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DISCUSSION OF

The Consequences of Providing Lower-Quality Audits at the Engagement Partner Level

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I. INTRODUCTION

The paper "The consequences of providing lower-quality audits at the engagement partner level" has been selected for presentation at the plenary session of the 2018 *Journal of International Accounting Research* (*JIAR*) conference. Chi, Lisic, Myers, Pevzner, Seidel (2019; hereafter, CLMPS) investigate the reputational consequences that engagement partners suffer for having a recent history of past audit failures. In particular, relying on the Taiwanese setting where audit quality is observable because of the engagement partner disclosure, the authors empirically provide evidence that engagement partner identification is useful in helping audit clients form opinions about partner-level audit quality. Further, the engagement partner's prior audit quality also influences audit firms' engagement partner selection. Overall the paper makes a significant contribution extending to audit clients the results of prior literature that found audit partners' name disclosure useful for both investors and creditors when making judgments about the quality of audited financial information. Section II provides discussion about motivation and prior literature. Section III describes the research design, findings, and relevance. Section IV provides concluding remarks with suggestions for future research avenues.

II. MOTIVATION AND PRIOR LITERATURE

The international debate about the usefulness of providing engagement partner disclosure is one of the main timely motivations for examining the audit clients' decision making to engage or retain an engagement partner after he or she has been involved in client restatements of previously issued financial statements. Audit partners' names in the United States have been publicly disclosed starting in 2017; and initial evidence is emerging (Cunningham, Li, Stein, and Wright 2019). Indeed, prior literature at the audit partner level mostly relies on archival research in non-U.S. settings, i.e., China, Australia, Taiwan, and Sweden, where engagement partners' disclosure has been made public for many years.

Partnership is the dominant organizational form for audit firms around the world (Lennox and Wu 2018, 3) and, because of that, moral hazard problems affecting auditing quality may arise. Prior studies examine factors that may motivate different levels of audit quality, among which are the economic importance of a client to an individual partner, the length of partner-client tenure, the partner's workload, personal connections between partners and clients, and partner characteristics such as age, gender, education, experience, expertise, and ethics (Lennox and Wu 2018). Most recent results provide evidence that individual partner incentives (He, Pittman, and Rui 2016; Hossain, Monroe, Wilson, and Jubb 2016; Lai, Sasmita, Gul, Foo, and Hutchinson 2018), characteristics (Goodwin and Wu 2016; Cameran, Campa, and Francis 2016; Li, Qi, Tian, and Zhang 2017), and experience (Chen, Dai, Kong, and Tan 2017; Chi, Myers, Omer, and Xie 2017) impair audit quality.

CLMPS mainly rely on Aobdia, Lin, and Petacchi's (2015) and Chi et al.'s (2017) results. The former study suggests capital market participants care about the identity and quality of the engagement partner observable from his/her name disclosure. The latter study finds engagement partner disclosure is used by creditors when making judgments about the quality of audited financial information. Building on these studies and on the perspective adopted by Carcello and Li (2013), which examines the consequences of mandatory disclosure of audit partner names, CLMPS wonder what are the reputational consequences that engagement partners might suffer from current and potential audit clients and from within audit firms for having a reputation of past audit failure.

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III. RESEARCH DESIGN, FINDINGS, AND RELEVANCE

To answer to the research question, CLMPS develop four macro hypotheses regarding the likelihood of an engagement partner's recent involvement in restatements and (1) the audit firms' ability to retain their current clients and to attract new business; (2) change of the engagement partner's assignment; (3) alternatively, being removed from or voluntarily leaving client service, but not immediately; and (4) a decrease in the number of lead partner assignments and an increase in the number of concurring partner assignments. To test their hypotheses, CLMPS run logistic and negative binomial regressions on 25,182 client-year—representing 5,929 partner-year—nonfinancial observations (from 1996 to 2016) in the Taiwanese setting, where the audit partner's name is publicly disclosed for both publicly listed and private companies.

Findings empirically provide evidence of the usefulness of engagement partner disclosure to audit clients. Indeed, when poor audit quality is observable at the engagement partner level, engagement partners are more likely to lose their clients (even non-restating clients) and to barely attract new ones in the following five years. Further, partners are more likely to be removed from client service within five years, and those who are not removed are re-allocated to the concurring partner role. Interestingly, the same reputational consequences of poor audit quality also extend to concurring partners.

Thus, CLMPS offer new insight into the reputational consequences that partners face when providing lower-quality audits by showing that audit partners' name disclosure could reduce moral hazard problems in audit firms. Such disclosure may have the effect of increasing engagement partners' accountability, which in turn could generate more effort in enhancing their audit quality.

IV. CONCLUDING REMARKS

The discussed paper feeds the international debate about the merits of engagement partner disclosure. While some argue additional disclosure is redundant due to regulatory oversight and threat of litigation, CLMPS's findings support the position of those who argue such disclosure would increase transparency and accountability. In particular, they support the internationally widespread policies on engagement partner disclosure required in most countries with highly developed capital markets (e.g., Australia, France, Germany, Italy, Japan, The Netherlands, South Africa, Spain, Sweden, Switzerland, Taiwan, U.K.). Further, the discussed paper is very timely given the recent application of such a policy in the U.S., which gives the opportunity for many explorations in this setting.

Given the study examined the reputational consequences at the engagement partner level in terms of audit clients' and audit firms' behavior after restatements, future research may investigate how the disclosure of audit partners' names affects partner behavior, particularly in those contexts where ligation concerns are more salient. Finally, following the call by Lennox and Wu (2018) about the understanding of how audit partners are compensated, it would be of interest to examine whether observable higher audit quality is rewarding at the engagement partner level.

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