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Since January of 2017, after more than a decade of discussion and debate, a new regulation from the U.S. Public Company Oversight Accounting Board has required the annual report of each public corporation not only to identify the firm responsible for the company financial audit, as previously mandated, but to disclose the audit-firm partner leading this engagement.

Has audit partner disclosure (APD) benefited investors, as its proponents claimed it

decisions.

But that impact may turn out to be more problematic than the regulation's proponents foresaw, for, although the study does not purport to judge the wisdom of the new rule, its findings inevitably raise doubts about it. In the words of co-author Tamara A. Lambert of Lehigh University, audit partner disclosure "may have a greater impact on investor decisions than would be warranted or than what regulators would have anticipated or intended."

Concurring with this observation are Prof. Lambert's two co-authors, Benjamin L. Luippold of Babson College and Chad M. Stefaniak of the University of South Carolina.

Prior research on APD has tended to focus on countries where partner disclosure has been required long enough to yield substantial outcome data. While the mandates' effects have generally been found to be positive, the authors of the current study note that "the reporting, regulatory, and legal environment within these countries is quite different from that of the United States." Taking a different tack, they focus on the intended beneficiaries of APD – namely, individual investors – through an experiment that gauges their response to knowing the identities of engagement partners in addition to those of auditing firms.

As suggested above, the response is considerable. Although the engagement partners named in the experiment are fictitious, and investors participating in the experiment receive a bare minimum of information about them, APD occasions a striking shift of about 17% in participants' investment decisions, inviting suspicion that irrational factors are at play. As the authors explain, social psychology research "finds that individuals' judgments related to people are more extreme, more hastily and confidently formed, and more easily recalled than those made of groups."

Is this true of judgments involving audit firms and engagement partners?

And does it ever.

The 157 participants in the experiment, which was conducted via computer, were about evenly divided between male and female; were college graduates averaging about 49 years of age; had at least five and a half years of work experience preparing and analyzing financial information; and were experienced in trading individual shares of stocks or bonds and not simply investing in mutual funds. CPAs were excluded out of concern that familiarity with the APD issue would affect their experiment responses.

Participants were presented with information about five fictitious, publicly traded tech companies, which they were asked to consider for long-term investments – American Computers, Computer World, Electronics USA, US Technologies, and Wired States. The basic information about the companies, provided to all investors, was that, besides being in the same industry, all were located in the same region and had received an unqualified audit opinion from one of two Big-4 accounting firms operating in the same city, with the audit firms being identified as ABC or DEF. In addition, five key performance metrics of the tech companies were provided – ratio of assets to liabilities, days' sales of inventories, return on assets, profit margin and market share.

Key to the experiment are three factors:

- One of the tech companies, US Technologies, surpasses all the others in every one of the five performance metrics.

- One company, Wired States, recently restated its results from the prior year, with the restated metrics much lower than what was previously reported. While two other companies happen to use the same auditing firm as Wired States, only one of the two, US Technologies, also has the same engagement partner as the restating

the other four firms." Among those who also knew the identity of engagement partners, only about 63% chose US Technologies. The drop of 14 percentage points suggestsa contagion effect more than 17% greater than that caused by audit-firm identification alone.

As the authors note, "All participants were provided with the information that US Technologies was linked to the contaminated firm by the same audit firm, while APD participants saw both the audit firm *and*partner name. That is, our results suggest that audit partner identity disclosure results in partner-based contagion above and beyond any effect due to shared industry and shared firm."

Why should the gap be so big? Social psychology research, the authors believe, suggests a likely answer. In the words of the study, "Social psychology research finds that when forming impressions, perceivers make more extreme trait judgments, make judgments more quickly and with greater confidence and...are likely to react more strongly when the reactions are associated with an individual than when they are associated with a group."

Is an effect this strong of benefit to investors? Or does the new regulation have too much potential to distort investment decision-making? The authors demur, observing that "for the sake of brevity, participants were only provided with limited information rather than a full set of financial information...Other information within a complete set of financial statements could moderate our results."

Still, they think the evidence uncovered in their experiment should give pause. At the least, regulators, they believe, should be prepared to monitor the effects of this rule with particular care.

Prof. Lambert adds: "As we worked on this research, we were surprised that there seemed to be no consideration by regulators of potential long-term effects to audit independence. With the whole new layer of pressure on audit partners that our

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