

PCAOB requirement to disclose certain audit participants: Bank loan officers' views

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ABSTRACT

The audit report is one way that users of financial statements can have confidence in financial statements of any business. However, there is concern that the audit report does not provide adequate information (Church et al., 2008). The communicative value of the report beyond the pass or fail report has been questioned by users of auditor's report (Church et al., 2008). Though users of the auditor's report value the auditor's opinion on the financial statements, they yearn for auditors to provide more relevant information especially after the financial crisis in early 2000's. In response, standard setters and regulators have proposed and made amendments to several auditing standards. One of the new requirements adopted by the PCAOB is Rule 3211: Auditor Reporting of Certain Audit Participants. This rule requires firms to disclose information about engagement partners and other accounting firms that participate in audits of issuers (PCAOB 2017). This study investigates bank loan officer's (BLOs) view concerning the requirement to disclose information about other accounting firms that participated in an audit. The survey results indicate that BLOs believe that this requirement provides additional information that is relevant to their decision making. The results provide information to regulators and standard setters who have not implemented the requirement to disclose information about other accounting firms in an audit.

Keywords: PCAOB, disclosure, participants, transparency, accountability

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INTRODUCTION

The audit report is the auditor's primary means of communicating its findings to an entity's stakeholders. There is concern that the audit report does not provide adequate information (Church, Davis, & Mccracken, 2008). The current report is shaped so that users can only differentiate a standard unqualified opinion (pass) from a modified opinion (fail). The communicative value of the report beyond the pass or fail report has been questioned by users of auditor's report (Church et al., 2008; Mock et al., 2013).

Several studies show that different stakeholders have conflicting views on what the auditor's reports should portray. For instance, a study by McEnroe and Martens (2001) shows that investors have higher expectations on the various aspects of an audit and the assurance provided than the auditors do. Also, Gray et al. (2011) conducted a study to investigate five different stakeholder groups' perception of the auditor's report. The stakeholders include financial statement preparers (CFOs), users of financial statement (bankers, analysts, and non-professional investors) and external auditors. The different stakeholders were neither sure on what the auditor's report is intended to communicate nor clear on the level of assurance provided by the report. Similarly, Asare and Wright (2012) conducted a study with three different stakeholders and found that there is a difference not only in the expectations between auditors and other stakeholders, but various stakeholders have different expectations on the purpose of the auditor's report. The difference in views between auditors and users of financial statements is referred to as "expectation gap" (Bedard et al. 2012). There is expectation gap because users of financial statements and auditors have different views of what auditors' responsibilities are concerning the audit report. The expectation gap is not a new phenomenon, McEnroe and Martens (2001) note that it may have originated from the 1937 publicized public hearing of McKesson & Robbins fraud case. The Cohen Commission study also confirmed the existence of expectation gap.

The financial crises of the early 2000s intensified the expectation gap. Mock et al. (2013, 3) note that as a result of the 2008 financial crises "regulators and others (e.g., U.S. Department of Treasury's [2008] Advisory Committee on the Auditing Profession, International Organization of Securities Commissions [IOSCO 2009], and European Commission [EC 2010]) have questioned the value of the current audit report and asked for improvement in the audit report". In response to the outcry from the public, audit regulators and standard setters (e.g. the International Auditing and Assurance Standards Board [IAASB], the Public Company Accounting Oversight Board [PCAOB], the European Union [EU] and the Financial Reporting Council in the United Kingdom [FRC]) have proposed and/or adopted amendments to several auditing standards.

In September of 2014, the IAASB adopted changes to the auditor's report. The changes include a new standard ISA 701 which deals with the auditor's responsibility to communicate key audit matters in the auditor's report. In addition, the IAASB revised the following standards: ISA 705: Modifications to the Opinion in the Independent Auditor's Report; ISA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report; ISA 800: Special Considerations-Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks; and ISA 805: Special Considerations-Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement (IAASB, 2015a). The IAASB new and revised Auditor Reporting standards are effective for audits of financial statements for periods ending on or after December 15, 2016. The IAASB believes that changes

to auditor's report will increase transparency and enhance informational values. Additional benefits noted by the IAASB include enhanced communication between the auditor and investors, increased attention by management and those charged with governance, and renewed focus of the auditor on matters to be reported (IAASB 2015b).

PCAOB also proposed and made changes to the auditing standards. The proposed changes include critical audit matter, which requires the auditor to communicate in the auditor's report any critical audit matters arising from the current period's audit of the financial statements or state that the auditor determined that there are no critical audit matters. Also, the board included additional improvement to the auditor's report. The board states "that these improvements are mainly to clarify auditor's role and responsibilities related to the audit of the financial statements, provide additional information about the auditor and make the auditor's report easier to read" (PCAOB 2017, 14). Some of the improvements relate to auditor tenure and auditor independence. For auditor tenure, the auditor will include a statement that shows the year the auditor began serving uninterruptedly as the company's auditor. While for auditor independence, the auditor will also include a statement that the auditor is required to be independent. Another notable change is that the opinion will appear in the first section of the auditor's report (PCAOB, 2017).

Another new rule adopted by the PCAOB is Rule 3211: Auditor Reporting of Certain Audit Participants. Rule 3211 requires firms to provide information about engagement partners and other accounting firms that participate in audits of issuers (PCAOB, 2017). Firms are required to disclose this information on Form AP. Also, firms have the option of including this information in the auditor's report. The effective date for filing Form AP for engagement partner's information is January 31, 2017. While the effective date for other accounting firm information is June 30, 2017. The PCAOB requires that for other accounting firm providing over 5% to report the name, location, and percentage of total hours as a single number or with an appropriate range on Form AP. The information can be aggregated for firms providing less than 5% (PCAOB, 2015).

The purpose of this study is to investigate bank loan officers' (BLOs) general views on the PCAOB requirement to disclose information about other accounting firms that participate in an audit. This paper further explores whether disclosure of this information provides relevant information to BLOs. IAASB, FRC and EU, and PCAOB all require disclosure of partner's name, but only PCAOB requires disclosure of information about accounting firms that participated in an audit (PCAOB, 2017). The result of this study provides information for other regulators that are thinking of implementing a similar rule.

DISCLOSURE OF CERTAIN PARTICIPANTS IN AN AUDIT

The PCAOB states that "robust disclosure is the cornerstone of the U.S. federal securities regulatory regime and is essential to efficient capital formation and allocation" (PCAOB 2013, 2). The PCAOB believes that more disclosure about certain aspects of the audit of a public company would add to the variety of information about public companies that are available to investors and other financial statement users. The PCAOB also believes that the requirement to disclose information about certain participants in an audit would lead to a heightened sense of accountability to the various users of the auditor's report (PCAOB 2013).

Studies on disclosure of audit partners show that disclosure of audit partners provides additional information for users of financial statements (Carcello, Hermanson, & Ye, 2011;

Carcello & Santore, 2015; Dee, Lulseged, & Zhang, 2013; Lambert, Luippold, & Stefaniak, 2017). For instance, Carcello & Li (2013) indicate that partner signature requirement increased audit quality and audit fees. Dee et al. (2013) show that there is a significant adverse reaction from investors for companies identified as having other participants. The authors did not find any significant market reactions for the matched control group. There are arguments that disclosure of audit partners will likely pressure auditors to be more conservative and thereby carry out more audit procedures which may lead to an increase in audit cost (Carcello & Santore, 2015; King, Davis, & Mintchik, 2012). The studies mentioned above investigated the effects of disclosing audit partner. This paper examines BLOs' general view on the PCAOB requirement to disclose information about other accounting firms.

METHODOLOGY

The participants are bank loan officers. They are recruited via Qualtrics, a web-based company that works with industry partners to build both broad and targeted participant panels (Brandon, Long, Loraas, Mueller-Phillips, & Vansant, 2014). The survey was administered in November of 2015 to BLOs located in the United States of America (USA). The participants were given sixteen statements on the PCAOB requirements on disclosure, followed by their demographic information. The first seven statements relate to general information on PCAOB requirement to disclose information about other participants in an audit. The last nine statements are on BLO's perceptions of how disclosing other participants will affect relevance, transparency and other participants' sense of accountability. The participants are asked to respond to the statements on a 5 point Likert scale with 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree and 5 = Strongly Agree. Responses of 1 and 2 are collectively referred to as "disagree," and responses of 4 and 5 are collectively referred to as "agree."

In addition to using descriptive statistics to evaluate the responses, this study also uses one-sample Wilcoxon Signed Rank Test (WSRT). WSRT is used to provide insight as to how participant mean responses differ from the midpoint of '3' (neutral) on the 5-point Likert scale used. WSRT is a non-parametric alternative to one sample t-test used to measure central tendency. Prior studies have used WSRT to analyze responses from participants (e.g., Coram et al. 2008; Dee et al. 2015; Hodder et al. 2008)

Table 1 (Appendix) shows the demographic information of the participants. The demographic statistics in Table 1 shows that sixty-five (65) percent of the participants have at least five years of lending experience, and seventy-eight (78) percent hold at least a bachelor's degree. Eighty-seven percent of the participants have a current title of bank loan officer or higher, and approximately two-thirds of the participants (64 percent) devote more than fifty percent of their time to loan approval. About seventeen (17) percent of the participants report that they have some professional certification. A substantial majority of the participants (83 percent) are with banks that have assets of over one hundred million. Also, ninety-two (92) percent of the participants reported that they are either somewhat knowledgeable about auditing or very knowledgeable. Seventy-five percent report that they are slightly knowledgeable or very knowledgeable about outsourcing audit procedures while sixty-two (62) percent report that they are either somewhat knowledgeable or very knowledgeable about offshoring audit procedures. Sixty-five percent of the participants are 36 years or older with 54 percent male and 46 percent female.

RESULTS

Table 2 (Appendix) summarizes the participants mean response, standard deviation (SD) and the related percentages of the participants' opinions on each of the statements. It also shows the p-value of WRST. Statement 1 seeks bank loan officers' perceptions of the importance of disclosing pertinent information. A majority (81.5%) of the bank loan officers in this study agree that disclosing relevant information is very important to them. The response to statement 2 shows that 43 percent of the participants have a neutral view on whether disclosing information about other participants not employed by the audit firm will improve audit quality. Statement 3 and 5 requests the participants view on how communicating information about other participants not employed by the audit firm will affect competition. The result from statement 3 shows that about two-thirds of the participants (67%) agree that disclosure of information about certain participants will increase competition. The result of statement 5 compliments statement 3. It shows that only about 25 percent believe disclosure will inhibit competition. Statement 4 states that disclosing information about other participants not employed by the audit firm will increase transparency. Approximately two thirds (65.5%) of the participants agree with this statement. Statements 6 and 7 seek BLOs' opinions on disclosing outsourcing and offshoring of audit procedures. Based on the results, over 74 percent of the participants agree that information about audit procedures performed in another country either by the office of an accounting firm or another accounting firm should be disclosed.

Statements 8 through 16 relate to BLOs' perceptions on disclosing the name, location, and extent of participation on relevancy, transparency, and accountability. As shown in these statements, 58 percent or more of the participants believe that disclosing the name, location and the extent of participation of others not employed by the audit firm yet participated in the audit is relevant to them. BLOs further believe that this disclosure will increase transparency of the auditor's report. They are also of the opinion that the other participants will feel more accountable. WSRT shows that apart from statement 5 with a non-significant p-value of .239, the other statements have significant p-values of $< .01$.

DISCUSSION

Auditor's report is one of the ways that financial position of a company is communicated to users of financial statements. Many have complained that it does not provide enough communicative value. In response, the PCAOB and other regulators have either proposed or implemented changes that will expand the auditor's report. One of the new requirements adopted by the PCAOB is Rule 3211: Auditor Reporting of Certain Audit Participants. This rule requires firms to provide information about engagement partners and other accounting firms that participate in audits of issuers (PCAOB 2017). The study investigates BLOs' view concerning this requirement.

The results of the survey indicate that bank loan officers believe that the PCAOB requirement to disclose the name, location, and extent of participation of others not employed by the auditor yet participated in the audit will improve their perceptions of audit transparency. They also believe that this requirement will be relevant to them and will increase other participants' sense of accountability. The result further shows that a majority of the participants

agree that outsourcing and offshoring of audit procedures should be disclosed to users of financial statements. The results of this study support PCAOB notion that disclosing information about participants provide additional information for users of financial statements.

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APPENDIX

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TABLE 1
Demographic Statistics

| Variable | Grouping | Frequency | Percent |
|---|---------------------------------|------------------|----------------|
| Loan Experience | 1-4 years | 52 | 35 |
| | 5-10 years | 52 | 35 |
| | 11-15 years | 14 | 9 |
| | Over 15 years | 33 | 21 |
| Highest Degree Earned | High School Diploma | 14 | 9 |
| | Associate Degree | 19 | 13 |
| | Bachelor's Degree | 69 | 46 |
| | Master's Degree and above | 49 | 32 |
| Percentage of Time Devoted to Loan | Below 50% | 39 | 25.8 |
| | 50-69% | 44 | 29.1 |
| | 70-79% | 29 | 19.2 |
| | 80-89% | 23 | 15.2 |
| | Over 90% | 16 | 10.7 |
| Title | Credit Analyst | 19 | 12.6 |
| | Loan officer | 84 | 55.6 |
| | Vice President | 28 | 18.5 |
| | President/CEO | 4 | 2.6 |
| | Other | 16 | 10.7 |
| Certification | Yes | 25 | 16.6 |
| | No | 126 | 83.4 |
| Bank Asset Size | Less than \$100 million | 25 | 16.6 |
| | \$100million - \$ 1 billion | 57 | 37.7 |
| | Over \$1 billion - \$10 billion | 43 | 28.5 |
| | Over \$10 billion | 26 | 17.2 |
| Knowledge of Auditing | Not at all Knowledgeable | 12 | 8 |
| | Somewhat Knowledgeable | 100 | 66 |
| | Very Knowledgeable | 39 | 26 |
| Knowledge of Outsourcing | Not at all Knowledgeable | 37 | 25 |
| | Somewhat Knowledgeable | 85 | 56 |
| | Very Knowledgeable | 29 | 19 |
| Knowledge of Offshoring | Not at all Knowledgeable | 58 | 38 |
| | Somewhat Knowledgeable | 65 | 43 |
| | Very Knowledgeable | 28 | 19 |
| Age | Under 26 | 8 | 5 |
| | 26-35 | 45 | 30 |
| | 36-45 | 36 | 24 |
| | 46-55 | 34 | 23 |
| | Over 55 | 28 | 19 |
| Gender | Male | 81 | 54 |
| | Female | 70 | 46 |

TABLE 2
Loan officers' views (n =151)

| | Statements^a | Sig^b | Mean (SD) | SD (1) | D (2) | N (3) | A (4) | SA (5) |
|---|--|------------------------|----------------------|-------------------|------------------|------------------|------------------|-------------------|
| 1 | Disclosing pertinent information is very important to me. | <.001 | 4.13 (.98) | 2.6% | 5.3% | 10.6% | 39.1% | 42.4% |
| 2 | Requiring auditors to disclose information about other participants not employed by the audit firm will improve audit quality. | <.001 | 3.19 (.89) | 2.0% | 19.2% | 43% | 29.1% | 6.6% |
| 3 | Disclosing information about other participants not employed by the audit firm will promote competition. | .009 | 3.66 (1.03) | 4.0% | 11.3% | 17.9% | 48.3% | 18.5% |
| 4 | Disclosing information about other participants not employed by the audit firm will increase transparency. | <.001 | 3.74 (.93) | 1.3% | 9.3% | 23.8% | 45.0% | 20.5% |
| 5 | Requiring disclosure of information about other participants not employed by the audit firm will inhibit competition. | .239 | 2.91 (.95) | 6.0% | 27.2% | 41.7% | 20.5% | 4.6% |
| 6 | Information about audit procedures performed by an office of the firm located in another country should be disclosed. | <.001 | 3.94 (.85) | 1.3% | 4.6% | 17.2% | 52.3% | 24.5% |
| 7 | Information about an audit procedures performed by another accounting firm located in another country should be disclosed. | <.001 | 4.11 (.92) | 0.7% | 4.0% | 21.2% | 31.8% | 42.4% |
| 8 | Auditor's report will be more relevant to me if the names of other participants in the audit are disclosed. | <.001 | 3.53 (.86) | 0.7% | 14.6% | 25.8% | 49.0% | 9.9% |

TABLE 2
(continued)

| | | | | | | | | |
|----|--|-------|---------------|------|------|-------|-------|-------|
| 9 | Disclosing the names of the other participants in the audit increases my perception of transparency of the auditor's report. | <.001 | 3.72 (.95) | 2.0% | 8.6% | 25.2% | 44.4% | 19.9% |
| 10 | Disclosing names of other participants in the audit increases other participants' sense of accountability. | <.001 | 3.79 (.91) | 0.7% | 9.3% | 21.9% | 46.4% | 21.9% |
| 11 | Auditor's report will be more relevant to me if the location of other participants in the audit are disclosed. | <.001 | 3.71 (.88) | 0.7% | 8.6% | 27.8% | 45.0% | 17.9% |
| 12 | Disclosing the location of other participants in the audit increases my perception of transparency of the auditor's report. | <.001 | 3.72 (.82) | 0.7% | 6.6% | 27.2% | 51.0% | 14.6% |
| 13 | Disclosing location of other participants in the audit increases other participants' sense of accountability. | <.001 | 3.77 (.87) | 0.7% | 6.6% | 27.2% | 45.7% | 19.9% |
| 14 | Auditor's report will be more relevant to me if the extent of participation of other participants in the audit are disclosed. | <.001 | 3.83 (.85) | 1.3% | 5.3% | 21.9% | 52.3% | 19.2% |
| 15 | Disclosing the extent of participation of other participants in the audit increases my perception of transparency of the auditor's report. | <.001 | 3.85 (.80) | 0.7% | 2.0% | 30.5% | 45.7% | 21.2% |
| 16 | The requirement to disclose the extent of participation of other participants will make the other participants feel more accountable. | <.001 | 3.82 (.83) | 0.7% | 4.6% | 27.2% | 47.0% | 20.5% |

^a Responses to statements are measured on a scale of 1 to 5, with 1 = Strongly Disagree (SD), 2 = Disagree (D), 3 = Neutral (N), 4 = Agree (A) and 5 = Strongly Agree (SA).

^b One –Sample Wilcoxon Signed Ranked Test (WSRT) was conducted for each statements to determine how the mean response of the participants differ the median score (3 = neutral). Sig is the p-value.