Information in Financial Statement Misstatements at the Engagement Partner Level

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Information in Financial Statement Misstatements at the Partner Level

Abstract: Using data from Taiwan where engagement partner names are disclosed and *misstatements* of clients' annual financial statements to proxy for audit quality, we examine whether audit quality at the engagement partner level persists, and whether an engagement partner's reputation for prior audit quality is informative about current audit quality. We find that at the engagement partner level, year *t-1* misstatements *made by other audit clients* predict year *t* misstatements for clients without a history of misstatements in the preceding three years, but this effect is mitigated by engagement partner experience and the quality of the concurring (second) partner. In addition, we find a positive association between the incidence of *restatements* made by an engagement partner's clients in the previous two or three years and the likelihood that a different client misstates in the current year, suggesting that partner-level restatements provide information about future audit quality. Finally, we find that an engagement partner's reputation for past client misstatements (as disclosed in restatements) is associated with a higher likelihood of that partner losing existing clients, a lower likelihood of that partner attracting new audit clients, and that these client losses persist over the next five years. Collectively, our results suggest that engagement partner identification can reveal information that is informative about audit quality and affects stakeholder perceptions of audit quality, providing some support for the Public Company Accounting Oversight Board's decision to disclose the names of engagement partners in the U.S.

Keywords: audit quality, engagement partners, misstatements, restatements

I. INTRODUCTION

After soliciting public comment on a 2009 concept release that would require engagement partners to sign their audit reports, in October 2011, the Public Company Accounting Oversight Board (PCAOB) formally proposed that names of engagement partners be disclosed. The original concept release argued that requiring engagement partner signatures

> could improve audit quality in two ways. First, it might increase the engagement partner's sense of accountability to financial statement users, which could lead him or her to exercise greater care in performing the audit. Second, it would increase transparency about who is responsible for performing the audit, which could provide useful information to investors and, in turn, provide an additional incentive to firms to improve the quality of all of their engagement partners

(PCAOB 2009, p. 5). The 2009 concept release and 2011 proposal generated strong responses from investors, academics, and practitioners. A comment letter written by the Texas Society of Certified Public Accountants (TSCPA) states:

> We believe this [exposure draft] has many flaws in both the basis for its issuance and the guidance it proposes… The justification for this document appears to come from the views of the Council of Institutional Investors and inconclusive research provided by the academic community. The focus of the document seems to be on rectifying the inadequacies of those in charge of audit engagements by identifying them and publicizing the perception of their inappropriate performance. We believe this is a very poor basis for the development of an auditing standard!

Interestingly, the TSCPA's comment letter claims that the PCAOB's exposure draft is based on "inconclusive research provided by the academic community" (TSCPA 2011, p. 1).

In 2013, the PCAOB formally reproposed the standard, again requiring engagement partner name disclosure. Commenting on the 2013 reproposed standard, PCAOB Chairman James Doty remarked that the requirement "holds the promise of improving audit quality by sharpening the mind and reminding auditors of their responsibility to the public."[1] The PCAOB's position seems to imply that, in addition to increasing an engagement partner's sense of

[1] See http://pcaobus.org/News/Speech/Pages/12092013_Doty_AICPA.aspx.

accountability, engagement partner reputation should be informative about audit quality.[2] Moreover, PCAOB board member Louis Ferguson argued that the 2013 reproposed standard would result in greater transparency about the engagement partner's reputation for audit quality:[3]

> I do think over time … that information will be gathered about these auditor partners, probably by third-party information providers, including things like the industry experience of that auditor, the public companies with which the auditor has been associated, whether the auditor has been involved in public disciplinary proceedings or litigation or been involved in publicly-disclosed financial restatements, as well as information about the professional activities of the auditor. I believe that this would be useful information to investors.

Despite its expected benefits, the proposal received strong opposition from some audit practitioners, who argue that the current practice of signing the audit firm name already makes the firm as well as individual audit partners responsible for the quality of the audit report.[4] In addition, the sentiments in the TSCPA's comment letter were echoed by PCAOB board member Jeannette Franzel, who, when the PCAOB reproposed this standard in late 2013, stated:[5]

> I'm starting to think that naming the audit engagement partner in the auditor's report is a solution in search of a problem. First, as I said, the objectives of this project are difficult to follow over its various iterations. Second, the current release does not articulate how the proposed solution addresses any particular problem; nor does it present an analysis of benefits that is supported by data. Finally, many questions remain unanswered about the potential costs and exposure of auditors to additional liability.

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[2] This is consistent with arguments related to the recent conviction of senior KPMG partner Scott London for insider trading activities. For example, in light of this revelation, defense attorney Patrick Craine argued, "If you look at a case like this, KPMG initially failed to disclose the name of the audit partners involved. Even once the name of the audit partner was disclosed, you had no idea what other audits he may have been leading. And as an investor, it would have been very interesting to know what other audits he was leading because they were likely to have implications as well…" Also see "PCAOB Could Toughen Auditor Rules after KPMG Insider Trading Case" at *accountingtoday.com* (April 12, 2013).

[3] See http://pcaobus.org/News/Speech/Pages/12042013_Ferguson_oral.aspx.

[4] See, for example, http://pcaobus.org/Rules/Rulemaking/Docket029/014b_TSCPAs.pdf. Moreover, the minutes of the PCAOB's November 9, 2011 Standing Advisory Group meeting state, "…it would be misleading because the audit is…a collective enterprise and requires resources of many, many different people in the firm" (see http://pcaobus.org/Rules/Rulemaking/Docket029/11092011_SAG_Transcript_Excerpt_and_Slides.pdf).

[5] See http://pcaobus.org/News/Speech/Pages/12042013_Franzel_Transparency.aspx.

PCAOB board member Jay Hanson also expressed concerns that the reproposed engagement partner disclosure has not been proven beneficial and is potentially risky.[6] Finally, the Illinois CPA Society stated, "We believe that the disclosure of the engagement partner's name and information about other participants in the audit will not provide truly useful information to investors and other financial statement users. While the information may be 'used' for numerous purposes … the how, why or to what extent that information may really be 'useful' is not evident."[7]

Responding to this debate, in December 2013, the PCAOB formally requested comments on their reproposed standard.[8] The request for comments asks,

> Over time, would the reproposed requirement to disclose the engagement partner's name allow databases and other compilations to be developed in which investors and other financial statement users could track certain aspects of an individual engagement partner's history, including, for example, his or her industry expertise, restatement history, and involvement in disciplinary proceedings or other litigation?
> a. Would such databases or compilations be useful to investors and other financial statement users? If so, how?
> b. Would they provide investors and audit committees with relevant benchmarks against which the engagement partner could be compared? If so, how?

Once again, objections were voiced from a variety of sources.[9] Despite these objections, in 2016, the PCAOB adopted new rules requiring that each issuer file a new PCAOB form disclosing the name of the engagement partner and others participating in the audit (PCAOB 2015).

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[6] See http://pcaobus.org/News/Speech/Pages/12042013_Hanson_Transparency.aspx.
[7] See http://pcaobus.org/Rules/Rulemaking/Docket029/019c_ILCPAS.pdf.
[8] See http://pcaobus.org/Rules/Rulemaking/Docket029/PCAOB%20Release%20No%20%202013-009%20-%20Transparency.pdf.
[9] According to "PCAOB Proposal to Name Engagement Partner May Generate Debate" in *Journal of Accountancy* (December 2, 2013), available at: http://www.journalofaccountancy.com/News/20139121.htm: BDO stated, "[w]e believe that there is already a sufficient level of accountability in the existing environment, obviating the need for engagement partner identification"; the Audit and Assurance Services Committee of the Illinois CPA Society stated, "[t]he name of the engagement partner would provide no more protection to investors than the names of the chief of drilling operators of oil companies could protect the Gulf of Mexico from oil spills"; EY stated, "[w]e do not believe that a partner's name would add anything useful to the total mix of information relied upon by investors and will likely cause some persons to make incorrect inferences about audit partners and audits"; and the Accounting

In recent years, several studies have examined whether engagement partner disclosure is useful to financial statement users. Some of this research suggests that individual engagement partners impact audit quality (Knechel et al. 2015; Wang et al. 2015; Li et al. 2017). In addition, Carcello and Li (2013) examine the impact of engagement partner name disclosure on audit quality in the U.K. They find evidence that suggests that greater visibility leads to higher quality audits. Other research also finds evidence that engagement partner disclosure is useful to investors (Aobdia et al. 2015; Gul et al. 2016) and lenders (Chi et al. 2017). In this study, we first provide further evidence on whether such disclosure can be informative about audit quality. Although prior research has examined this question using data from China (Wang et al. 2015; Li et al. 2017), Chi et al. (2012) note that the Chinese setting may be less generalizable to other market-based economies. For instance, Chinese listed companies are owned primarily by local governments, are disciplined by regulators rather than market forces, and only a small percentage are audited by the Big N audit firms. We also extend these studies by also examining whether engagement or concurring partner experience or concurring partner quality can mitigate the persistence of misstatements at the engagement partner level. Second, we investigate whether companies use the information available from engagement partner name disclosures when making partner engagement decisions.

Using data from Taiwan, which has an audit market and auditing standards more similar to other market-based economies such as the U.S. and where engagement partners are required to sign the audit reports (so engagement partner names disclosed),[10] we examine whether annual

Principles and Auditing Standards Committee of the California Society of CPAs stated, "[t]he name of the engagement partner is not meaningful information to investors."

[10] "Although identifying the engagement partner by name is not identical to requiring the partner to sign the report, such public identification may serve to increase partner accountability and transparency" (Carcello and Li 2013, p. 1512).

financial statement *misstatements* and financial statement *restatements* (i.e., publicly disclosed corrections of prior period misstatements) can provide information about future annual financial statement misstatements *of other clients* with the same engagement partner in charge. In our tests, we exclude companies that have misstated in the past three years so that our results are not a function of client-specific financial reporting quality.[11] First, we examine whether companies with an engagement partner whose other clients *misstated* their annual financial statements in the past year are more likely to misstate their annual financial statements in the current year (relative to companies with an engagement partner whose other clients did not misstate their annual financial statements in the past year). In addition, we examine whether this "persistence of misstatements" is affected by the engagement partner's general audit experience, industry-specific experience, or client-specific tenure, or the concurring (second) partner's general or industry experience and quality of audits performed as an engagement partner. We also test whether revealed misstatements (in the form of *restatements*) in prior years provides information about the likelihood that the engagement partner's other clients misstate in the current year. Finally, because the loss of audit clients or the inability to attract new audit clients following restatement announcements suggests that the audit market penalizes engagement partners for poor audit quality, we examine whether an engagement partner is more likely to lose audit clients and/or less likely to attract new audit clients after at least one of his clients restates.

We find that the likelihood of a company misstating its financial statements in the current year is significantly higher if at least one of its engagement partner's other clients misstated their annual financial statements in the prior year. This is consistent with evidence from Li et al.

[11] In untabulated analyses, however, we find that our results are stronger when we retain these companies.

(2017), which finds that poor audit quality contagion effects at the office-level manifest among certain partners, but do not extend across all engagement partners in the office.

We posit that engagement partner experience could affect audit quality because experience can affect engagement partners' ability to detect their clients' aggressive accounting choices (or their willingness to allow clients to make these choices). Research using data from Australia and Taiwan finds that engagement partner tenure is associated with proxies for audit quality (Carey and Simnett 2006, Chen et al. 2008).[12] We find that an engagement partner's general audit experience reduces the persistence of misstatements, suggesting that general audit experience is important for ensuring higher audit quality.[13] We also posit that the experience and quality of the concurring (second) partner can increase the quality of the audit. We find that when the concurring (second) partner is not involved in any client restatements as an engagement partner in the previous year, the likelihood of persistent misstatements is attenuated, suggesting that the quality of concurring partners can improve audit quality.

We also suggest that individual engagement partners build reputations for audit quality,[14] and that the public disclosure of misstatements (in the form of restatements) can be informative about future audit quality and about perceptions of audit quality. Specifically, we find that restatements issued by an engagement partner's clients in the past two or three years are associated with a higher likelihood of that engagement partner's other clients misstating in the

[12] For example, Carey and Simnett (2006) find that in Australia, longer engagement partner tenure is associated with greater earnings management (i.e., higher levels of discretionary accruals and a higher propensity to meet or just beat earnings expectations) as well as a lower likelihood of issuing going concern opinions. Alternatively, Chen et al. (2008) find evidence consistent with engagement partner tenure reducing earnings management in Taiwan.
[13] Interestingly, our discussions with a former senior partner of a Big 4 audit firm reveal that larger audit firms commonly assign more senior engagement partners as 'senior advisory partners' on audit engagements in order to ensure that less experienced engagement partners do not acquiesce to client demands. However, whether advisory engagement partner experience can effectively restrain aggressive accounting practices is unclear. For example, the senior partner assigned to David Duncan failed prevent the Arthur Andersen–Enron debacle (Squires et al. 2003).
[14] Consistent with this, Koch (2011) finds that engagement partner experience affects audit pricing in Germany.

current year. Finally, we find that an engagement partner with a history of past restatements is more likely to lose existing clients and less likely to attract new audit clients.

In additional analyses, we find that engagement partner client losses persist over a five year horizon. We also find that these partners are more likely to lose concurring (second) partner assignments and to no longer serve clients within the next five years. Additionally, the clients these partners continue to serve exhibit increased risk characteristics. These findings suggest that engagement partners face consequences for lower quality audits and that stakeholders can gain valuable information from engagement partner identification. The results suggest that stakeholders use this information to form opinions about partner level audit quality. However, the findings also suggest that clients may not be fully able to distinguish persistent audit quality issues from more transitory issues, as the increased likelihood of partner turnover is not attenuated when that partner has greater experience in general.

Overall, our study provides evidence that the disclosure of individual engagement partner names is informative about audit quality for companies in Taiwan. As such, our findings provide indirect support for the PCAOB's new requirement to disclose engagement partner names.

Our paper proceeds as follows. Section 2 reviews the literature and develops our hypotheses. Section 3 describes our sample selection methodology and research design. Section 4 describes the sample and presents empirical results. Section 5 concludes.

2. LITERATURE REVIEW AND DEVELOPMENT OF HYPOTHESES

Early research focused on audit firm-level auditor characteristics as determinants of financial reporting quality. The literature concludes that financial reporting quality is higher when the audit firm is large (i.e., is one of the Big N audit firms), has industry expertise, and has longer tenure with the client (Myers et al. 2003, Francis 2011, Knechel et al. 2013). However,

Francis (2011) suggests supplementing findings at the audit firm-level with research on the impact of individual auditors. We answer the call for engagement partner-level research in Francis (2011) and we add to the stream of research examining the effect of characteristics of individual auditors on audit quality.

An engagement partner's ability to exercise professional skepticism and withstand pressure from clients is critical, especially when the client is important to the audit firm and/or to the partner's client portfolio. Experimental evidence suggests that an audit partner's inherent traits affect his level of skepticism (Hurtt et al. 2008). Moreover, engagement partners lead other members of the audit team and tend to steer audit team judgments towards their own (Peytcheva and Gillett 2011). For instance, when audit managers perceive stronger partner pressure to retain clients, they are more likely to acquiesce to the client's aggressive accounting choices (Cohen and Trompeter 1998). Similarly, an engagement partner's focus on audit efficiency can lead audit managers to place inappropriate reliance on the work of internal auditors and to exercise lower levels of professional skepticism (Brown et al. 1999, Gramling 1999, Knechel et al. 2013). Exacerbating this problem, Messier et al. (2008) find that engagement partners tend to be overconfident about their subordinates' abilities to detect accounting malfeasance, although concurring partner reviews can reduce this bias (Woods 2011, Knechel et al. 2013).

Because individual engagement partners are key to audit quality, an engagement partner's reputation for conducting high or low quality audits should be informative to financial statement users. This was one of the basic arguments in the PCAOB's proposal to require companies to disclose engagement partner names. Consistent with the notion that knowledge of engagement partner names can be useful, some prior research suggests that individual engagement partners affect audit quality. For example, Carcello and Li (2013) find that when partners are required to

sign their audit reports in the U.K., abnormal accruals and the likelihood that their clients beat earnings benchmarks falls. In addition, using data from Sweden, Knechel et al. (2015) find that both aggressive and conservative auditor reporting, measured by the frequency of Type I and Type II going concern error rates, persist over time and extend across an engagement partner's clients.[15] Our study complements Knechel et al. (2015) because we include companies that are not financially distressed and we examine the persistence of misstatements, which are more prevalent than going concern opinions. In addition, using data from China, Wang et al. (2015) find that an engagement partner's past audit failure rate (measured using restatements for all the partner's clients) is positively associated with the probability that current year financial statements are subsequently restated. Li et al. (2017) also find, using data from China, that auditors who have delivered low quality audits have an increased likelihood of low quality audits both over time and to other audits performed by these auditors in the same year. Although our examination is related to Wang et al. (2015) and Li et al. (2017), we extend their work by confirming that their main result is generalizable outside of China to a market-based economy more similar to the U.S. (Chen et al. 2008; Chi et al. 2012), and by also examining the impact of the engagement and concurring partners' experience (general and industry) on this relation. Additionally, we examine whether clients appear to use this information when selecting and retaining auditors.

Prior research also suggests that engagement partner characteristics are important for audit quality. For example, Chin and Chi (2009) find that engagement partner expertise (i.e., industry-specific market share) is associated with a lower likelihood of future restatements. In

[15] Type I errors result when going concern opinions are issued to non-failing clients and Type II errors result when failing clients do not receive going concern opinions. The observed frequencies of Type I and Type II errors are indirect measures of audit quality because what causes auditors to issue or not issue going concern opinions in different situations it is not entirely clear (Knechel et al. 2013).

addition, Francis (2011, p. 138) argues that "partners will face more threats to their objectivity and independence if their compensation is locally tied to their personal portfolios or to office-level clienteles." Consistent with this reasoning, experimental evidence suggests that when engagement partner compensation is tied to client retention, downward audit adjustments are less likely (Trompeter 1994). Thus, poorly structured engagement partner compensation arrangements could lead to an increase in the likelihood of client misstatements but these compensation arrangements cannot be publicly observed.

An emerging literature suggests that top executives' individual preferences and risk-aversion impact firms' financial and accounting policies (e.g., Bamber et al. 2010, Ge et al. 2011, McGuire et al. 2012). We suggest that, similarly, individual engagement partner characteristics should matter for audit quality. Because a history of individual engagement partner-level data are not available in the U.S., an assessment of whether the likelihood of audit failures varies across individual partners cannot be made using data from the U.S. audit market. U.S.-based audit research therefore tends to focus on whether audit firm characteristics are determinants of financial reporting quality (Francis 2011, Knechel et al. 2013).

We note, however, that there are reasons to believe that we might not observe differences in audit quality across engagement partners. For example, the TSCPA's comment letter argues that audit firms' quality control policies, professional ethics, rules, and peer review programs can prevent systematic malfeasance by certain engagement partners.[16] Moreover, Hilary and Lenox (2005) suggest that audit firms' peer review programs can improve audit quality because

[16] See "RE: Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2," available at: http://www.accountingtoday.com/news/TSCPAletterPCAOBImprovingTransparencyinAudits.php. Note, however, that academic research finds that quality control policies within firms, while generally beneficial, are not always effective. Some factors identified in prior literature as negatively affecting quality control reviews are known reviewer preferences, partner over-confidence, assumed preparer reputation, and congruency of the opinions of reviewers and preparers. These negative factors can be mitigated, however, when the level of review is higher (Knechel et al. 2013).

negative peer review opinions result in client losses. Thus, at least some negative individual engagement partner effects on audit quality could be mitigated by firm- and profession-level institutional safeguards. Given that there is some question about whether audit quality is observable at the audit partner level, we test our first alternative hypothesis:

> **H1:** The likelihood that a client misstates its annual financial statements will be higher if at least one of its engagement partner's other clients misstated its annual financial statements in the prior year.

Prior research demonstrates that longer engagement partner tenure is associated with higher accounting quality (Manry et al. 2008) and also finds that more experienced auditors are better at detecting financial statement errors, have more accurate knowledge of error occurrence rates, and are better able to categorize errors (Libby and Frederick 1990). Thus, misstatements associated with more experienced auditors (i.e., engagement partners with more general audit experience, experience in the client's industry, or experience with a given client (i.e., tenure)) could be more transitory in nature. Likewise, misstatements could be more transitory in nature when the concurring (second) audit partner delivers higher audit quality, or has greater industry and/or general experience serving as an engagement partner. We investigate these possibilities in our empirical tests.

Past misstatements become public when companies restate their financial statements. Thus, we investigate whether past restatements issued by an engagement partner's clients provide information about the likelihood that other clients will misstate in the current year. Because misstatements take some time to be revealed as restatements and because market participants can consider an engagement partner's history of misstatements, in our empirical tests, we focus on the incidence of restatements over the past two and three years.

Finally, prior literature suggests that clients suffer adverse consequences when they

restate. For example, the market penalizes restating companies with negative stock price reactions (Palmrose et al. 2004), an increased cost of capital (Hribar and Jenkins 2004), and higher executive turnover (Desai et al. 2006). Moreover, companies take actions to 'repair' their tarnished reputations after restatements (Chakravarthy et al. 2014). Prior research also finds that audit firms are more likely to lose clients and/or are less likely to gain new clients following problems with audit quality,[17] and Swanquist and Whited (2015) finds that reputation effects are located at the audit office level in that audit offices associated with past restatements experience market share losses. We extend this thinking to the engagement partner level. Specifically, because restatements are costly to clients, both in terms of audit fees and market perceptions,[18] audit clients should want to avoid engaging partners whose audits are associated with subsequent financial statement restatements. If certain partners are known to provide lower quality audits, we expect their personal reputations to suffer, reducing their ability to attract new business and to retain their current clients. Furthermore, because audit firms are likely to care about the quality of audit work provided by their partners, they may reassign the clients of partners associated with audit failures to other partners or may avoid assigning newly engaged clients to partners associated with lower quality audits. In either case, audit failures (in the form of restatements), should be associated with future client losses.[19] Thus, our second alternative hypothesis is as follows:

> **H2**: Restatements are associated with a higher likelihood of client losses and a lower likelihood of new client acquisitions at the engagement-partner level.

[17] See, for example, Firth (1990), Wilson and Grimlund (1990), Hilary and Lennox (2005), Blouin et al. (2007), Weber et al. (2008), Daugherty et al. (2011), Skinner and Srinivasan (2012), Abbott et al. (2013), Hennes et al. (2014), and Boone et al. (2015).

[18] For example, Feldmann et al. (2009) document an average decrease in audit fees of 17 percent following a restatement and Palmrose et al. (2004) document an average stock price reaction of -9 percent to restatements announced in the U.S. prior to the passage of the Sarbanes Oxley Act of 2002.

[19] This is also consistent with results in Lambert et al. (2012), which show that in an experimental setting, prospective investors are less willing to invest in a company audited by an engagement partner with a previously restating client.

3. SAMPLE SELECTION, METHODOLOGY, AND RESEARCH DESIGN

We use data from Taiwan to test our hypotheses because in Taiwan, audit reports include the names of the two engagement partners along with the name of the audit firm. Following Chin and Chi (2009), we focus on the lead signing partner in all of our analyses.[20] Another unique feature of the Taiwanese audit market is that data are available for both publicly listed and privately owned companies.[21] We use the database provided by the Taiwan Economic Journal (TEJ) to collect all publicly disclosed financial statement data. Thus, we can include the engagement partner's publicly listed clients and unlisted clients in our analyses.

H1 predicts that a client is more likely to misstate if its engagement partner was associated with at least one misstatement made by another client in the prior year. This hypothesis conjectures that audit quality is 'sticky' at the engagement partner level. To test H1, we follow prior research (Hribar and Jenkins 2004, Palmrose et al. 2004, Desai et al. 2006, Cao et al. 2012) and use the likelihood of misstatements to proxy for audit quality. We estimate the following logit regression:

$$\begin{aligned} MISSTATE_t = {} & a_0 + a_1 MISSTATE\_PARTNER_{t-1} \\ & + a_2 LONG\_PARTNER\_GEN\_EXPERIENCE_t \\ & + a_3 LONG\_PARTNER\_IND\_EXPERIENCE_t + a_4 LONG\_PARTNER\_TENURE_t \\ & + a_5 LONG\_PARTNER2\_GEN\_EXPERIENCE_t \\ & + a_6 LONG\_PARTNER2\_IND\_EXPERIENCE_t + a_7 PARTNER\_IND\_EXPERT_t \\ & + a_8 MISSTATE\_FIRM_{t-1} + a_9 FIRM\_TENURE_t + a_{10} LASSET_t + a_{11} \Delta ASSET_t \end{aligned}$$

[20] Chin and Chi (2009, p. 731) state that the lead signing engagement partner "typically directs the total effort, interprets the audit evidence, and ultimately determines the appropriate audit report (Francis et al. 1999; Reynolds and Francis 2000). Finally, the lead partner generally exhibits more hands-on experience during the audit engagement than the concurring partner (Reynolds and Francis 2000)." Consistent with this argument, Chin and Chi (2009) find that the industry experience of the lead engagement partner has a stronger effect on audit quality than that of the concurring partner. Thus, we limit our analyses to the lead signing partner.

[21] The Taiwan Securities and Exchange Act mandates that all companies issuing securities, including those listed on the Taiwan Stock Exchange Corporation and GreTai Securities Market as well as unlisted companies, publicly disclose audited financial statements. Before 2001, the mandatory reporting requirement applied to both publicly listed and privately held companies with contributed capital exceeding a certain threshold (Taiwan dollars (TWD) 200 million after 1981 and TWD 500 million after 2000). The reporting requirement for privately held companies was rescinded in 2001 so public disclosure of audited financial statements was at management's discretion. Thus, not all unlisted companies are included in the TEJ database.

$$+ a_{12}AR\_IN_{t-1} + a_{13}FOREIGN_{t-1} + a_{14}FINANCING_{t-1} + a_{15}LEV_{t-1} + a_{16}ROA_{t-1} + a_{17}LOSS_{t-1} + a_{18}STD\_CFO_t + a_{19}HERF_{t-1} + a_{20}LISTED_t + a_{21}OWNERSHIP_{t-1} + a_{22}LBOARD\_SIZE_{t-1} + INDUSTRY\ FIXED\ EFFECTS + e_t \quad (1)$$

where:

$MISSTATE_t$	= an indicator variable set equal to one if the current year's annual financial statements are misstated, and zero otherwise;
MISSTATE_PARTNER	= an indicator variable set equal to one if the client's engagement partner was associated with at least one misstatement (made by another client) in the past year, and zero otherwise;
LONG_PARTNER_ GEN_EXPERIENCE	= an indicator variable set equal to one if the engagement partner's general audit experience to date exceeds the sample mean, and zero otherwise, where general audit experience is measured as number of years since the partner was first identified in the TEJ database;
LONG_PARTNER_ IND_EXPERIENCE	= an indicator variable set equal to one if the engagement partner's industry experience to date exceeds the sample mean, and zero otherwise, where industry experience is measured as number of years that the partner has audited clients in the given 2-digit TEJ code industry;
LONG_PARTNER_TENURE	= an indicator variable set equal to one if the engagement partner's client tenure to date exceeds the sample mean, and zero otherwise, where client tenure is defined as the length of the engagement partner-client relationship;
LONG_PARTNER2_ GEN_EXPERIENCE	= an indicator variable set equal to one if the concurring (second) partner's general audit experience to date while serving as an engagement (first) partner exceeds the sample mean, and zero otherwise, where general audit experience is measured as number of years since the partner was first identified in the TEJ database;
LONG_PARTNER2_ IND_EXPERIENCE	= an indicator variable set equal to one if the concurring (second) partner's industry experience to date while serving as an engagement (first) partner exceeds the sample mean, and zero otherwise, where general audit experience is measured as number of years since the partner was first identified in the TEJ database;
PARTNER_IND_EXPERT	= an indicator variable set equal to one if the engagement partner is an industry expert, and zero otherwise, where industry experience is measured as number of years that the partner has audited clients in the given 2-digit TEJ code industry;

MISSTATE_FIRM	= an indicator variable set equal to one if the audit firm was associated with at least one misstatement (made by another client) in the prior year, and zero otherwise;
FIRM_TENURE	= the length of the audit firm-client relationship to date;
LASSET	= the natural log of total assets, to proxy for company size;
Δ*ASSET*	= the percentage change in total assets during the year, to proxy for growth;
AR_IN	= the sum of accounts receivable and inventory deflated by total assets;
FOREIGN	= the proportion of company sales generated in foreign countries, to proxy for a complexity;
FINANCING	= an indicator variable set equal to one if the number of shares outstanding increases by at least 10 percent or if the value of long-term debt increases by at least 20 percent during the year, and zero otherwise (following Cao et al. (2012));
LEV	= leverage, measured as the ratio of total debt to total assets;
ROA	= return on assets (i.e., net income divided by average total assets), to proxy for company profitability;
LOSS	= an indicator variable set equal to one if the company reports negative net income in the year, and zero otherwise;
STD_CFO	= the standard deviation of operating cash flows over the prior four years;
HERF	= industry concentration, measured using the Herfindahl index;
LISTED	= an indicator variable set equal to one if the company is listed on a stock exchange, and zero otherwise;
OWNERSHIP	= the percentage of common stock owned by insiders, where insiders are defined as managers, directors, and members of the supervisory board;
LBOARD_SIZE	= the natural log of board size; and
t	= a year indicator.

In all of our regression models, we winsorize all continuous variables at their 1st and 99th percentiles to mitigate the influence of potential outliers. We also cluster-adjust all test statistics at the audit client and year levels (Gow et al. 2010) and include industry fixed effects. We follow Cao et al. (2012) to the extent possible when selecting control variables that affect misstatements.[22]

H1 predicts a positive coefficient on $MISSTATE\_PARTNER_{t-1}$. That is, we expect that a client will be more likely to misstate its annual financial statements if at least one of its engagement partner's other clients misstated their annual financial statements in the prior year. In addition, if audit quality is persistent at the audit-firm level, we would expect a positive coefficient on $MISSTATE\_FIRM_{t-1}$.

We further examine whether the ability of prior misstatements to predict future misstatements varies with engagement partner experience as follows:

$$
\begin{aligned}
MISSTATE_t = {} & \lambda_0 + \lambda_1 MISSTATE\_PARTNER_{t-1} \\
& + \lambda_2 LONG\_PARTNER\_GEN\_EXPERIENCE_t \\
& + \lambda_3 MISSTATE\_PARTNER_{t-1} * LONG\_PARTNER\_GEN\_EXPERIENCE_t \\
& + \lambda_4 LONG\_PARTNER\_IND\_EXPERIENCE_t \\
& + \lambda_5 MISSTATE\_PARTNER_{t-1} * LONG\_PARTNER\_IND\_EXPERIENCE_t \\
& + \lambda_6 LONG\_PARTNER\_TENURE_t \\
& + \lambda_7 MISSTATE\_PARTNER_{t-1} * LONG\_PARTNER\_TENURE_t \\
& + \lambda_8 LONG\_PARTNER2\_GEN\_EXPERIENCE_t \\
& + \lambda_9 MISSTATE\_PARTNER_{t-1} * LONG\_PARTNER2\_GEN\_EXPERIENCE_t \\
& + \lambda_{10} LONG\_PARTNER2\_IND\_EXPERIENCE_t \\
& + \lambda_{11} MISSTATE\_PARTNER_{t-1} * LONG\_PARTNER2\_IND\_EXPERIENCE_t \\
& + \lambda_{12} PARTNER2\_QUALITY_t \\
& + \lambda_{13} MISSTATE\_PARTNER_{t-1} * PARTNER2\_QUALITY_t \\
& + \lambda_{14} PARTNER\_IND\_EXPERT_t + \lambda_{15} RESTATE\_FIRM_{t-1} + \lambda_{16} FIRM\_TENURE_t
\end{aligned}
$$

[22] We do not include company reputation, mergers and acquisitions, and the number of segments because this information is not available in Taiwan. In addition, audit fees and non-audit fees are required disclosures only when the ratio of non-audit to audit fees at least 0.25 or the amount of non-audit fees is at least 500,000 TWD, the client switches audit firms and the subsequent audit fees are less than the previous audit fees, or when audit fees are at least 15 percent lower than in the prior year. We do not include market-to-book ratio and stock return volatility because our sample includes non-listed companies. We do not include board independence because these data are not machine-readable for our sample. Finally, we consider financing activity but use a different measure since the measure in Cao et al. (2012) requires data about mergers and acquisitions (which are unavailable).

$$+ \lambda_{17}LASSET_t + \lambda_{18}\Delta ASSET_t + \lambda_{19}AR\_IN_{t-1} + \lambda_{20}FOREIGN_{t-1} + \lambda_{21}FINANCING_{t-1}$$
$$+ \lambda_{22}LEV_{t-1} + \lambda_{23}ROA_{t-1} + \lambda_{24}LOSS_{t-1} + \lambda_{25}STD\_CFO_t + \lambda_{26}HERF_{t-1} + \lambda_{27}LISTED_t$$
$$+ \lambda_{28}OWNERSHIP_{t-1} + \lambda_{29}LBOARD\_SIZE_{t-1} + INDUSTRY\ FIXED\ EFFECTS$$
$$+ e_t \qquad (2)$$

where:

PARTNER2_QUALITY = one of two variables: 1) *PARTNER2_QUALITY_NOMISSTATE* = an indicator variable set equal to one if the client's concurring (second) partner was not associated with any misstatement while serving as an engagement (first) partner in the past year, and zero otherwise, or 2) *PARTNER2_QUALITY_NORESTATE* = an indicator variable set equal to one if the client's concurring (second) partner was not associated with a restatement while serving as an engagement (first) partner in the past year, and zero otherwise; and

all other variables are as previously defined.

If engagement partner general, industry-specific, or client-specific experience mitigates the persistence of poor audit quality, then the coefficients on the interactions between $MISSTATE\_PARTNER_{t-1}$ and $LONG\_PARTNER\_GEN\_EXPERIENCE_t$, $LONG\_PARTNER\_IND\_EXPERIENCE_t$, and $LONG\_PARTNER\_TENURE_t$ will be negative and significant, respectively. Likewise, if the concurring (second) partner's quality or experience (general or industry) mitigates the persistence of poor audit quality, then the coefficients on the interactions between $MISSTATE\_PARTNER_{t-1}$ and *PARTNER2_QUALITY*, $LONG\_PARTNER2\_GEN\_EXPERIENCE_t$, and $LONG\_PARTNER2\_IND\_EXPERIENCE_t$ will be negative and significant respectively.

We also test whether prior *restatements* are associated with current year misstatements at the engagement partner level. Here, we estimate the following logistic regression:

$$MISSTATE_t = \eta_0 + \eta_1 PAST\_RESTATE\_PARTNER2(3)$$
$$+ \eta_2 LONG\_PARTNER\_GEN\_EXPERIENCE_t$$
$$+ \eta_3 LONG\_PARTNER\_IND\_EXPERIENCE_t + \eta_4 LONG\_PARTNER\_TENURE_t$$
$$+ \eta_5 PARTNER\_IND\_EXPERT_t + \eta_6 PAST\_RESTATE\_FIRM2(3)$$

$$+ \eta_7 FIRM\_TENURE_t + \eta_8 LASSET_t + \eta_9 \Delta ASSET_t + \eta_{10} AR\_IN_{t-1} + \eta_{11} FOREIGN_{t-1}$$
$$+ \eta_{12} FINANCING_{t-1} + \eta_{13} LEV_{t-1} + \eta_{14} ROA_{t-1} + \eta_{15} LOSS_{t-1} + \eta_{16} STD\_CFO_t$$
$$+ \eta_{17} HERF_{t-1} + \eta_{18} LISTED_t + \eta_{19} OWNERSHIP_{t-1} + \eta_{20} LBOARD\_SIZE_{t-1}$$
$$+ INDUSTRY\ FIXED\ EFFECTS + e_t \quad (3)$$

where:

PAST_RESTATE_PARTNER2(3) = an indicator variable set equal to one if the client's engagement partner was associated with at least one restatement announcement (made by another client) in the past two (or three) years, and zero otherwise;

PAST_RESTATE_FIRM2(3) = an indicator variable set equal to one if the audit firm was associated with at least one restatement announcement (made by another client) in the past two (or three) years, and zero otherwise; and

all other variables are as defined earlier.

If past restatements predict current misstatements at the engagement partner level, the coefficient on *PAST_RESTATE_PARTNER2(3)* will be positive and significant.[23]

To examine the prediction in H2 – that an engagement partner's likelihood of losing current audit clients increases and of attracting new audit clients decreases if she was associated with a prior-year restatement – we modify the audit firm turnover regression model in Boone et al. (2014) as follows:[24]

$$CH\_PARTNER_t = \zeta_0 + \zeta_1 PREDECESSOR\_RESTATE2(3)$$
$$+ \zeta_2 SUCCESSOR\_RESTATE2(3) + \zeta_3 LASSET_t + \zeta_4 \Delta ASSET_t + \zeta_5 \Delta HASSET_t$$
$$+ \zeta_6 ABS\_DACC_t + \zeta_7 MAO_t + \zeta_8 ROA_t + \zeta_9 GC_t$$
$$+ \zeta_{10} LONG\_PARTNER\_TENURE_{t-1} + \zeta_{11} LOSS_t + \zeta_{12} LISTED_t + \zeta_{13} LEV_t$$
$$+ \zeta_{14} \Delta LEV_t + \zeta_{15} INVREC_t + \zeta_{16} CASH_t + \zeta_{17} FOREIGN_t + \zeta_{18} FINANCING_t$$

[23] In untabulated analyses, we test for, but do not find, an association between partner restatements in only the one year prior and current misstatements.

[24] Boone et al. (2014) use a similar model to examine whether Deloitte lost more audit clients and/or gained fewer audit clients following the PCAOB disciplinary order against it in 2007. We include the variables in Boone et al. (2014) to the extent possible but do not control for client/auditor mismatch because we require that the client does not change audit firms for this test. However, we also control for the audit firm type (Big N) because Big N firms may be more likely to rotate engagement partners since they should have more partners and multiple partners with related audit expertise. We also do not control for abnormal audit fees because the audit fee data are not widely available for Taiwanese companies or for client mergers and acquisitions because TEJ does not provide these data. Finally, we supplement the Boone et al. (2014) model with additional control variables from Equation (1).

$$+ \zeta_{19}OWNERSHIP_t + \zeta_{20}FIRM\ TENURE_t + \zeta_{21}LBOARD\_SIZE_t + \zeta_{22}STD\_CFO_t + \zeta_{23}HERF_t + \zeta_{24}Big\ N_t + INDUSTRY\ FIXED\ EFFECTS + e_t \quad (4)$$

where:

$CH\_PARTNER_t$ = an indicator variable set equal to one if the year *t* engagement partner (i.e., the successor auditor) is different from the year *t-1* engagement partner (i.e., the predecessor auditor);

PREDECESSOR_RESTATE2(3) = an indicator variable set equal to one if least one of the predecessor engagement partner's clients disclosed a restatement in the two (three) years preceding the partner change, and zero otherwise;

SUCCESSOR_RESTATE2(3) = an indicator variable set equal to one if least one of the successor engagement partner's clients disclosed a restatement in the two (three) years preceding the partner change year, and zero otherwise;

ABS_DACC_t = the absolute value of performance-adjusted discretionary accruals;

MAO_t = an indicator variable set equal to one if the company receives a modified audit opinion other than for going concern reasons, and zero otherwise;

GC_t = an indicator variable set equal to one if the company receives a going concern audit opinion, and zero otherwise;

$INVREC_t$ = the ratio of the sum of inventory and accounts receivable to total assets;

$CASH_t$ = the ratio of cash to total assets;

$Big\ N_t$ = indicator variable set equal one if the audit firm belongs to the Big N, and zero otherwise; and

all other variables are as previously defined.

We begin with the sample used to estimate Equation (1) but we exclude client-year turnover observations that are likely to be unrelated to partner-level audit quality. These include engagement partner turnovers due to mandatory partner rotation, turnovers where the original engagement partner rotates back to the client within two years, and changes where the order of

the engagement partner signatures reverses (so that the first signing partner becomes the second signing partner but does not leave the engagement).[25] We also exclude any observations where the audit firm (rather than just the engagement partner) changed because we want to capture the reputational effects of restatements on engagement partners as opposed to cases where the client changes audit firms because of other pressures (e.g., audit fees, auditor-client misalignment, etc.). To avoid confounding the reputational effects of past restatements (made by other clients) with potential disagreements related to current company-specific restatements, we also exclude observations that report a restatement in year *t*. If a reputation for past restatements reduces engagement partners' ability to retain current clients and/or to attract new clients, the coefficient on *PREDECESSOR_RESTATE2(3)* will be positive and significant and the coefficient on *SUCCESSOR_RESTATE2(3)* will be negative and significant.

4. SAMPLE DESCRIPTION AND EMPIRICAL RESULTS

4.1. Sample Description

We obtain all non-financial observations from the TEJ database for the years 1996 through 2010. Our sample period starts in 1996 because the TEJ database provide coverage of a relatively stable sample of companies starting in this year and because some of the control variables used in our study are not available before 1996. For tests of H1, we restrict our sample to companies whose engagement partners audit at least three clients in the current year. When estimating Equations (1), (2), and (3), we also omit clients that have misstated in the preceding three years so that any results cannot be attributed to client-specific financial reporting quality. This results in a sample comprised of 13,505 company-year observations for the estimation of Equations (1) through (3). For tests of H2, our sample consists of 12,174 company-year

[25] Our inferences are robust, however, if we do not exclude partner changes arising from changes in the order of the engagement partner signatures.

observations; recall that we lose additional observations in these partner turnover tests because we exclude any observations where 1) the signing partner "rotates back" within two years after a signing partner change occurs, 2) the first signing partner becomes the second signing partner, and 3) the audit firm changes.

Table 1 presents descriptive statistics for the sample we use to test H1. On average, one percent of companies in Taiwan report misstatements of their financial statements in a given year. Thirteen (13) percent of engagement partners had at least one client misstate in the prior year and 79 percent of audit firms had at least one client restate in the prior year. Four (4) percent of engagement partners are industry experts. Untabulated statistics reveal that partner general audit experience ranges from 3 to 23 years, with a sample mean of 12 years, partner industry experience ranges from 1 to 20 years, with a sample mean of 9.76 years, and partner client-specific experience (tenure) ranges from 1 to 17 years, with a sample mean of 5.75 years. Audit firm tenure ranges from 1 to 24 years, with a sample mean of 9.21 years.

4.2 Empirical Results

Table 2 presents correlations between selected key variables. $MISSTATE\_PARTNER_{t-1}$ is positively correlated with $MISSTATE_t$ ($\rho = 0.03$), suggesting that when a partner's other clients have misstated in the past year, it is more likely that her current clients will misstate. We do not find a significant correlation, however, between misstatements in year *t-1* at the audit firm level and year *t* misstatements at the client level.[26]

To determine whether misstatements are persistent at the engagement partner level (i.e., whether past misstatements made by other clients increase the likelihood of current client

[26] Untabulated analyses reveal that the correlations among control variables not included in this table are consistent with expectations. For example, client size is positively and significantly correlated with listing status ($\rho = 0.42$), audit firm tenure ($\rho = 0.41$), and board size ($\rho = 0.32$). To provide assurance that mulitcollinearity does not affect our inferences, we calculate variance inflation factors (VIFs) and find that all VIFs are below 2.5.

misstatements), in Table 3, we present the results from estimating Equation (1). The coefficient on $MISSTATE\_PARTNER_{t-1}$ is positive and statistically significant (p-value = 0.03), confirming the univariate result in Table 2 – the likelihood that a current client misstates is significantly higher when at least one of its engagement partner's other clients misstated in the prior year. In addition, the effect is economically important; holding all the other independent variables at their means, the probability of a current client misstating is 13.28 percent greater when at least one of its engagement partner's other clients misstated in the prior year (relative to when none of its engagement partner's other clients misstated in the prior year).[27] The coefficient on *MISSTATE_FIRM* is insignificant (p-value = 0.85), suggesting that our results are not driven by prior misstatements occurring at the audit firm (but not engagement partner) level.

In Table 4, we examine whether the persistence of misstatements at the engagement partner level varies with engagement partner general audit experience, industry-specific experience, and/or firm-specific experience (tenure). We also examine whether the persistence of misstatements at the engagement partner level varies with the experience and quality of the concurring (second) partner. Because these measures can be highly correlated, we estimate the model with each individual interaction and then with all of the interactions in the model. In Column 1, we find a negative and significant coefficient on *MISSTATE_PARTNER* LONG_PARTNER_GEN_EXPERIENCE* (untabulated p-value = 0.01), suggesting that when engagement partners have more years of audit experience, the likelihood that their other clients misstate in the year subsequent to another client's misstatement (i.e., that misstatements are persistent) is lower. Similarly, in Column 2, we find a negative and significant coefficient on *MISSTATE_PARTNER*LONG_PARTNER_IND_EXPERIENCE* (untabulated p-value = 0.04),

[27] We used the MARGINS, AT MEANS command in STATA to derive this estimate.

suggesting that when engagement partners have more years of audit experience in the client's industry, the likelihood that their clients misstate following another client's prior year misstatement is lower. However, in Columns 3 through 6, we find no evidence that an engagement partners' client-specific experience (tenure), that the concurring (second) partner's general experience, industry experience and quality as measured by the lack of associated misstatements in the prior year while serving as an engagement partner have an impact on the relation between prior misstatements made by other clients and current client misstatements. However, when the quality of the concurring partner is measured by lack of associated restatements in the prior year while serving as an engagement partner, we find a negative and significant coefficient on *MISSTATE_PARTNER* PARTNER2_QUALITY_NORESTATE* (untabulated p-value = 0.04), providing at least some evidence that the quality of the concurring (second) partner's audits as an engagement partner can improve audit quality. Finally, when we estimate the full model in Column 8, we find that only the coefficients on *MISSTATE_PARTNER*LONG_PARTNER_GEN_ EXPERIENCE* and *MISSTATE_PARTNER* PARTNER2_QUALITY_NORESTATE* are significantly negative (untabulated p-values = 0.06 and 0.07, respectively). These results suggest that an engagement partner's general audit experience and the concurring (second) partner's quality (i.e., lack of associated restatements in the prior year as an engagement partner) are important for preventing persistent audit quality problems at the audit partner level.[28] The finding that an engagement partner's general audit

[28] Because of issues raised in Ai and Norton (2003) regarding the interpretation of interaction effects in nonlinear models, we examine in untabulated analyses plots of the z-statistics for each of the individual interaction terms from the Table 4 models. We do not plot the distributions where all interactions are included in the model because the INTEFF procedure in STATA does not account for multiple interactions in LOGIT models. Related to the engagement partner's experience, the distributions of z-statistics for the first three interactions are consistently negative, supporting the notion that experience reduces the persistence of partner misstatements. Related to the three variables capturing a partner's experience, we find that the average z-statistic for general audit experience is statistically negative, while the average z-statistic for industry and client-specific experience is not statistically significant. Related to the concurring partner experience and quality variables, we find that when the concurring

experience improves the quality of the audit is consistent with prior literature which finds that experience in an area increases knowledge and improves the quality of subsequent performance in judgment tasks in related areas (Hammersley 2006). The finding related to the quality of the concurring (second) partner provide some evidence that quality controls at the engagement level can improve audit outcomes.

In Table 5, we find that an engagement partner's history of past restatements predicts current misstatements at the engagement partner level (i.e., the coefficients on *PAST_RESTATE_PARTNER2(3)* are positive and significant (p-values = 0.00 in both specifications)). This is important because it demonstrates that investors can use an engagement partner's reputation for past financial reporting quality that is available from previously disclosed misstatements to draw inferences about current financial reporting quality.[29]

Finally, we examine whether prior client restatements result in the engagement partner losing audit clients and/or failing to attract new audit clients. In Panel A of Table 6, we first summarize descriptive statistics for the sample used to estimate Equation (5). Approximately 13 percent of our client-year observations change engagement partners, and 18 (23) percent of predecessor engagement partners and 17 (23) percent of successor engagement partners were associated with a restatement in the preceding two (three) years.

We provide results from estimating Equation (5) in Panel B. The coefficients on *PREDECESSOR_RESTATE2* and *PREDECESSOR_RESTATE3* are positive and significant (p-values < 0.00), indicating that engagement partners are more likely to lose clients when

partner does not experience a restatement in the prior year as an engagement partner, the average z-statistic is statistically negative. However, the average z-statistic for the concurring partner's general and industry experience as well as quality measured by associated misstatements in the prior year are not statistically significant.

[29] Note that untabulated analyses reveal that considering only the immediately prior year does not allow us to draw this inference. This suggests that information about an engagement partner's performance over multiple years can be valuable even though partner level misstatements do not occur each year.

misstatements made by other audit clients are revealed in the preceding two (three) years. In addition, the coefficients on *SUCCESSOR_RESTATE3* are negative and significant (p-values < 0.00), indicating that auditors with a past history of restatements are less likely to attract new clients.

Overall, the results from our multivariate tests suggest that audit clients do obtain valuable information from partner name disclosures and make auditor engagement decisions based on information about past audit quality at the engagement partner level.

4.3 Additional Analyses

We perform a number of additional analyses related to the consequences engagement partners with a recent history of restatements face. Given the findings in Table 6, which suggest that engagement partners are more likely to lose clients when misstatements made by other audit clients are revealed in the preceding two (three) years, we examine: 1) how long these client losses persist into the future, 2) the change in the number of concurring (second) partner assignments, and 3) the likelihood of the auditor no longer serving clients within the next one, three, and five year horizons. To examine how long client losses persist into the future, we estimate the following negative binomial regression at the audit partner-year level:

$$CH\_CLIENT\_COUNT = \beta_0 + \beta_1 RESTATE\_COUNT\_PRIOR3 + \beta_2 Big\ N_t + \beta_3 PARTNER\_GEN\_EXPERIENCE_t + \beta_4 PARTNER\_IND\_EXPERIENCE_t + e_t \quad (5)$$

where:

CH_CLIENT_COUNT = one of three variables: 1) the change in the number of clients the engagement partner serves from year *t-1* to year *t*, 2) the change in the number of clients the engagement partner serves from year *t-1* to year *t+3*, and 3) the change in the number of clients the engagement partner serves from year *t-1* to year *t+5*;

RESTATE_COUNT_PRIOR3 = the number of restatements the engagement partner was associated with over the previous three years;

PARTNER_GEN_ EXPERIENCE= general audit experience to date measured as number of years since the partner was first identified in the TEJ database;

PARTNER_IND_ EXPERIENCE= industry experience to date measured as number of years that the partner has audited clients in the given 2-digit TEJ code industry; and

all other variables are as previously defined. For each time horizon examined, the sample is conditional on the auditor being in the dataset (e.g., when examining the time horizon of the change in clients from year *t-1* to year *t+5*, we ensure the auditor is in the dataset in year *t+5*).

To examine how an engagement partner's recent history of restatements impacts the change in that partner's number of concurring (second) partner assignments, we estimate the following negative binomial regression at the audit partner-year level:

$$CH\_PARTNER2\_COUNT = \beta_0 + \beta_1 RESTATE\_COUNT\_PRIOR3 + \beta_2 CH\_CLIENT\_COUNT + \beta_3 Big\ N_t + \beta_3 PARTNER\_GEN\_\ EXPERIENCE_t + \beta_4 PARTNER\_IND\_\ EXPERIENCE_t + e_t \quad (6)$$

where:

CH_PARTNER2_COUNT = one of three variables: 1) the change in the number of concurring (second) partner assignments from year *t-1* to year *t*, 2) the change in the number of concurring (second) partner assignments from year *t-1* to year *t+3*, and 3) the change in the number of concurring (second) partner assignments from year *t-1* to year *t+5*; and

all other variables are as previously defined. For each time horizon examined, the sample is conditional on the auditor being in the dataset (e.g., when examining the time horizon of the change in clients from year *t-1* to year *t+5*, we ensure the auditor is in the dataset in year *t+5*) and the horizon of the variable *CH_CLIENT_COUNT* corresponds with the horizon of *CH_PARTNER2_COUNT*.

To examine the likelihood of the auditor no longer serving clients, we estimate the following logistic regression at the audit partner-year level:

$$DISAPPEAR = \beta_0 + \beta_1 RESTATE\_COUNT\_PRIOR3 + \beta_2 CLIENT\_COUNT + \beta_3 Big\ N_t + \beta_3 PARTNER\_GEN\_EXPERIENCE_t + \beta_4 PARTNER\_IND\_EXPERIENCE_t + e_t \quad (7)$$

where:

DISAPPEAR = one of three variables: 1) an indicator variable set equal to one if the partner is no longer in the dataset within 1 year (i.e., after year *t+1*), and zero otherwise; 2) an indicator variable set equal to one if the partner is no longer in the dataset within 3 years (i.e., after year *t+3*), and zero otherwise; and 3) an indicator variable set equal to one if the partner is no longer in the dataset within 3 years (i.e., after year *t+5*), and zero otherwise; and

CLIENT_COUNT = the number of clients the engagement partner serves in year *t*;

all other variables are as previously defined. For each time horizon examined, the sample is limited to available data to examine the 1, 3, or 5 year horizon. For example, when examining whether the auditor disappears from the dataset within 1 year, the sample is constrained to 1996 through 2008. When examining whether the auditor disappears from the dataset within the next 3 (5) years, the sample is constrained to 1996 through 2006 (2004).

The results of these analyses are presented in Table 7. In Panel A, we find that the number of restatements the engagement partner has been associated with in the prior three years is negatively associated with a change in that partner's clients, and that this negative association persists over a one, three, and five year horizon. The coefficient on *RESTATE_COUNT_PRIOR3* in columns 2 and 3 indicates that these partners have three less clients on average, and do not subsequently regain clients over a five year horizon. In Panel B, we also find that the number of restatements the engagement partner has been associated with in the prior three years is negatively associated with a change in that partner's concurring (second) partner assignments,

and that this negative association persists over a one, three, and five year horizon. These results suggest that these partners have fewer concurring partner assignments following lower quality audits. In Panel C, we find that the number of restatements the engagement partner has been associated with in the prior three years increases the likelihood that the auditor disappears from the dataset within the next five years, suggesting an increased likelihood that these partners no longer serve clients, possibly as the result of sanctions or termination. Taken together, these results highlight the consequences that engagement partners face when they have been associated with a recent history of restatements, namely, a loss of clients and concurring partner assignments over a five year horizon, as well as an increased likelihood of no longer serving clients.

Next, we examine the characteristics of clients that these engagement partners serve in the three years following an associated restatement announcement. To do this, we limit the sample to client years audited by an engagement partner that experiences a restatement at some point within the sample with at least one year prior to the restatement announcement. We then create an indicator variable for all client years where the engagement partner experienced a restatement in the previous three years and regress this variable using logistic regression on a set of variables capturing client characteristics. In untabulated analysis, we find that the clients of engagement partners associated with a restatement in the previous three years are larger, more likely a listed company, are more highly leveraged, and have greater cash flow volatility. Given that client size and listing status could capture clients with more complex operations and increased incentives to manipulate earnings, these results potentially indicate an increase in the riskiness of these partner's client portfolios – another potential consequence of providing lower audit quality.

Finally, we examine whether the consequences of losing clients extend to all partners with a recent history of restatements or only among those with less general or industry experience and whether the successor engagement partner following an audit partner change tends to have more general or industry experience than the predecessor engagement partner with a recent history of restatements. To examine whether the consequences of losing clients extend to all partners with a recent history of restatements, we use the sample to test H2 and incorporate the variables *LONG_PARTNER_GEN_EXPERIENCE* and *LONG_PARTNER_IND_EXPERIENCE* into Model (4). We then interact these variables with *PREDECESSOR_RESTATE2(3)*. We continue to find a positive and significant coefficient on *PREDECESSOR_RESTATE2(3)*, but insignificant coefficients on both interactions terms. This suggests that the increased likelihood of partners with recent restatements losing clients is not attenuated by the partners' general or industry experience and that audit committees and clients perhaps are not able to distinguish persistent audit quality issues from perhaps more transitory ones. To examine whether the successor engagement partner, following an audit partner change, tends to have more general or industry experience than the predecessor engagement partner with a recent history of restatements, we limit the sample to observations that change auditors where the predecessor audit partner had a restatement in the previous three years. We then compare the mean and median years of general or industry experience between the predecessor and successor partners. We do not find a significant difference in the number of years of general or industry experience between the predecessor and successor engagement partners. We do find in Panel B, Table 6, however, that the successor auditor is less likely to have been associated with recent restatements.

5. CONCLUSION

In this study, we examine the association between an engagement partner's reputation for past audit failures and actual and perceived audit quality using a sample of audit engagements from Taiwan, where engagement partner names are disclosed. We also examine the consequences these partners for having a reputation of past audit failures. This examination is important in light of the recent rule adopted by the PCAOB which requires engagement partner name disclosure (PCAOB 2015).

We find that the likelihood of an engagement partner's current client misstating its financial statements is greater when at least one of the engagement partner's other clients misstated in the prior year. Analyses related to auditor experience reveal that misstatements are less persistent when engagement partners have more general auditing experience (and in some specifications, more industry-specific experience), but client-specific experience does not impact the persistence of misstatements. Misstatements are also less persistent if the concurring (second) partner has not been associated with a restatement as an engagement partner in the prior year. These findings are important because they confirm the notion that the individual engagement partner, as well as the concurring partner, play an important role in determining the quality of audit services and reveal that audit quality is persistent at the audit partner level.

We also find that when an engagement partner's clients restate their financial statements in the prior two or three years, the likelihood that her other clients will misstate in the current year is greater. In addition, we find that following client restatements, engagement partners are more likely to lose current clients and less likely to acquire new clients for up to a five year horizon. These partners are also more likely to lose concurring (second) partner assignments and to no longer serve clients within the next five years. Finally, we find that the clients these

partners continue to serve exhibit increased risk characteristics. These findings suggest that stakeholders can gain valuable information from engagement partner identification and they appear to use the information to form opinions about partner level audit quality. However, our findings also suggest that clients are not able to fully distinguish persistent audit quality issues from perhaps more transitory ones, as the increased likelihood of partner turnover is not attenuated when that partner has greater experience in general. This evidence is germane to the PCAOB's call for research that contributes to the ongoing debate about whether disclosure of engagement partner names provides information that is useful for market participants.

The Securities and Exchange Commission has criticized the PCAOB for not pursuing more technical auditing standard setting activities and for "trying to overhaul and set policy for the accounting industry."[30] The PCAOB's work on engagement partner name disclosure is cited as an example of this focus on policy making. The findings in our study suggest that the PCAOB's recent rule requiring partner name disclosure in the U.S. could provide valuable information to market participants. A limitation of our study, however, is that we cannot measure the potential costs associated with such a disclosure.

[30] See "SEC: Accounting Board Is Dragging Feet" in the *Wall Street Journal* (December 14, 2014), available at: http://www.wsj.com/articles/sec-accounting-board-is-dragging-feet-1418605107?KEYWORDS=pcaob.

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Appendix
Variable Definitions

$\Delta ASSET$	= the percentage change in total assets during the year, to proxy for growth
ABS_DACC	= the absolute value of performance-adjusted discretionary accruals
AR_IN	= the sum of accounts receivable and inventory deflated by total assets
Big N	= an indicator variable set equal one if the audit firm belongs to the Big N, and zero otherwise
CASH	= the ratio of cash to total assets
CH_CLIENT_COUNT	= one of three variables: 1) the change in the number of clients the engagement partner serves from year *t-1* to year *t*, 2) the change in the number of clients the engagement partner serves from year *t-1* to year *t+3*, and 3) the change in the number of clients the engagement partner serves from year *t-1* to year *t+5*
CH_PARTNER	= an indicator variable set equal to one if the year *t* engagement partner (i.e., the successor auditor) is different from the year *t-1* engagement partner (i.e., the predecessor auditor), and zero otherwise
CH_PARTNER2_COUNT	= one of three variables: 1) the change in the number of concurring (second) partner assignments from year *t-1* to year *t*, 2) the change in the number of concurring (second) partner assignments from year *t-1* to year *t+3*, and 3) the change in the number of concurring (second) partner assignments from year *t-1* to year *t+5*
CLIENT_COUNT	= the number of clients the engagement partner serves in year *t*
DISAPPEAR	= one of three variables: 1) an indicator variable set equal to one if the partner is no longer in the dataset within 1 year (i.e., after year *t+1*), and zero otherwise; 2) an indicator variable set equal to one if the partner is no longer in the dataset within 3 years (i.e., after year *t+3*), and zero otherwise; and 3) an indicator variable set equal to one if the partner is no longer in the dataset within 3 years (i.e., after year *t+5*), and zero otherwise

FINANCING	= an indicator variable set equal to one if the number of shares outstanding increases by at least 10 percent or if the value of long-term debt increases by at least 20 percent during the year, and zero otherwise (following Cao et al. (2012)
FIRM_TENURE	= the length of the audit firm-client relationship to date
FOREIGN	= the proportion of company sales generated in foreign countries, to proxy for a complexity
GC	= an indicator variable set equal to one if the company receives a going concern audit opinion, and zero otherwise
HERF	= industry concentration, measured using the Herfindahl index
INVREC	= the ratio of the sum of inventory and accounts receivable to total assets
LASSET	= the natural log of total assets, to proxy for company size
LBOARD_SIZE	= the natural log of board size
LEV	= leverage, measured as the ratio of total debt to total assets
LISTED	= an indicator variable set equal to one if the company is listed on a stock exchange, and zero otherwise
LONG_PARTNER_ GEN_EXPERIENCE	= an indicator variable set equal to one if the engagement partner's general audit experience to date exceeds the sample mean, and zero otherwise, where general audit experience is measured as number of years since the partner was first identified in the TEJ database
LONG_PARTNER2_ GEN_EXPERIENCE	= an indicator variable set equal to one if the concurring (second) partner's general audit experience to date while serving as an engagement (first) partner exceeds the sample mean, and zero otherwise, where general audit experience is measured as number of years since the partner was first identified in the TEJ database;
LONG_PARTNER_ IND_EXPERIENCE	= an indicator variable set equal to one if the engagement partner's industry experience to date exceeds the sample mean, and zero otherwise, where industry experience is

	measured as number of years that the partner has audited clients in the given 2-digit TEJ code industry
LONG_PARTNER2_ IND_EXPERIENCE	= an indicator variable set equal to one if the concurring (second) partner's industry experience to date while serving as an engagement (first) partner exceeds the sample mean, and zero otherwise, where general audit experience is measured as number of years since the partner was first identified in the TEJ database;
LONG_PARTNER_TENURE	= an indicator variable set equal to one if the engagement partner's client tenure to date exceeds the sample mean, and zero otherwise, where client tenure is defined as the length of the engagement partner-client relationship
LOSS	= an indicator variable set equal to one if the company reports negative net income in the year, and zero otherwise
MAO	= an indicator variable set equal to one if the company receives a modified audit opinion other than for going concern reasons, and zero otherwise
MISSTATE	= an indicator variable set equal to one if the current year's annual financial statements are misstated, and zero otherwise
MISSTATE_FIRM	= an indicator variable set equal to one if the audit firm was associated with at least one misstatement (made by another client) in the prior year, and zero otherwise
MISSTATE_PARTNER	= an indicator variable set to equal one if the client's engagement partner was associated with at least one misstatement (made by another client) in the past year, and zero otherwise
OWNERSHIP	= the percentage of common stock owned by insiders, where insiders are defined as managers, directors, and members of the supervisory board
PARTNER_GEN_ EXPERIENCE	= general audit experience to date measured as number of years since the partner was first identified in the TEJ database
PARTNER_IND_ EXPERIENCE	= industry experience to date measured as number of years that the partner has audited clients in the given 2-digit TEJ

code industry

PARTNER_IND_EXPERT = an indicator variable set equal to one if the engagement partner is an industry expert, and zero otherwise, where an industry expert is defined as the engagement partner with the largest number of clients in the 2-digit TEJ code industry (following Chin and Chi (2009))

PARTNER2_QUALITY_NOMISSTATE = an indicator variable set equal to one if the client's concurring (second) partner was not associated with any misstatement while serving as an engagement (first) partner in the past year, and zero otherwise

PARTNER2_QUALITY_NORESTATE = an indicator variable set equal to one if the client's concurring (second) partner was not associated with a restatement while serving as an engagement (first) partner in the past year, and zero otherwise

PAST_RESTATE_FIRM2(3) = an indicator variable set equal to one if the audit firm was associated with at least one restatement announcement (made by another client) in the past two (or three) years, and zero otherwise

PAST_RESTATE_PARTNER2(3) = an indicator variable set equal to one if the client's engagement partner was associated with at least one restatement announcement (made by another client) in the past two (or three) years, and zero otherwise

PREDECESSOR_RESTATE2(3) = an indicator variable set equal to one if least one of the predecessor engagement partner's clients disclosed a restatement in the two (three) years preceding the partner change, and zero otherwise

RESTATE_COUNT_PRIOR3 = the number of restatements the engagement partner was associated with over the previous three years

ROA = return on assets (i.e., net income divided by average total assets), to proxy for company profitability

STD_CFO = the standard deviation of operating cash flows over the prior four years

SUCCESSOR_RESTATE2(3) = an indicator variable set equal to one if least one of the successor engagement partner's clients disclosed a restatement in the two (three) years preceding the partner change year, and zero otherwise

Table 1
Descriptive Statistics (N=13,505)

VARIABLES	MEAN	STD	Q1	MED	Q3	MIN	MAX
MISSTATE (Prob*(MISSTATE=1)*$_t$)	0.01	0.08	0.00	0.00	0.00	0.00	1.00
***MISSTATE_PARTNER*$_{t-1}$**	**0.13**	**0.34**	**0.00**	**0.00**	**0.00**	**0.00**	**1.00**
MISSTATE_FIRM$_{t-1}$	0.79	0.40	1.00	1.00	1.00	0.00	1.00
PARTNER_IND_EXPERT$_t$	0.04	0.19	0.00	0.00	0.00	0.00	1.00
LONG_PARTNER_GEN _EXPERIENCE$_t$	0.46	0.49	0.00	0.00	1.00	0.00	1.00
LONG_PARTNER_IND _EXPERIENCE$_t$	0.50	0.50	0.00	0.00	1.00	0.00	1.00
LONG_PARTNER_TENURE$_t$	0.44	0.50	0.00	0.00	1.00	0.00	1.00
LONG_PARTNER2_GEN _EXPERIENCE$_t$	0.25	0.43	0.00	0.00	0.00	0.00	1.00
LONG_PARTNER2_IND _EXPERIENCE$_t$	0.23	0.42	0.00	0.00	0.00	0.00	1.00
PARTNER2_QUALITY_ NOMISSTATE	0.95	0.23	1.00	1.00	1.00	1.00	1.00
PARTNER2_QUALITY_ NORESTATE	0.94	0.24	1.00	1.00	1.00	1.00	1.00
FIRM_TENURE$_t$	9.21	5.28	5.00	8.00	12.00	1.00	24.00
LASSET$_t$	14.88	1.31	13.92	14.74	15.66	12.39	18.77
Δ*ASSET*$_t$	0.14	0.29	-0.03	0.07	0.22	-0.37	1.47
AR_IN$_{t-1}$	0.32	0.19	0.18	0.29	0.43	0.00	0.97
FOREIGN$_{t-1}$	0.45	0.36	0.06	0.44	0.79	0.00	1.00
FINANCING$_{t-1}$	0.38	0.49	0.00	0.00	1.00	0.00	1.00
LEV$_{t-1}$	0.39	0.17	0.27	0.39	0.51	0.07	0.88
ROA$_{t-1}$	0.04	0.11	0.00	0.05	0.10	-0.38	0.30
LOSS$_{t-1}$	0.23	0.42	0.00	0.00	0.00	0.00	1.00
STD_CFO$_t$	0.12	0.12	0.05	0.08	0.14	0.01	0.75
HERF$_{t-1}$	0.06	0.07	0.02	0.03	0.06	0.01	0.38
LISTED$_t$	0.73	0.44	0.00	1.00	1.00	0.00	1.00
OWNERSHIP$_{t-1}$	0.30	0.17	0.17	0.27	0.40	0.00	1.00
LBOARD_SIZE$_{t-1}$	1.99	0.29	1.79	2.08	2.08	1.39	3.00

See the Appendix for variable definitions.

Table 2
Pearson Correlation Matrix

		1	2	3	4	5	6	7	8	9
MISSTATE (Prob*(MISSTATE=1)*$_t$)	1	-								
MISSTATE_PARTNER$_{t-1}$	2	**0.03**	-							
LONG_PARTNER_GEN_EXPERIENCE$_t$	3	0.00	**0.07**	-						
LONG_PARTNER_IND_EXPERIENCE$_t$	4	0.00	**0.05**	**0.59**	-					
LONG_PARTNER_TENURE$_t$	5	0.00	**0.02**	**0.31**	**0.35**	-				
PARTNER_IND_EXPERT$_t$	6	0.00	**0.09**	**0.02**	**0.03**	0.01	-			
MISSTATE_FIRM$_{t-1}$	7	0.00	**0.11**	-0.01	-0.01	**-0.03**	**0.04**	-		
FIRM_TENURE$_t$	8	0.00	**-0.07**	**0.10**	**0.13**	**0.37**	**0.08**	**-0.08**	-	
LASSET$_t$	9	**0.04**	**0.02**	**0.06**	**0.05**	**0.14**	**0.15**	0.00	**0.41**	-
ROA$_{t-1}$	10	**-0.05**	-0.01	**-0.02**	0.00	**-0.02**	0.00	**0.03**	**-0.06**	**0.04**

The table summarizes Pearson correlations for the selected key variables in our analyses. Correlations that are significant at *p-value* < 0.05 are bolded. See the Appendix for variable definitions

Table 3
The Persistence of Misstatements at the Engagement Partner Level

Dependent variable = Prob*(MISSTATE=1)*$_t$

	Coefficient Estimate	*p-value*
Intercept	-8.48***	0.00
***MISSTATE_PARTNER*$_{t-1}$**	**0.56****	**0.03**
LONG_PARTNER_GEN_EXPERIENCE$_t$	-0.24	0.35
LONG_PARTNER_IND_EXPERIENCE$_t$	0.39	0.16
LONG_PARTNER_TENURE$_t$	-0.02	0.94
LONG_PARTNER2_GEN_EXPERIENCE$_t$	0.02	0.96
LONG_PARTNER2_IND_EXPERIENCE$_t$	-0.02	0.94
PARTNER_IND_EXPERT$_t$	-0.97	0.11
MISSTATE_FIRM$_{t-1}$	0.05	0.85
FIRM_TENURE$_t$	-0.03	0.22
LASSET$_t$	0.30***	0.00
Δ*ASSET*$_t$	0.72**	0.05
AR_IN$_{t-1}$	-1.07	0.15
FOREIGN$_{t-1}$	-0.51	0.20
FINANCING$_{t-1}$	-0.03	0.91
LEV$_{t-1}$	2.00***	0.00
ROA$_{t-1}$	-2.59*	0.08
LOSS$_{t-1}$	0.67**	0.02
STD_CFO$_t$	1.53*	0.08
HERF$_{t-1}$	-4.48	0.41
LISTED$_t$	0.05	0.87
OWNERSHIP$_{t-1}$	-1.17*	0.09
LBOARD_SIZE$_{t-1}$	-0.48	0.25
Industry fixed effects	Yes	
N	13,505	
Area under the ROC curve	0.80	

This table presents the results from estimating a logistic regression of the likelihood of an accounting misstatement in the current year as a function of an accounting misstatement (made by another client of the same engagement partner) in the preceding year. The sample consists of client-year observations from 1996 through 2010. Two-tailed *p-values* are based on cluster-robust standard errors (clustered by audit client and year). *, **, *** denote significance of 0.1, 0.05, and 0.01 level, respectively. See the Appendix for variable definitions.

Table 4
The Effects of Experience on the Persistence of Misstatements

Dependent variable = Prob(*MISSTATE*=1)$_t$

	(1) Coef. Estimate	(2) Coef. Estimate	(3) Coef. Estimate	(4) Coef. Estimate	(5) Coef. Estimate	(6) Coef. Estimate	(7) Coef. Estimate	(8) Coef. Estimate
Intercept	-8.79***	-8.70***	-8.80***	-8.46***	-8.45***	-8.69***	-9.37***	-9.66***
MISSTATE_PARTNER$_{t-1}$	**1.18***	**1.05***	**0.61***	**0.43**	**0.40**	**0.76**	**2.40***	**2.83***
LONG_PARTNER_GEN_EXPERIENCE$_t$	0.09	-0.26	-0.24	-0.24	-0.23	-0.24	-0.24	0.02
MISSTATE_PARTNER$_{t-1}$ *LONG_PARTNER_GEN_EXPERIENCE$_t$	**-1.41***							**-1.14***
LONG_PARTNER_IND_EXPERIENCE$_t$	0.36	0.65**	0.39	0.38	0.37	0.39	0.38	0.52
MISSTATE_PARTNER$_{t-1}$ *LONG_PARTNER_IND_EXPERIENCE$_t$		**-1.06****						**-0.65**
LONG_PARTNER_TENURE$_t$	-0.04	-0.04	0.01	-0.01	-0.02	-0.02	-0.02	-0.13
MISSTATE_PARTNER$_{t-1}$ *LONG_PARTNER_TENURE$_t$			**-0.12**					**0.32**
LONG_PARTNER2_GEN_EXPERIENCE$_t$	0.02	0.02	0.01	-0.10	0.01	0.03	0.03	0.03
MISSTATE_PARTNER$_{t-1}$ *LONG_PARTNER2_GEN_EXPERIENCE$_t$				**0.46**				**0.02**
LONG_PARTNER2_IND_EXPERIENCE$_t$	-0.01	0.00	-0.02	-0.02	-0.19	-0.02	-0.03	-0.08
MISSTATE_PARTNER$_{t-1}$ *LONG_PARTNER2_IND_EXPERIENCE$_t$					**0.71**			**0.33**
PARTNER2_QUALITY_NOMISSTATE$_{t-1}$						0.22		
MISSTATE_PARTNER$_{t-1}$ * PARTNER2_QUALITY_NOMISSTATE$_{t-1}$						**-0.22**		
PARTNER2_QUALITY_NORESTATE$_{t-1}$							0.87	0.84
MISSTATE_PARTNER$_{t-1}$ * PARTNER2_QUALITY_NORESTATE$_{t-1}$							**-1.98****	**-1.82***
PARTNER_IND_EXPERT$_t$	-1.02*	-0.95	-0.97	-0.97	-0.97	-0.97	-0.98	-1.00
MISSTATE_FIRM$_{t-1}$	0.07	0.08	0.05	0.06	0.07	0.06	0.07	0.10
FIRM_TENURE$_t$	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03	-0.03
LASSET$_t$	0.31***	0.31***	0.30***	0.30***	0.30***	0.30***	0.30***	0.31***
Δ*ASSET$_t$*	0.76**	0.74**	0.73**	0.72*	0.71*	0.73**	0.72**	0.75**
AR_IN$_{t-1}$	-1.09	-1.08	-1.07	-1.06	-1.05	-1.08	-1.08	-1.08

$FOREIGN_{t-1}$	-0.49	-0.49	-0.51	-0.51	-0.50	-0.51	-0.51	-0.46
$FINANCING_{t-1}$	-0.04	-0.04	-0.03	-0.02	-0.02	-0.02	-0.03	-0.05
LEV_{t-1}	2.00***	1.99***	1.99***	1.99***	2.01***	1.99***	2.01***	2.02***
ROA_{t-1}	-2.58*	-2.59*	-2.58*	-2.58*	-2.61*	-2.61*	-2.63*	-2.63*
$LOSS_{t-1}$	0.68**	0.66**	0.67**	0.67**	0.68**	0.67**	0.67**	0.68**
STD_CFO_t	1.48*	1.49*	1.54*	1.51*	1.50*	1.53*	1.50*	1.40
$HERF_{t-1}$	-4.70	-4.54	-4.48	-4.46	-4.43	-4.48	-4.41	-4.58
$LISTED_t$	0.08	0.06	0.05	0.05	0.04	0.05	0.05	0.07
$OWNERSHIP_{t-1}$	-1.23*	-1.18*	-1.17*	-1.19*	-1.19*	-1.17*	-1.15	-1.21*
$LBOARD\_SIZE_{t-1}$	-0.41	-0.47	-0.47	-0.48	-0.48	-0.47	-0.47	-0.42
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	13,505	13,505	13,505	13,505	13,505	13,505	13,505	13,505
Area under the ROC curve	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.81

This table presents the results from estimating logistic regressions investigating the effects of engagement partner experience on the probability of accounting misstatements in a particular year as a function of an accounting misstatement (made by another client of the same engagement partner) in the preceding year. The sample consists of client-year observations from 1996 through 2010. Untabulated two-tailed *p-values* are based on cluster-robust standard errors (clustered by audit client and year). *, **, *** denote significance of 0.1, 0.05, and 0.01 level, respectively. See the Appendix for variable definitions.

Table 5
Using restatements to predict future misstatements

Dependent variable = Prob*(MISSTATE=1)*$_t$

	Coefficient Estimate	*p-value*	Coefficient Estimate	*p-value*
Intercept	-8.55	0.00	-8.61	0.00
PAST_RESTATE_PARTNER2	**0.83*** **	**0.00**		
PAST_RESTATE_PARTNER3			**0.80*** **	**0.00**
LONG_PARTNER_GEN_EXPERIENCE$_t$	-0.37	0.24	-0.30	0.39
LONG_PARTNER_IND_EXPERIENCE$_t$	0.32	0.39	0.34	0.37
LONG_PARTNER_TENURE$_t$	-0.10	0.65	-0.08	0.72
PARTNER_IND_EXPERT$_t$	-1.03	0.11	-0.97	0.13
PAST_RESTATE_FIRM2	0.48*	0.08		
PAST_RESTATE_FIRM3			0.40	0.13
FIRM_TENURE$_t$	-0.02	0.31	-0.03	0.26
LASSET$_t$	0.29***	0.00	0.30***	0.00
Δ*ASSET*$_t$	0.73**	0.04	0.72***	0.04
AR_IN$_{t-1}$	-1.19**	0.03	-1.09**	0.04
FOREIGN$_{t-1}$	-0.49	0.28	-0.48	0.29
FINANCING$_{t-1}$	-0.02	0.89	-0.03	0.80
LEV$_{t-1}$	2.03***	0.00	2.04***	0.00
ROA$_{t-1}$	-2.53	0.14	-2.56	0.14
LOSS$_{t-1}$	0.67**	0.04	0.67**	0.04
STD_CFO$_t$	1.64**	0.03	1.59**	0.04
HERF$_{t-1}$	-1.77	0.72	-2.11	0.67
LISTED$_t$	0.06	0.88	0.06	0.15
OWNERSHIP$_{t-1}$	-1.21	0.14	-1.23	0.13
LBOARD_SIZE$_{t-1}$	-0.51	0.10	-0.48	0.13
Industry fixed effects	Yes		Yes	
N	13,505		13,505	
Area under the ROC curve	0.81		0.81	

This table presents the results from estimating logistic regression of the likelihood of an accounting misstatement in the current year as a function of an announced accounting restatement (made by another client of the same engagement partner) in the two and three preceding years. Two-tailed *p-values* are based on cluster-robust standard errors (clustered by audit client and year). *, **, *** denote significance of 0.1, 0.05, and 0.01 level, respectively. See the Appendix for variable definitions.

Table 6
The Effect of Engagement Partner Reputation on Client Turnover and on Client Gains

Panel A: Descriptive Statistics (N=12,174)

Variable	MEAN	STD	Q1	MED	Q3	MIN	MAX
$CH\_PARTNER_t$	0.13	0.34	0.00	0.00	0.00	0.00	1.00
PREDECESSOR_RESTATE2	0.18	0.38	0.00	0.00	0.00	0.00	1.00
SUCCESSOR_RESTATE2	0.17	0.38	0.00	0.00	0.00	0.00	1.00
PREDECESSOR_RESTATE3	0.23	0.42	0.00	0.00	0.00	0.00	1.00
SUCCESSOR_RESTATE3	0.23	0.42	0.00	0.00	0.00	0.00	1.00
$LASSET_t$	14.81	1.31	13.85	14.65	15.58	12.32	18.66
$\Delta ASSET_t$	0.16	0.31	-0.02	0.08	0.24	-0.36	1.60
ABS_DACC_t	0.09	0.09	0.03	0.06	0.11	0.00	0.46
MAO_t	0.50	0.50	0.00	1.00	1.00	0.00	1.00
ROA_t	0.05	0.11	0.01	0.05	0.10	-0.37	0.31
GC_t	0.02	0.15	0.00	0.00	0.00	0.00	1.00
$LONG\_PARTNER\_TENURE_{t-1}$	0.46	0.50	0.00	0.00	1.00	0.00	1.00
$LOSS_t$	0.21	0.41	0.00	0.00	0.00	0.00	1.00
$LISTED_t$	0.68	0.47	0.00	1.00	1.00	0.00	1.00
LEV_t	0.40	0.18	0.27	0.40	0.52	0.07	0.93
ΔLEV_t	0.06	0.18	-0.04	0.02	0.11	-0.30	0.83
$INVREC_t$	0.32	0.19	0.18	0.29	0.43	0.01	0.84
$CASH_t$	0.10	0.11	0.02	0.06	0.12	0.00	0.53
AR_IN_t	0.32	0.19	0.18	0.29	0.43	0.00	0.97
$FOREIGN_t$	0.44	0.36	0.05	0.43	0.79	0.00	1.01
$FINANCING_t$	0.38	0.49	0.00	0.00	1.00	0.00	1.00
$OWNERSHIP_t$	0.30	0.17	0.17	0.27	0.39	0.00	1.00
$FIRM\_TENURE_t$	8.96	5.07	5.00	8.00	12.00	2.00	24.00
$LBOARD\_SIZE_t$	2.00	0.29	1.79	2.08	2.08	1.39	3.00
STD_CFO_t	0.12	0.14	0.05	0.08	0.14	0.01	0.90
$HERF_t$	0.06	0.08	0.02	0.03	0.06	0.01	0.38
Big_N_t	0.85	0.36	1.00	1.00	1.00	0.00	1.00

This panel summarizes the descriptive statistics for the audit partner turnover sample used to estimate Equation (5). See the Appendix for variable definitions.

Panel B: The Effects of Partner Reputation on the Likelihood of Partner Turnover

Dependent variable = ($CH\_PARTNER_t = 1$)

	X=2 (restatements going back two years)		**X=3 (restatements going back three years)**	
	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*
Intercept	-2.46***	0.00	-2.42***	0.00
PREDECESSOR_RESTATE_X	**1.04*** **	**0.00**	**1.29*** **	**0.00**
SUCCESSOR_RESTATE_X	**-1.38*** **	**0.00**	**-1.45** **	**0.00**
$LASSET_t$	-0.06	0.18	-0.07	0.13
$\Delta ASSET_t$	-0.35	0.17	-0.33	0.19
ABS_DACC_t	-0.11	0.73	-0.16	0.62
MAO_t	-0.07	0.42	-0.06	0.44
ROA_t	0.33	0.39	0.33	0.39
GC_t	0.12	0.57	0.12	0.58
$LONG\_PARTNER\_TENURE_{t-1}$	-0.35	0.10	-0.38*	0.07
$LOSS_t$	-0.06	0.57	-0.05	0.62
$LISTED_t$	0.29**	0.04	0.30*	0.04
LEV_t	0.58***	0.00	0.58***	0.00
ΔLEV_t	0.01	0.97	-0.02	0.96
$INVREC_t$	0.28	0.12	0.29	0.11
$CASH_t$	0.28	0.22	0.28	0.24
$FOREIGN_t$	0.07	0.34	0.07	0.36
$FINANCING_t$	-0.12	0.11	-0.12	0.10
$OWNERSHIP_t$	-0.58***	0.00	-0.59***	0.00
$FIRM\_TENURE_t$	0.08***	0.00	0.08***	0.00
$LBOARD\_SIZE_t$	0.10	0.43	0.10	0.43
STD_CFO_t	-0.92***	0.00	-0.93***	0.00
$HERF_t$	-0.08	0.96	0.16	0.93
BIG_N_t	0.58***	0.00	0.56***	0.00
Industry fixed effects	Yes		Yes	
N	12,174		12,174	
Area under the ROC curve	0.67		0.66	

This panel presents the results from regressing changes in engagement partners in year *t* on predecessor and successor engagement partner reputation variables. Two-tailed *p-values* are based on cluster-robust standard errors (clustered by audit client and year). *, **, *** denote significance of 0.1, 0.05, and 0.01 level, respectively. See the Appendix for variable definitions.

Table 7
Additional Analyses: Consequences to Partners with History of Recent Restatements

Panel A: Change in Number of Clients

Dependent variable = (*CH_CLIENT_COUNT*)

	(1) Horizon: *Year t-1* to *Year t*		**(2) Horizon: *Year t-1* to *Year t+3***		**(3) Horizon: *Year t-1* to *Year t+5***	
	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*
Intercept	1.43***	0.00	3.36***	0.00	4.86***	0.00
RESTATE_COUNT_PRIOR3	**-0.76*** **	**0.00**	**-3.05*** **	**0.00**	**-3.19*** **	**0.00**
BIG_N_t	0.53***	0.00	1.23***	0.00	0.86***	0.00
$PARTNER\_GEN\_EXPERIENCE_t$	-0.06***	0.00	-0.27***	0.00	-0.50***	0.00
$PARTNER\_IND\_EXPERIENCE_t$	-0.09***	0.00	-0.20***	0.00	-0.25***	0.00
N	5,349		3,708		2,535	

Panel B: Change in Concurring Partner Assignments

Dependent variable = (*CH_PARTNER2_COUNT*)

	(1) Horizon: *Year t-1* to *Year t*		**(2) Horizon: *Year t-1* to *Year t+3***		**(3) Horizon: *Year t-1* to *Year t+5***	
	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*
Intercept	0.41***	0.00	0.388	0.11	0.23	0.49
RESTATE_COUNT_PRIOR3	**-0.20** **	**0.03**	**-0.47** **	**0.02**	**-0.44* **	**0.09**
CH_CLIENT_COUNT	-0.16***	0.00	-0.14***	0.00	-0.22***	0.00
BIG_N_t	0.26***	0.00	0.17	0.41	-0.09	0.74
$PARTNER\_GEN\_EXPERIENCE_t$	-0.04***	0.00	-0.02	0.50	-0.05	0.23
$PARTNER\_IND\_EXPERIENCE_t$	-0.02	0.31	-0.09**	0.01	-0.09*	0.07
N	4,799		3,248		2,184	

Panel C: Likelihood of Auditor No Longer Serving Clients

Dependent variable = (*DISAPPEAR = 1*)

	(1) Horizon: *within 1 year*		(2) Horizon: *within 3 years*		(3) Horizon: *within 5 years*	
	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*	Coef. Estimate	*p-value*
Intercept	-0.35***	0.00	0.14	0.19	0.40***	0.00
RESTATE_COUNT_PRIOR3	**0.09**	**0.52**	**0.16**	**0.21**	**0.30****	**0.03**
$CLIENT\_COUNT_t$	-0.19***	0.00	-0.10***	0.00	-0.06***	0.00
BIG_N_t	-0.45***	0.00	-0.65***	0.00	-0.73***	0.00
$PARTNER\_GEN\_EXPERIENCE_t$	-0.01	0.41	-0.02	0.34	-0.00	0.83
$PARTNER\_IND\_EXPERIENCE_t$	0.02	0.29	0.04**	0.03	0.05*	0.05
N	5,680		4,863		4,025	
Area under the ROC curve	0.755		0.717		0.679	

Panel A presents the results from regressing changes in engagement partner clients over three different horizons on the count of engagement partner restatements over the prior three years and other partner level controls using negative binomial regression. The sample sizes in columns (1) through (3) are conditional on the partner being in the dataset over the respective horizon. Panel B presents the results from regressing changes in concurring (second) partner assignments over three different horizons on the count of engagement partner restatements over the prior three years and other partner level controls using negative binomial regression. The sample sizes in columns (1) through (3) are conditional on the partner being in the dataset over the respective horizon. Panel C presents the results from examining the impact of the count of engagement partner restatements over the prior three years on the likelihood of the auditor falling out of the dataset over three different horizons using logistic regression. For each time horizon examined in columns (1) through (3), the sample is limited to available data (for column 1, the sample is constrained 2008, for column 2, the sample is constrained to 2006, and for column 3, the sample is constrained to 2004). Two-tailed *p-values* are based on cluster-robust standard errors (clustered by audit client and year). *, **, *** denote significance of 0.1, 0.05, and 0.01 level, respectively. See the Appendix for variable definitions.