Study Finds PCAOB's Rule to Name Lead Audit Partner Has Not Been Beneficial (October 29, 2019)

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Today's News

Audit Practice News

Study Finds PCAOB's Rule to Name Lead Audit Partner Has Not Been Beneficial

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Summary: *After strong investor demand, the PCAOB at the end of 2015 finally issued a rule that requires accounting firms to identify the name of the engagement partner in an audit of a public company. Investors said the rule will improve an auditor's performance knowing that their name will be made public, but a study raises doubt that the rule produced the intended benefits.*

By Soyoung Ho

After several years of effort-because of industry opposition-the PCAOB at the end of 2015 finally issued a rule that requires accounting firms to identify the name of the engagement partner in an audit of a public company. Investors had pushed for the rule, saying that it will improve an auditor's performance knowing that their name will be made public. But a study raises doubt that the rule produced the intended benefits.

The rule went into effect in 2017 under **Release No. 2015-008** , *Improving the Transparency of Audits:*

Rules To Require Disclosure of Certain Audit Participants on a New PCAOB Form and Related Amendments to Auditing Standards. The disclosure is made on a new form titled "Auditor Reporting of Certain Audit Participants," or Form AP. Form AP has to be filed within 35 days of the submission of the client's 10-K filing, which includes the auditor's report, according to Rule 3211.

"Overall, we are unable to detect a significant change in audit quality attributable to Rule 3211 when evaluated along" several dimensions, including the "propensity to misstate and the likelihood of issuing an incorrect material weakness opinion, the study's authors said.

The study appears in the September/October 2019 issue of *The Accounting Review*, published by the American Accounting Association.

Lauren Cunningham of the University of Tennessee, Chan Li of the University of Kansas, Sarah Stein of Virginia Tech, and Nicole Wright of James Madison University are the authors of the study. They cautioned that their findings only provide initial evidence and further research is necessary to evaluate other potential effects of the rule.

In particular, the researchers found that audit quality improved during implementation period. "Results indicate that several of the proxies of audit quality…increased in the first year of Rule 3211," the study said, continuing similar improvement in the previous year.

When they looked deeper, the findings suggested that whatever improvement may have been occurring had little to do with Rule 3211.

To study the matter, they used two control groups of public company audit clients. One group, the "early discloser sample", consisted of companies in the Standard & Poor's 1,500 index that disclosed audit engagement partners in the year before Rule 3211. A second group, the "pseudo adopter sample," consisted of all companies that issued their annual reports in the months prior to January 31, 2017 and thus did not have to identify the lead audit partner.

The academics said that if the new rule brought about better audit quality, that change should have been significantly greater for companies that did not previously disclose the engagement partners than for the early disclosers. The increased audit quality should have also been significantly greater for companies disclosing audit partner identities in Form AP than for the pseudo adopters. But neither was the case.

The study used three principal proxies of audit quality: amount of discretionary accruals, non-cash accounting items that are often subjective and are considered particularly subject to manipulation; F-scores or measures of companies' propensities to misstate earnings; and mistaken assessments of firms' internal controls over financial reporting.

They added six proxies to make their findings more credible. But eight of nine measures did not show significant improvements.

"First, accounting firms argued that partner accountability was already sufficiently high prior to mandatory disclosure, such that partner identification would not induce additional improvements to audit quality," the researchers said. "Second, the final adoption of Rule 3211 required audit partner disclosure in Form AP, which…may not pervasively affect partners' sense of accountability as the PCAOB originally intended."

The PCAOB originally wanted the audit engagement partners to sign their names, not just be identified in a different form that most people will not look up.