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New audit partner identification rules may offer opportunities and benefits

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Abstract From the WorldCom and Enron accounting debacles that triggered the demise of Arthur Andersen to Ernst & Young's 2013 and 2015 settlements of claims that its audits facilitated massive accounting fraud by financial services firm Lehman Brothers, large-scale financial scandals have led to increasing scrutiny of public auditors. Investors are justifiably eager to ascertain the quality of audits of public companies when making investment decisions. In the U.K., the reputation of the audit partner is recognized as a signal of audit quality, and as such, the names of the lead partners have been disclosed to the public since 2009. The U.S. standard of providing the auditing firm name without identifying the lead partner recently changed to match the U.K. and EU standard after much debate. As of May 2016, the Public Company Accounting Oversight Board has adopted—and the Securities and Exchange Commission has approved—new regulations that will require the public disclosure of the individual audit partner responsible for each public company audit, as well as the identification of any additional accounting firms that contribute to the audit. This article examines the new rules in light of disclosure requirements imposed on other professionals, as well as international auditor disclosure requirements. The accounting profession has generally opposed the new disclosures, but this article suggests opportunities and benefits for the profession as a result of the changes, including the opportunity for audit partners to develop individual reputations for quality and specialization. In addition, this article makes recommendations for business managers, owners, and investors for making the best use of the information the new disclosures will provide.

1. The accounting profession catches up with other professions

Accountants performing public audits provide a crucial service for their clients—the publicly traded

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companies that are required to publish audit results in their financial statements—as well as for the investing public who relies on the information provided in those financial statements and audits. Yet, U.S. engagement partners responsible for public audits have been invisible roles compared both to other U.S. professionals and to auditors in other countries, in that they historically have not personally been identified as the responsible party in their final work product. Signature and identification requirements are viewed generally as promoting accountability and improving outcomes for those who rely on the services of professionals who are subject to the regulations. For example, tax preparation professionals are held accountable for their advice by being required to sign and identify themselves on the returns they prepare. Attorneys must sign the pleadings that they file in court on behalf of their clients and, by signing, take responsibility for the content of the filing. Likewise, doctors, engineers, architects, and other professionals are subject to similar requirements, as are auditors in many other countries.

New federal regulations, codified in May 2016 and which became effective in early 2017, will bring auditors of public companies in line with these other professionals by requiring, among other things, identification by name of the engagement partner of an accounting firm who is primarily responsible for a public company audit. Notably, the new regulations do not apply to audits of private companies, but they do apply to emerging growth companies as federal law defines that term. The goal of the Securities and Exchange Commission (SEC) in adopting the new regulations is to promote transparency and accountability in the audit process for the benefit of investors. Evidence from studies in countries that mandate auditor identification shows that identification can, in fact, increase accountability and audit quality.

In this article, we first describe the new rule requiring identification of engagement partners on public audits and summarize the conflicting positions regarding the rule's merit. We then review the rules governing signature requirements and identification of other professionals and the important public policies served by those requirements. We next examine the empirical evidence related to the benefits of audit partner identification from other countries, as we evaluate the potential for the new rule to increase audit quality. We share some thoughts concerning potential benefits to the accounting profession and audit partners as a result of the new disclosure requirement. Although the new rule may increase potential litigation exposure for individual audit partners, the incremental cost of that increased risk likely will be outweighed by the benefits, as the new rule creates opportunities for the audit partners, their firms, and the profession. Finally, we conclude with a discussion of opportunities for both companies and investors who can use information regarding auditors to make better-informed business and investing decisions including holding management and audit committees accountable for properly managing the relationship with the auditor.

2. New rule adopted to increase transparency of public audits

Formed pursuant to the Sarbanes-Oxley Act of 2002, the Public Company Accounting Oversight Board (PCAOB) is tasked with monitoring the accounting firms that provide public audits, and it serves as a regulator with the interest of the users of financial information in mind. The board's stated vision is to improve audit quality, reduce audit failure, and promote public trust in the auditing profession. The board has proposed a number of reforms directed at the accounting profession and more directly at accounting firms that audit public clients and is focused on increasing the transparency of public audits.

With this goal in mind, the PCAOB initially proposed a rule that would have required audit partners to sign the audit reports that accompany the financial statements of a company within the annual 10-K form filed with the SEC (81 Federal Register 7927, 2016). Previously, public audits identified only the accounting firm with primary responsibility for a public audit and none of the specific accountants performing the audit were identified, nor were any other firms contributing to the audit no matter the significance or nature of their contribution. As the culmination of years of rulemaking procedure that involved several rounds of public comments and the PCAOB's alteration of its position twice in 2011 and 2013, the board adopted new regulations that require disclosure of both the engagement partner responsible for each audit of a publicly traded company as well as other firms contributing to audits. The SEC approved the regulations on May 9, 2016 (81 Federal Register 29925, 2016).

Instead of requiring the engagement partner to sign the audit report, the final version of the rule mandates that that partner be identified through Form AP on the PCAOB's website (81 Federal Register 7927, 2016). The form also discloses the name, location, and extent of participation by other accounting firms that contribute 5% or more of the