ The results from this research suggest that financial markets may be similarly discerning when forming their opinion about an engagement partner or other participant in the audit.

ii. Overauditing and Audit Fees

Some commenters have suggested that increased incentives to avoid adverse outcomes may lead to instances of overauditing, in which the engagement team undertakes more procedures than it otherwise might have performed, which do not contribute to forming an opinion on the financial statements.³⁸ This would result in unnecessary costs and an inefficient utilization of resources, and might cause undue delays in financial reporting. While the possibility of overauditing cannot be eliminated, commenters did not provide any specific evidence that transparency would result in overauditing and there are counterincentives that mitigate that risk.

³⁶ See Letter from Denise L. Nappier, State Treasurer, State of Connecticut, to the Office of the Secretary, PCAOB (March 17, 2014) at 3.

³⁷ Academic research documents differences in the market impact of restatements and going concern opinions based on the specific facts and circumstances of the events. See, e.g., Susan Scholz, *The Changing Nature and Consequences of Public Company Financial Restatements 1997–2006*, *The Department of the Treasury* (April 2008); and Krishnagopal Menon and David D. Williams, *Investor Reaction to Going Concern Audit Reports*, 85 *The Accounting Review* 2075 *passim* (2010).

³⁸ See King et. al., *Mandatory Disclosure of the Engagement Partner's Identity: Potential Benefits and Unintended Consequences*.

It should also be noted that the disclosures under consideration are not performance standards and do not mandate the performance of additional audit procedures. It is possible, however, that some auditors may perform additional procedures as a result of the potential requirements (for example, because they were not previously complying with PCAOB standards or because they want to obtain a higher level of confidence in some areas). If and to the extent there are increased costs for auditors as a result of the application of the disclosures under consideration, however, such costs may be passed on—in whole, in part, or not at all—to companies and their investors in the form of higher audit fees.³⁹ Further, increased procedures may also require additional time from the company's management to deal with such procedures.

iii. Changes in Behavior of Engagement Partners

A recent study documents certain ways in which the disclosures could change the incentives of engagement partners resulting in changed behavior.⁴⁰ Under a purely theoretical model developed by Carcello and Santore that has not yet been empirically tested, potential reputation costs stemming from disclosure leads engagement partners to become more conservative and gather more evidence than the accounting firm finds to be optimal. Although the authors found that the disclosures lead to increased audit quality, their analysis indicated that engagement partner identification likely leads to decreases in the welfare⁴¹ of engagement partners and accounting firms. The authors argued that changes in the welfare of engagement partners and accounting firms may not be optimal within their theoretical analysis.

³⁹ The Board is aware of public reports that have analyzed historical and aggregate data on audit fees and which suggest that audit fees generally have remained stable in recent years, notwithstanding the fact that the Board and other auditing standard setters have issued new performance standards during that period. See, e.g., Audit Analytics, *Audit Fees and Non-Audit Fees: A Twelve Year Trend* (September 2014). In its reproposal, the Board sought data that might provide information or insight into such costs. As noted previously, commenters did not provide data regarding the extent of such costs.

⁴⁰ See Joseph V. Carcello and Rudy Santore, *Engagement Partner Identification: A Theoretical Analysis*, Accounting Horizons (forthcoming 2015).

⁴¹ The term "welfare" can be thought of as overall well-being. In economic theory, welfare typically refers to the prosperity and living standards of individuals or groups. Some of the typical factors that are accounted for in welfare functions (or utility functions) include: compensation, leisure, effort, reputation, et cetera.

The Carcello and Santore analysis is limited since, among others, they do not explicitly analyze the effects of increased auditor conservatism and increased audit quality on investor utility. Therefore, their description of the "society" is missing a key participant, the investors. This limitation notwithstanding, they do note that increased conservatism at large accounting firms may actually be socially optimal as it could limit damages to market participants stemming from aggressive financial reporting at large issuers.

iv. Disincentive to Perform Risky Audits

Some commenters have suggested that engagement partners and other accounting firms participating in audits may avoid complex and/or risky audits because of the potential negative consequences of an adverse audit outcome. It is also possible that accounting firms could increase audit fees or adjust their client acceptance and retention policies because of heightened concerns about liability, including the cost of insurance, or reputational risks. This could enhance auditors' performance of their gatekeeper function to the extent that it increases auditors' reluctance to take on clients at a high risk of fraudulent or otherwise materially misstated financial statements. But it would impose a cost if firms or partners become so risk averse that companies that do not pose such risk cannot obtain well-performed audits. This could effectively compel certain particularly risky companies to use engagement partners or accounting firms with substandard reputations or, in extreme circumstances, lead them to cease SEC reporting. If investors are better able to evaluate the quality of audit work performed by engagement partners and other accounting firms participating in the audit, companies that engage accounting firms with a reputation for substandard quality may experience an increased cost of capital.

v. Mismatch of Skills

Some commenters suggested that reputational concerns may lead audit committees not to select qualified engagement partners associated with prior restatements and to select a perceived "star" partner. It is, therefore, possible that, in some instances, high-demand auditors might be engaged when other auditors whose skills may be more relevant for a particular engagement are not selected. This could result in decreased audit quality. However, accounting firms have incentives to staff engagements appropriately, and star engagement partners would also be incented to avoid performing audits for which they are not qualified in order to maintain that status or to mitigate any skill mismatch and maintain or enhance their reputation by consulting with others within their firm as necessary to ensure audit quality.

The ability to identify audit quality at the engagement level could also facilitate the intentional selection of auditors with a reputation for substandard quality. Companies may do this for a variety of reasons, including the potential for lower audit

fees or to identify auditors who are less likely to challenge management's assertions. The ability for investors and other financial statement users to identify a mismatch in auditor skill and company-specific audit needs should limit the extent to which companies can choose an auditor with a reputation for substandard quality.

vi. Possible Changes in Competitive Dynamics

Differentiation in stature and reputation of individual auditors who serve as engagement partners, and in other firms that participate in audits, could have a number of competitive effects. One commenter suggested that transparency could create a permanent structural bias against smaller, less-known firms and partners as audit committees may be reluctant to engage firms or select partners that are not well-established or well-known. As described in Section A, it appears that the disclosures under consideration could promote increased competition based on factors other than general firm reputation. In particular, if investors are better able to assess variations in audit quality, any resultant financial market effects should incent accounting firms to increase the extent to which they compete based on audit quality.

Moreover, the disclosures could result in changes to the market dynamics for the services of engagement partners and other firms participating in audits. The ability to differentiate among engagement partners and among other firms participating in audits could change external perceptions of particular partners and accounting firms, which may affect the demand for their services. This shift in demand could, in turn, affect auditor compensation and supply dynamics.

It should be noted, however, that a marked increase in the mobility of engagement partners and other accounting firms participating in audits seems unlikely due to high switching costs and contractual limitations. For example, partnership agreements, noncompete agreements, and compensation and retirement arrangements may affect partners' incentives and contractual ability to change firms. In addition, the costs to an issuer of replacing the global audit team and explaining the decision to change accounting firms to the market may affect companies' incentives to follow an engagement partner to a new firm. As a result, engagement partners may be reluctant to or contractually precluded from changing accounting firms, and those who elect to change firms may be unable to bring their clients with them. Additionally, the five-year partner rotation requirement would preclude an engagement partner from serving a company for more than five years, even if the engagement partner switched accounting firms.⁴²

⁴² Rule 2-01(c)(6) of Regulation S-X, 17 CFR § 210.2-01(c)(6); see also Section 203 of the Sarbanes-Oxley Act.

C. Alternatives Considered

After considering these factors and public comments, the Board continues to consider whether disclosure of the name of the engagement partner and certain information about other participants in the audit is in the public interest. The Board also continues to consider the appropriate location of such disclosure.

In December 2013, the Board repropoed amendments to its standards that would require disclosure in the auditor's report of: (1) the name of the engagement partner; (2) the names, locations, and extent of participation of other independent public accounting firms that took part in the audit; and (3) the locations and extent of participation, on an aggregate basis by country, of certain nonaccounting firm participants in the audit. The Board continues to consider whether to adopt these requirements through disclosure in the auditor's report or on Form AP.⁴³ As described below, the Board has considered a number of alternative approaches to achieve the potential benefits of enhanced disclosure and in this supplemental request for comment, is considering another disclosure alternative.

1. Alternatives Considered Previously

Over the past several years, the Board has considered a number of alternative approaches to the issue of transparency. Initially, the Board considered whether an approach short of rulemaking would be a less costly means of achieving the desired end. The Board's usual vehicles for informal guidance—such as staff audit practice alerts, answers to frequently asked questions, or reports under PCAOB Rule 4010, *Board Public Reports*—did not seem suitable. U.S. accounting firms have not voluntarily disclosed information about engagement partners and other audit participants. Also, even if some auditors disclosed more information under a voluntary regime, practices among auditors likely would vary widely. That would defeat one of the Board's goals of achieving widespread and consistent disclosures about the auditors that are registered with the PCAOB. Thus, the Board did not pursue an informal or voluntary approach.

In the 2009 Release, the Board considered a requirement for the engagement partner to sign the auditor's report in his or her own name in addition to the name of the accounting firm. A number of commenters supported and continue to support the signature requirement. However, many other commenters opposed it, mainly because including the signature in the auditor's report, in their view, would appear to minimize

⁴³ As discussed in Section V of the release, the Board is also reconsidering the appropriateness of the proposed disclosures regarding nonaccounting firm participants.

the role of the accounting firm in the audit and could increase the engagement partner's liability. Some commenters believed that this alternative would increase both transparency and the engagement partner's sense of accountability. Other commenters believed that engagement partners already have a strong sense of accountability and that signing their own name on the audit opinion would not affect that.

In the 2011 Release, in addition to the requirement to disclose the name of the engagement partner in the auditor's report, the Board proposed to add to Form 2⁴⁴ a requirement to disclose the name of the engagement partner for each audit required to be reported on the form. As originally proposed, disclosure on Form 2 would supplement more timely disclosures in the auditor's report by providing a convenient mechanism to retrieve information about all of a firm's engagement partners for all of its audits.⁴⁵

There are, however, a number of disadvantages to a Form 2-only approach, as discussed in the 2013 Release. It would delay the disclosure of information useful to investors and other financial statement users from 3 to 15 months.⁴⁶ It also would make the information more difficult to find by investors interested only in the name of the engagement partner for a particular audit, rather than an aggregation of all of the firm's engagement partners for a given year, because they would have to search for it in the midst of unrelated information in Form 2.

Some commenters on both the 2011 Release and 2013 Release suggested that the names of the engagement partner and the other participants in the audit should be included, if they were to be disclosed at all, not in the auditor's report but on an existing or newly created PCAOB form only. This would make the information publicly available, while responding to concerns expressed by commenters related to liability. Some commenters on the 2013 Release also suggested that these disclosures would be more appropriately made in the company's audit committee report.

⁴⁴ Form 2 provides basic information about the firm and the firm's issuer-related practice over the most recent 12-month period.

⁴⁵ The 2011 Release also proposed to require disclosure about other participants in the most recent period's audit.

⁴⁶ Form 2 must be filed no later than June 30 of each year—according to PCAOB Rule 2201, *Time for Filing of Annual Report*—and covers the preceding 12-month period from April 1 to March 31; see Form 2, General Instruction 4. Special reports must be filed no later than 30 days after the triggering event. See PCAOB Rule 2203, *Special Reports*.

In considering commenters' views in the development of this supplemental request for comment, the Board also considered providing auditors the option of making disclosure either in the auditor's report or on a newly created PCAOB form. This alternative would have had the advantage of allowing auditors to decide how to comply with the disclosure requirements based on their particular circumstances, may have imposed lower compliance costs in some instances compared to mandatory form filing or mandatory auditor's report disclosure, and may have resulted in more disclosures in the auditor's report than a mandatory form because some auditors may have preferred to avoid the cost of filing the form by disclosing the information in the auditor's report. However, such an approach would have permitted disclosures in multiple locations, which could have caused confusion and increased search costs compared to either auditor's report disclosure or disclosure on a mandatory form.

2. *Disclosure in the Auditor's Report*

Under the alternative proposed in the 2013 Release, auditors would be required to disclose the name of the engagement partner and certain other participants in the audit in the auditor's report. This approach has certain benefits to market participants related to timing and visibility of the disclosures. For example, mandated disclosure in the auditor's report would reduce search costs for market participants in some instances. The required information would be disclosed in the primary vehicle by which the auditor communicates with investors and where other information about the audit is already found, and would be available immediately upon filing with the SEC of a document containing the auditor's report. However, market participants may incur costs to aggregate the information disclosed in separate auditors' reports.

It is possible that, compared to disclosure on Form AP, disclosing the information in the auditor's report may have an incrementally larger effect on the sense of accountability of identified participants in the audit, because, for example, the engagement partner would be involved in the preparation of the auditor's report, but may not be involved in the preparation of the form. As discussed above, increased auditor accountability could have both positive and negative effects on the audit.

Mandating disclosure of the name of the engagement partner in the auditor's report would also create consistency between PCAOB auditing standards and requirements of other global standard setters regarding engagement partner disclosure.⁴⁷ For example, 16 out of the 20 countries with the largest market

⁴⁷ In 2014, the International Auditing and Assurance Standards Board ("IAASB") adopted International Standards on Auditing ("ISA") 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, which generally requires disclosure of the name of the engagement partner in the auditor's report. Following this adoption,

capitalization, including seven European Union member states, already require disclosure of the name of the engagement partner in the auditor's report.⁴⁸ However, it should be noted that baseline conditions, including those regarding auditor liability, may differ among these jurisdictions.

As previously discussed, disclosure in the auditor's report could trigger the consent requirement of Section 7 and subject the identified parties to potential liability under Section 11 of the Securities Act. As a result, there could be additional indirect costs to engagement partners and other accounting firms participating in audits associated with defense of the litigation.

3. *Disclosure on a New PCAOB Form*

Under the new alternative being considered by the Board in this supplemental request for comment, auditors would be required to disclose the name of the engagement partner and certain other accounting firms that participated in the audit in a separate PCAOB form to be filed in most cases by the 30th day after the date the auditor's report is first included in a document filed with the SEC with a shorter deadline of 10 days for initial public offerings.

The approach described in the supplemental request for comment would allow auditors to decide whether to also provide disclosure in the auditor's report taking into account, for example, any costs associated with obtaining consents pursuant to the Securities Act and the potential for liability stemming from disclosure in the auditor's report. Although many auditors may prefer to avoid the potential legal issues associated with disclosure in the auditor's report, some auditors may choose, or be urged by audit clients or investors and other financial statement users, to also make the required disclosures in the auditor's report. Financial statement users could interpret an auditor's

disclosure of the engagement partner's name in the auditor's report of a listed entity will become the norm in those jurisdictions that have adopted the ISAs as adopted by the IAASB. See *also* 2013 Release for further discussion of the requirements regarding engagement partner disclosure in other jurisdictions.

⁴⁸ Out of the 20 countries with the largest market capitalization (based on data obtained from the World Bank, World Development Indicators), the four that currently do not require the disclosure of the name of the engagement partner are the United States, Canada, Republic of Korea, and Hong Kong. The 16 countries that currently require disclosure of the name of the engagement partner are Japan, United Kingdom, France, Germany, Australia, India, Brazil, China, Switzerland, Spain, Russian Federation, the Netherlands, South Africa, Sweden, Mexico, and Italy.

willingness to be personally associated with the audit in the auditor's report as a signal of audit quality or, more generally, as a means of differentiating among auditors.⁴⁹

Requiring disclosure in a separate PCAOB form may decrease the chances that investors and financial statement users would seek out the information. While disclosure in the auditor's report would make information available on the date of SEC filing of the document containing the auditor's report, disclosure on Form AP could occur up to 30 days later and information would only be included in the auditor's report when the auditor also chose to disclose in the auditor's report. Regardless of where it is disclosed, investors should be able to consider the information in developing their investment strategies.⁵⁰

⁴⁹ Changes to the format of the auditor's report in the United Kingdom may have provided auditors with a mechanism to distinguish themselves from their peers. Some filings suggest that some auditors may be using the new format to showcase the rigor and quality of their audit work. See Sara Deans and Terence Fisher, *New UK Auditor's Reports: Findings from the FTSE 100 New Auditor's Reports*, Citi Research (September 3, 2014).

⁵⁰ There is an extensive body of academic literature demonstrating that financial markets are able to incorporate information into securities prices. Because securities prices can be viewed as public goods, investors are able to learn important information about a company by looking at the prices of its securities. See, e.g., Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 *The Journal of Finance* 383 (1970); Sanford Grossman, *Further Results on the Informational Efficiency of Competitive Stock Markets*, 18 *Journal of Economic Theory* 81 (1978); John C. Coffee, Jr., *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 *Virginia Law Review* 717 (1984); and Verrecchia, *Essays on Disclosure*.