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Disclosure of Lead Audit Partner's Name to Benefit Investors, Study Finds

The PCAOB's rule requiring accounting firms to disclose the name of the lead partner for a client engagement is scheduled to go into effect at the end of January. A recent study says the requirement will benefit investors because it will provide information about networks of clients that could be ripe for conflicts of interest.

The PCAOB's rule requiring accounting firms to disclose the name of the lead partner in an audit of a public company on a new form is scheduled to go into effect on January 31, 2017.

According to a recent study, the requirement will shine a light on a partner's network of clients and provide investors with useful information. Four researchers in Australia, where audit firms are required to identify the name of the engagement partner, said the disclosure will let investors see so-called "interlock networks" that can be sources of conflicts of interest. They define the networks as situations where a member of the audit committee of a company board also belongs to another company's audit committee that also employs the same audit firm and the same engagement partner to supervise the examination of company financial statements. Audit committees have oversight of auditors.

"Audit partner dependence on fees from [such networks] erodes audit quality," said the study in the November 2016 to January 2017 edition of ***Auditing: A Journal of Practice and Theory*** , published by the **American Accounting Association**.

When an engagement partner earns more than 10 percent of the annual fees from a distressed company in the network, the probability that the company will receive a going-concern opinion is only 3.3 percent. When an auditor examines the financial statements of a company that is not part of an interlock network, there is a 7.3 percent likelihood that a going-concern opinion will be issued.

"Our results strongly support requiring identification of the engagement partner," said Gary Monroe, an accounting professor at the University of New South Wales (UNSW). "Coupled with disclosure of audit committee members and audit fees, it uniquely enables investors and regulators to identify interlocking networks likely to impair audit quality— as, for example, in willingness to issue a going-concern opinion."

Monroe conducted the research with his UNSW colleague Sarowar Hossain, Mark Wilson of the Australian National University, and Christine Jubb of Swinburne University of Technology.

They looked at companies listed on the Australian Securities Exchange from 2003 to 2011 to study the relationship between network clients' fee dependence and audit quality.

The research also found that interlocked companies tend to rely more heavily on the estimates and judgments that are indications of fraudulent reporting. Interlocked companies will use discretionary accruals, the noncash expenses or inflows of funds that make use of estimates, for 9.3 percent of their assets. Companies that are not part of the interlock networks will use noncash accruals equal to 7.7 percent of their assets.

The study said audit quality deteriorated when the links involve the audit committee and audit engagement partner. Quality did not seem to be affected when an audit firm has clients who share a common audit committee member, but the engagement is supervised by different partners.

The PCAOB adopted rules in December 2015 in 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* , that require audit firms to submit Form AP. Form AP must be filed within 35 days of the submission of the client's 10-K filing, which includes the auditor's report. The disclosure of the other firms in the audit will become effective after June 30, 2017.

The PCAOB said the public will be able to do searches of the Form AP database by looking up the name of the engagement partner, the audit firm, or the public company.