Audit Partner Characteristics and Their Impacts on Audit Quality: Evidence from around the World

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Definition: Public company audits are not homogenous. Varying audit partner attributes, including gender, age, location, and expertise, play important roles in explaining audit outcome disparities. The extant literature underscores the influence of firm-level and office-level differences, in areas such as size, culture, and industry expertise, in shaping audit outcomes. Commonwealth countries, such as the U.K., Australia, New Zealand, and Continental European countries, along with Asian economic entities, mandate the disclosure of audit partner names. Consequently, significant research efforts have been devoted to investigating the impact of audit partner characteristics on audit outcomes in these jurisdictions. With the adoption of Public Company Accounting Oversight Board (PCAOB) Rule 3211, mandating disclosure of audit engagement partner details for U.S.-registered public accounting firms on Form AP, there has been a surge in U.S. firm research exploring the significance of audit partner characteristics on audit outcomes in recent years. This paper outlines research that considers audit partner attributes’ influence on audit partner selection and audit quality across different economic entities. This entry contributes by synthesizing findings from recent research across diverse economic contexts, including the recently available insights from U.S.-based audits. The analysis of this entry not only provides insights into the current state of audit partner research but also delineates avenues for future research on this topic.

Keywords: audit partner characteristics; audit quality; global evidence

1. Introduction

Auditors play an essential role in validating the accuracy and reliability of financial statements prepared by companies. These statements are a primary input into the financial decisions for a wide spectrum of users, such as investors, creditors, regulators, and the public. Given the broad range of financial statement users, different parties often disagree on what constitutes the “best” disclosure policy. For example, accounting rules on expensing executive option grants reflect a comprise of divergent opinions among several regulatory agencies, such as the Public Company Accounting Oversight Board (PCAOB), the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC), and the U.S. Congress. In this article, the focus is on regulations in various jurisdictions regarding the disclosure of individual audit partner identities in mandatory financial statements.

Theoretically, the value of audited information depends on the decision facing the economic agent who consumes such accounting information [1], as the preparers and users of audited financial statements are subject to different economic forces and have divergent economic incentives [2,3]. Outside users are not generally privy to the procedures used to conduct any specific audit. For this reason, they rely heavily on the expected framework
regarding how audits are conducted rather than having specific knowledge of the audit itself. These expectations are present even after they have used it to make financial decisions (in formal economic terms, financial statements are credence goods) [4,5]. In order to lend credibility to the audit reports, audit firms strive to build a reputation of trustworthiness. The main argument in favor of naming a specific audit partner in an audit report is that it will incentivize audit partners to exert care above and beyond what they would do under anonymity. In turn, this would result in financial statements deemed by investors as being more reliable. The case of Herbalife is a real-world example that illustrates how the disclosure of individual audit partner identities could alter the outcome of an audit engagement. In 2014, Herbalife’s then auditor, KPMG, was forced to withdraw their audit reports after it was discovered that the lead audit partner was sharing insider information with a golf associate who subsequently traded on such tips. Had the identity of this individual auditor been widely available, the lead audit partner’s social ties would have been subject to greater scrutiny, which might have led to a different audit outcome [6]. Nevertheless, any regulation typically comes with a benefit and a cost. The naming of a specific partner potentially imposes costs on that partner by the possible exposure to greater litigation risk [7]. To mitigate this concern, the U.S. PCAOB changed its initial requirement making audit partners personally sign the financial statements and instead requires them to submit the Form AP directly to the PCAOB [8]. This compromise arrangement balances the costs to the auditor with the benefits to the public.

The availability of audit partner-identifying information provides data for regulators and researchers to observe variability in audit inputs. For example, auditors with characteristics such as professional skepticism, independence, experience, and ongoing professional development, among other physical characteristics, may approach audits differently and obtain different-quality results. Prior empirical studies show that firm-level and office-level details, such as size, culture, and industry specialization, have an impact on audit quality [9]. Given that considerable discourse underscores the importance of understanding individual audit partner characteristics, the number of regulations mandating the disclosure of audit partner identity information continues to grow around the world, which provides researchers with multiple avenues to test these theoretical implications [8]. Historically, Australia, New Zealand, and the U.K. in the Commonwealth; China and Taiwan in Asia; and Belgium, the Netherlands, Sweden, and Finland in Continental Europe have required their filers to disclose audit partner names. In response to this global trend, the U.S. issued PCAOB Rule 3211, requiring audit partner names to be disclosed after 1 January 2017. There are noticeable differences between these locality-specific regulations. For example, China requires two audit partner signatures as part of the audit report, whereas the U.S. only requires a singular audit partner signature. In addition, in smaller concentrated economic markets like Australia and New Zealand, the personal reputation and network of an audit partner might play a more significant role in audit quality compared with larger markets like the U.S. An extant review of audit partner archival research in emerging markets challenges researchers to evaluate their contributions and consider enhanced testing methodologies to better understand audit partner characteristic impacts on audit research [10]. As such, audit partner data from Commonwealth countries, Asian economic entities, and Continental European countries have created a large body of empirical research due to their open access to individual partner characteristics and unique economic settings, creating a path to new U.S.-based audit partner research.

This entry contributes to the literature by synthesizing recent research findings across varied economic contexts and incorporating insights from newly available U.S.-based studies. The emphasis on the legal environment and institutional background from a global perspective distinguishes this entry from other review papers on audit partner research that focuses on partners’ economic incentives, innate characteristics, and governance arrangements [10], or a single country (i.e., China) [11], or research methodology [12]. The following sections are organized by geographic setting, outlining empirical outcomes in
the audit partner characteristic space. We additionally highlight some qualitative data that underscore the importance of audit partner characteristics in practical applications.

2. Commonwealth Countries: Australia, New Zealand, the U.K.

Commonwealth countries provide insights regarding audit partner characteristics because countries such as Australia and the U.K. require audit partner name disclosures. The Corporations Act 2001 created stronger regulation around audit partner rotation and disclosure in Australia and New Zealand, making these Commonwealth countries some of the earliest adopters of such reform internationally. The Australian Auditing Standards require that the engagement partner’s name is included in the Auditor’s Report where required by law and regulation (ASA 700, paragraph 46). In the U.K., the auditor is legally required to sign the audit opinion if that firm is a legal entity or partnership. Further requirements exist within the auditing standards issued by the Auditing Practices Board (APB) and audit regulations and guidance issued by the Institute of Chartered Accountants in England and Wales (“ICAEW”) to identify audit partners.

2.1. Australia

Australian data provide audit partner names from publicly listed companies within the engagement audit report. In 2006, Australia mandated partners rotate after 5 years, in addition to the disclosure of an audit partner’s name. As a result, researchers were able to examine the impact of audit partner rotation and audit quality. The literature in Australia has shown that there is a reduction in audit quality associated with audit partners’ long tenure [13] and that there is an audit fee premium in the year of partner rotation. The audit fee premium persists in the first-year post-rotation [14]. Individual audit partners have a specific audit fee premium that is not explained by their audit firm or office, demonstrating that individual audit partner characteristics affect audit fees and possibly impact quality in the Australian setting [15]. Research also shows that audit partner busyness is not predictive of audit quality, even though the audit partner optimally chooses their busyness in equilibrium [16].

2.2. United Kingdom

The U.K. adopted standards requiring audit partner identification in 2009, providing additional insights into audit outcomes in the Commonwealth. Researchers have found that audit partners are the single most important auditor-related characteristics when accounting for firm fixed effects and client controls when explaining audit quality [17]. The U.K. has mandated expanded audit reports since 2013, describing key audit matters due to their challenging nature based on auditors’ professional judgment. Given the U.K.’s early adoption of audit partner identification requirements and expanded audit reports, the U.K. provides an ideal setting to empirically examine the impact of audit partner characteristics on expanded audit reports. Using a sample from the U.K. after 2013, researchers found that female partners disclose more key audit matters with more details but have a less optimistic tone and write less readable audit reports [18]. Furthermore, research indicates that clients who share the same partner receive key audit matters that exhibit a textual similarity 10% higher than clients with different partners, highlighting the importance of an auditor’s unique judgments [19].

3. Asian Economic Entities

Asian economic entities disclose audit partner identities and contain a wealth of literature regarding audit partner outcomes. Chinese auditing standards require the disclosure of two audit partner names via their signatures and identities on their associated audit reports as a part of Independent Auditing Standards No. 7 and the Practice Guidelines of Certified Public Accountants in China No. 1: Annual Report Audit [20,21]. Chinese data are often used as a testing source for audit partner characteristic studies because Chinese regulators mandated public firms to disclose engagement auditors’ identities before the U.S. data
became available. Chinese data are also extremely insightful because the Chinese Institute of Certified Public Accountants (CICPA) discloses additional partner information, such as gender, education, and experience, on their website. This allows researchers additional characteristic data points to execute archival empirical research. These studies have permitted researchers to provide insights that can also be applied to global market economies such as changes made to partner-level disclosures in the United States. Conversely, researchers have challenged the broad generalization of the Chinese partner data now that the U.S. and Europe are expanding their partner information [11]. Even still, a large volume of empirical research exploits the Chinese setting to gain valuable insights into the impacts of audit partner characteristics.

Utilizing Chinese data, researchers have found significant variations in audit quality between individual auditors [22]. Examining the relationship between audit partner characteristics and financial reporting quality, researchers have found that audit partners with more audit experience are less likely to be associated with an audit failure, have less discretionary accruals, and are associated with higher audit fees [23–26]. Researchers have also found that there are incremental effects related to specific audit partners’ characteristics, such as gender, engagement tenure, education, and industry specialty, in addition to experience alone on audit fees and audit quality [26]. A unique measure of audit partner workload compression based on audit fees finds that accrual quality is reduced and modified opinions are increased in auditors who have higher workload compression, with an increased risk of regulatory sanctions [27].

Additionally, researchers have found that an audit partner’s past audit failure rate impacts their subsequent audit quality, with a positive significant relationship with future restatements [24]. Audit partners suffer damage to their reputations after audit failures with major clients and have lower audit fees at subsequent engagements [7]. Partner-level evidence of audit opinion shopping is found in the Chinese setting, showing that partner shopping was more successful if the client was important to the audit firm and performed by clients with less earning quality [28]. Studies have also found that audit partners are affected by the workload and the staff size of their audit offices [29]. Hometown ties between engagement partners and review partners are negatively related to audit quality because close ties can impede monitoring functions and reduce independence [30]. Equity ownership in an audit firm changes how audit partners act, with increased monitoring provided by engagement quality partners when their equity stake is higher versus no difference in monitoring by engagement level partners based on equity stake [31]. In Taiwan, audit partner narcissism impacts audit quality, increasing audit quality with higher rates of narcissism measured by a partner’s signature size [32]. This further demonstrates that the granularity of partner data in Taiwan can also attest to the relation between audit partner characteristics and audit results.

Audit contracting and audit fee structures are highly investigated topics in audit-related empirical research. Additionally, audit partner networks can impact audit outcomes. Discounts in the initial year of audit fees have been documented across different jurisdictions and are found in Chinese data when both signing audit partners are different from one year to the next, with known reductions in audit quality [33]. Additionally, partner networks have been shown to enhance information transfers between new and rotating partners, which improves audit performance after the rotation transfer but can be a threat to the new partners’ independence [34].

Audit partner characteristics have also been associated with client firm choices. For example, Chinese research shows that clients of audit partners associated with low-quality audits are more likely to switch from equity to credit financing after the low-quality audits are revealed [35].

4. Continental European Countries

Continental European countries provide a wealth of data to allow for empirical research on audit partner characteristics because the revised EU 8th Directive (2006) requires
the disclosure of specific audit partner data in this setting. Article 28 of the directive 2006/43/EC states: “Where an audit firm carries out the statutory audit, the audit report shall be signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm.” Certain countries, including The Netherlands and Germany, mandated a partner signature before the EU implementation date, making Continental European countries a good source of audit partner research data [36].

4.1. Belgium and the Netherlands

Belgian data provide a unique setting to investigate audit partner characteristics because they provide longitudinal panel data. Additionally, the Belgian setting provides data on both public and private company audits, which expands the reach of empirical testing to the private sector. Researchers have found that audit partners in Belgium face gender discrimination within audit offices that have more male audit partners, with female audit partners having larger pay gaps, having to meet higher performance metrics, and receiving fewer desirable clients compared with their male counterparts [37]. Additionally, female audit partners have an audit fee premium, with client firms paying more audit fees to their female auditors than their male auditors [38]. In the Netherlands, researchers have not found a difference in audit quality after the disclosure of audit partner names, adding to the expanding debate about the benefits of mandatory partner disclosure [36].

4.2. Sweden

In Sweden, research has investigated individual partner-level data to determine whether Big 4 pricing is differentiated and has found significant differences in the sizes and composition of audit partner-specific clientele. One study found that while industry specialization is one area of partner-specific distinctiveness and competitive advantage, other partners have specific specializations that include the size of the company, or the complexity of business units separate from industry specialization [39]. Additionally, researchers have found that audit partner compensation can be partly attributed to individual partner performance [40]. Furthermore, at the audit partner level, audit reporting aggressiveness and conservatism endure and extend to future audits for clients from the same audit partner [41].

4.3. Finland

In Finland, audit partner specialization is negatively associated with abnormal accruals for audit partners with three to six public clients. In this study, it is more significant when the audit partners have less general auditing experience and realize the reputational implications associated with tax and financial reporting alignment within their specialized clients. These partners understand the negative reputational risks associated with accruals, discouraging tax avoidance in this setting [42]. As the increasing pervasiveness of digital interactions has raised expectations for the audit profession to comprehend digital business practices and utilize digital technologies in auditing processes, researchers in Finland have examined the effect of an audit partner’s digitalization expertise on audit fees. They have found that audit partners with digitalization expertise charge higher fees than other auditors because of their value-added service [43].

5. United States

Characteristic data at the partner level have been scant in the U.S. prior to PCAOB Rule 3211, also known as the Form AP standards, requiring disclosure of U.S. partner names to be disclosed on audit opinions starting in 2017 [8]. As a result of these Form A.P. disclosures, U.S. audit partner characteristic information has become more widespread in the literature in recent years. Prior to the revelation of partner identities, research in the U.S. has focused on audit firm- or office-level data [9]. More recently, studies have been mixed on the benefits of Rule 3211 for audit quality and audit fees. Researchers found that U.S.-based disclosure of audit partner names did not significantly change the audit
quality landscape for U.S.-based audits when comparing early adopters with those with full adoption [44]. However, other research demonstrated that the first year of audit partner disclosure as part of PCAOB Rule 3211 enhanced audit quality and audit fees [45]. Utilizing a model-based approach that incorporates the probability that an audit client will observe individual audit partners’ past performance, researchers have determined that Form AP disclosure may increase audit partners’ incentives to provide high-quality audits based on a level of internal quality control within their partnership. However, it could also decrease the partnership’s incentive to maintain good internal quality control systems, leading to a net reduction in audit quality [46]. Even with mixed evidence regarding the inherent implications of audit partner disclosure, Rule 3211 has significantly enriched audit research by making detailed audit partner characteristic data available for U.S. researchers.

Before Rule 3211, the audit partner characteristic literature in the U.S. was limited to studies that included populations based on regulatory filings. Research prior to partner name disclosure showed that auditor industry specialization and audit office experience were important factors of audit quality [47]. Research utilizing regulatory filing data showed that audit partner characteristics such as gender and experience impact the demand and supply sides of audit quality [48]. Larger geographical distances between audit partners and their clients have been shown to negatively impact audit quality [49]. Considering whether an audit partner’s psychological and behavioral experiences have impacts on their subsequent behavior, researchers have found that partners who experienced Arthur Andersen’s closure were stricter in their monitoring efforts and had lower misstatements, with clients who paid higher audit fees [50]. Gender has also been explored because of audit partner name disclosure. Research finds that audit quality has improved post-Rule 3211 for female audit partners and that female audit partners are associated with greater increases in fees and higher reporting lags [51]. Audit partner ethnicity is an additional avenue for researchers to explore. Recent studies have found that clients of ethnic minorities (audit partners of Asian, Black, or Hispanic origin) provide higher financial reporting quality, and ethnic-minority audit partners are more likely to work in smaller offices, earn lower audit fees, are non-Big 4, and have less prestigious clients [52].

Research has also explored innate personality traits that are not observable and could also affect audit quality. For example, audit partner risk tolerance research has found that audit partners with prior infractions are associated with lower levels of audit quality measured by material misstatements, “missed” material weaknesses, timely loss recognition, and audit fees [53]. In addition, auditors with industry specialization can mitigate audit risk because they possess a deeper understanding of their clients’ industry dynamics. As a result, they are more adept at assessing business risks and are inclined to safeguard their own reputation to a greater extent compared with auditors without industry specialization [54].

Recent research on audit partner characteristics has expanded the disclosure literature by considering how each individual audit partner affects audit reporting. Research has found that the similarity in audit narrative disclosures increases when two client firms have the same audit partner versus when they share the same audit firm or when they share the same audit office [55]. From a client’s perspective, common auditors may be prohibited due to confidential client information leakage concerns. Existing research points out that product market competitors are less inclined to have the same audit partner when they perceive information spillovers as more costly. Although concerns about information spillovers notably decrease the likelihood of product market rivals sharing the same audit partner, such concerns do not dissuade them from sharing the same audit office [56].

6. Qualitative Studies—International Evidence

In addition to the main empirical evidence utilizing audit partner data, further insights regarding audit partner characteristics can be obtained from international qualitative research, which adds to the international audit partner literature insights. In Canada, utilizing semi-structured interviews to gain insights regarding the practicality of revealing audit partners’ identities, researchers have found that audit partners would have taken
full accountability even without additional regulations on name disclosure. Essentially, further accountability initiatives will not change audit outcomes because partners are less concerned with managing their external reputation since their internal reputation is most important [57]. Qualitative information can further enhance research to provide insights into the practical implications and outcomes of empirical works. In Germany, considering the importance of individual attributes on whether audit employees make partners, researchers find that economic capital, social capital, and institutionalized cultural capital matter for partner promotion when investigating business-oriented social networks [58].

7. Conclusions

In summary, the landscape of public company audits is characterized by significant heterogeneity, influenced by a myriad of factors including specific audit partner attributes. While previous studies have predominantly focused on firm- and office-level distinctions, recent research has underscored the importance of individual audit partner characteristics, especially in light of the increasing availability of partner-level identification data throughout the world. The trend of audit partner-enhanced reporting is evident in Commonwealth nations such as the U.K., Australia, and New Zealand, Asian economic entities, and Continental European countries. With the enactment of PCAOB Rule 3211, the U.S. is also adding to the numerous studies around the world that investigate audit partner attributes and audit outcomes. By synthesizing recent research findings across diverse economic contexts, including insights from U.S.-based audits, this paper contributes to a deeper understanding of the impact of audit partner characteristics on specific audit outcomes. Furthermore, this entry highlights avenues for future investigation in this critical domain, emphasizing the need for continued research to enhance audit quality and effectiveness across global markets.

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