Audit Partner Disclosure: An Examination of Investor Reaction to Negative Information and
Potential Implications for Auditor Independence

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January 2012

We would like to thank Steve Fuller for his comments and assistance.
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ABSTRACT

The PCAOB recently issued two successive concept releases which seek feedback on a proposed amendment that would require audit partner name disclosure (“partner disclosure”) in the standard current year audit report (PCAOB 2008; PCAOB 2009; PCAOB 2011). The motivation behind the potential new requirement is to increase accountability on the part of the audit partner and transparency for interested parties who rely upon the financial statements (ACAP 2008; PCAOB 2008; PCAOB 2009; PCAOB 2011). We develop a model to explore the potential effect of a partner disclosure requirement on auditor independence. Specifically, we contend that partner disclosure may lead to an unintended transfer of (potentially biased) information from one reporting entity to another. We outline how this information transfer might alter audit partners’ incentive structures as they seek to minimize their personal reputational costs. We further explain how this might align partner incentives more closely with those of management, potentially resulting in impaired audit independence. We collect and present experimental evidence to substantiate this potential for audit information transfer (i.e., the first link in our model). We find that investors, particularly those with less experience working with financial statements, are less likely to invest in a reporting entity linked to a restating peer firm via the same audit partner than when the identity of the engagement partner is not disclosed (and the link is through the same audit firm/office only). In additional analyses, we show that this effect is partially mediated by our participants’ assessed likelihood that the linked firm will experience a restatement in the future.
I. Introduction

The PCAOB recently issued two successive concept releases which seek feedback on a proposed amendment that would require audit partner name disclosure (hereafter, “partner disclosure”) in the standard current year audit report (PCAOB 2008; PCAOB 2009; PCAOB 2011).¹ The motivation behind the potential new requirement is to increase accountability on the part of the audit partner and transparency for interested parties who rely upon the financial statements (ACAP 2008; PCAOB 2008; PCAOB 2009; PCAOB 2011). Investors and investor groups who commented on the original release generally support the idea and welcome the opportunity to investigate the experience and “track record” of individual audit partners (PCAOB 2011). Accounting professional organizations and firms largely assert that the proposed requirement will not increase partners’ sense of accountability and express strong concerns with potential ramifications for legal liability and fear that third parties will collect the information in order to make unwarranted inferences about audit quality (PCAOB 2011). Academics note the potential positive effects of increased accountability and transparency but also caution that the requirement may lead to incorrect inferences being drawn about audit quality and that existing research is not clear as to whether the proposed requirement would, in fact, enhance audit quality (PCAOB 2011).

We present an exploratory model that considers potential negative auditor independence implications that may correspond with the increase in transparency resulting from the proposed amendments, if enacted as currently proposed. We do so in response to the PCAOB’s question, posed in the most recent concept release, regarding whether (and why or why not) partner disclosure will

¹ According to the podcast of the most recent standing advisory group (SAG) meeting (available at http://pcaobus.org/News/Webcasts/Pages/10112011_OpenBoardMeeting.aspx), the audit partner is typically available to answer questions from shareholders at the annual shareholders meeting (and thus, his or her identity is presumably currently ascertainable to shareholders). However, this meeting is not usually well attended. In addition, while shareholders may be able to ascertain the identity of the audit partner who audits the particular company in which they invest, they will not have knowledge of the rest of that partner’s profile, and, therefore, would have little on which to base judgments regarding the partner’s ability or reputation.
enhance investor protection. Our model links partner disclosure to increased accounting information transfer (Proposition 1), increased accounting information transfer to a potential shift in the incentive structure of audit partners (Proposition 2), and such potential auditor incentive misalignment to auditor independence concerns (Proposition 3).

Following the development of our model, we present results of an experiment designed to test the first link in our model: that partner disclosure will lead to increased transfer of accounting information from one entity to a separate, but related, entity. More specifically, we test this link by examining whether partner disclosure will result in negative information about one reporting entity (a “contaminated” firm) being more likely to transfer to a linked reporting entity (a “peer” firm). That is, we examine whether investors will react to information about a firm undergoing a financial statement restatement (i.e., an event that is typically perceived negatively by investors) in such a way that will significantly alter their investment decisions related to a peer firm, when the peer firm is linked to the contaminated firm by nature of having the same audit partner. In other words, we test whether there is a significantly stronger contagion effect for firms linked via audit partner than when the partner identity is not known (and, therefore, the known links between the contaminated and peer firms is only via the same firm/office).

We conduct an incomplete 2 x 2 between-participants design. We manipulate whether or not the identity of the audit partner is disclosed and whether the audit report is altered in such a way that might be expected to reduce any enhanced information transfer due to partner disclosure.\(^2\) We predict and find that investors are significantly less likely to invest in, and are more likely to allocate fewer resources to, a peer firm linked to a contaminated firm in the presence of partner disclosure than

\(^2\)This results in an incomplete design as we could see no benefit in including a condition where there is no partner disclosure but there is a audit report modification related to the disclosure.
when partner identity is not disclosed. Contrary to our expectations, modifying the audit report in order to attempt to reduce the extent of the increased information transfer, based on partner disclosure, does not appear to have any discernible effect on investors’ decisions. In addition, we perform two supplementary analyses. First, we perform a mediation analysis and find that the increased information transform exhibited in our study is partially mediated by investors’ perception of the likelihood that the peer firm will experience a restatement in the future. Based on this, we conclude that our results might be, at least partially, due to investor reliance on the representativeness heuristic. Second, we find that investors who have more experience working with financial information do not appear to be influenced by partner disclosure. We interpret this as evidence that such increased information transfer may be a result of bias, rather than rational decision makers reacting to a piece of information with diagnostic content.

We acknowledge that, in this paper, we only present empirical evidence which tests the first link in our model. However, due to the timeliness and importance of our research question, we feel it is important and necessary to put forth the entire model for examination and evaluation as expediently as possible. We feel that examining this link is a logical, primary, step in the exploration of potential auditor independence concerns related to the PCAOB’s partner signature proposal. Specifically, if there is no increase in information transfer due to the proposal, that is, if investors do not attach negative information about one audit engagement to the individual reputation of the partner involved, then we feel it is less likely that the proposal will result in a misalignment of partner incentives and negative ramifications for the independence of the audit.

The remainder of our paper is organized as follows. We further explore the background of the proposed concept release and propose our model in Section II. In Section III we review the background literature and motivate the hypotheses for the experiment we use to test the first link in
our model. We describe the methods and results in Sections IV and V. Finally, we offer conclusions and discuss implications, limitations, and suggestions for future research in Section VI.

II. Background and Model

PCAOB Concept Release and Comment Letters

In July of 2009, the PCAOB issued a concept release seeking feedback on a proposed amendment to current auditing standards that would require audit engagement partners to sign their names to the audit report, in addition to their audit firms’ names (PCAOB 2009). The concept release was issued as a response to a recommendation by the Advisory Committee on the Audit Profession (ACAP 2008; PCAOB 2008; PCAOB 2009; PCAOB 2011). The ACAP report expressed the committee’s belief that such a requirement would increase accountability and transparency (ACAP 2008). The PCAOB’s concept release also expressed an expectation that the act of signing the report may increase the audit partner’s sense of personal accountability, which should have a positive effect on behavior (PCAOB 2009). The PCAOB contends that such a requirement will provide useful information to investors (i.e., the identity of the lead audit partner for an engagement) and, therefore, will be an additional incentive for firms to improve engagement partner, and audit, quality.3

Investors and investor groups who commented on the original release generally supported the idea, and agreed that the amendment would enhance accountability and transparency. Supporters referred to academic research that suggests accountability reduces auditor bias in information processing, enhances consensus and effort, and improves audit quality (e.g., DeZoort et al. 2006, Kennedy 1993, Johnson and Kaplan 1991). Investor groups also welcome the opportunity to

3 Following a period of comment, the PCAOB issued another concept release on October 11, 2011. In this release, the PCAOB sought comment on whether to amend current standards to require disclosure of (a) the name of the engagement partner, and (b) other independent public accounting firms or other persons who took part in the audit (PCAOB 2011). In this study, we focus solely on the proposed disclosure of audit partner identify as it has been the most controversial.
investigate the experience and “track record” of a particular engagement partner due to such increased transparency. For example, the Council of Institutional Investors stated, “Armed with valuable information provided by the lead auditor’s signature, investors and boards will demand skilled engagement partners… By more explicitly tying the lead auditor’s professional reputation to audit quality, requiring the engagement partners to sign the audit report will further result in better supervision of the audit team and the entire audit process” (PCAOB 2011).4

Accounting firms and organizations (e.g., New York State Society of Public Accountants, California Society of Certified Public Accountants) assert that an audit partner signature requirement will not increase accountability because existing factors (e.g., the firm’s quality control system, regulatory requirements, and potential litigation costs) already induce a strong sense of accountability in lead engagement partners (PCAOB 2011). Detractors of the amendment primarily express concerns related to enhanced transparency increasing engagement partner personal liability and contend that third parties will collect engagement statistics in order to make inferences about audit quality. For example, Ernst and Young (EY) argue that:

The general public does not have access to information to allow them to make informed judgments as to the significance of the audit partner's association with the company with financial reporting difficulties, whether actual, alleged, or rumored… If a partner is repeatedly tasked with handling the toughest of audit engagements, the public may gain an inaccurate impression of the partner due to a perception of guilt-by-association with companies with financial reporting difficulties (EY, 2009).

Some accounting researchers support the concern that the amendment could lead to incorrect inferences about a given partner’s audit quality (PCAOB 2011). Specifically, they acknowledge the positive effects of increased transparency and tend to agree that personal accountability effects would

4 See http://pcaobus.org/Rules/Rulemaking/Pages/Docket029Comments.aspx for all of the comment letters related to the 2009 concept release (the comment period related to the 2011 concept release was open through January 9, 2012). We note that this sentiment appears to presuppose the assumption that “investors and boards” will be able to accurately assess audit quality.
be positive; however, they caution that existing research is not clear as to whether the proposed requirement would enhance audit quality (PCAOB 2008; PCAOB 2011).

Based on respondents’ comments, it does not appear that opponents of the regulation dispute the notion that audit partner disclosure might lead to increased accountability (i.e., that the amendment would result in an increase in a partner’s sense of personal accountability). However, it is unclear, as the PCAOB also inquires, whether “… disclosure of engagement partner’s name in the audit report enhance investor protection? If so, how? If not, why not?” (PCAOB 2011).

To this end, we develop a model and provide initial empirical evidence to address one aspect of this question. Our model focuses on the potential impact of partner identity disclosure on auditor independence that we contend will eventually affect audit quality. Drawing from prior literature, our model suggests that (1) audit partner identity disclosure will lead to increased audit information transfer, (2) increased audit information transfer will lead to auditor incentive misalignment (i.e., alignment of partners’ reputation-related incentives so that they are more closely in line with those of client management), and (3) auditor independence conflicts arise from these incentive misalignments, thereby, potentially negatively influencing audit quality. The remainder of our paper develops and discusses each proposition in our model and then reports results of an experiment that tests the first link in our model (i.e., audit partner identity disclosure leads to increased audit information transfer).

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5 While the PCAOB has discussed several potential consequences to disclosing the name of the engagement partner (e.g., litigation concerns), to date there has little to no discussion surrounding any potential impairment of independence resulting from the audit partner name disclosure. It is interesting to note that a search of the SAG transcripts for mentions of potential negative independence implications elicits only one – an audit partner arguing that concurring review partners should be shielded from name disclosure because “Concurring reviews in our firm -- we want to keep those people insulated really, a higher level of independence than what the -- an engagement partner operates at” (PCAOB 126). This suggests there may be an intuitive, though unexpressed and perhaps unevaluated, concern among interested parties regarding potential negative independence implications of requiring the disclosure.
Model Development

Proposition 1: Audit Partner Identity Disclosure and Increased Accounting Information Transfer

Both audit firms and academics have expressed concern that audit partner identity disclosure could result in incorrect inferences concerning individual partners’ performance (PCAOB 2008; PCAOB 2011). Existing archival/markets-based research has established a theory of “accounting information transfer” between linked firms (c.f., Gleason et al. 2008). This theory suggests that information about one reporting entity (e.g., an accounting restatement, a going concern opinion) can affect investors’ reactions to different reporting entities with similar characteristics. For example, Schaub (2006) observes accounting information transfer based on shared external auditors, and Chen and Goh (2010) observe accounting information transfer based on common directors.

Accounting information transfer likely works via the representativeness heuristic, a “rule of thumb” in which a person determines the probability that a specific object is stereotypical of other known members of the class based on the degree to which that object is similar to other known members of the class (Tversky and Kahneman 1984; Tversky and Kahneman 1974). In general, the more specific the link, the more a decision maker will assume that the two entities share similar qualities. We contend that the representativeness heuristic suggests that the PCAOB’s proposed audit partner disclosure amendment will increase accounting information transfer of events occurring at one reporting entity (e.g., a restatement) to associated entities via the disclosure of the audit partner’s identity. That is, the knowledge of shared audit partner will create a more salient link between two reporting entities compared to entities only linked via a shared audit firm.

6 Use of this heuristic has traditionally been attributed to biased decision making, (e.g., insensitivity to base rates, sample size, and predictability; Tversky and Kahneman 1974). However, more recent literature suggests that such “fast-and-frugal” decision rules can be rational and sometimes lead to equal or better performance than more systematic weighting of options (Gigerenzer and Goldstein 1996; Read and Grushka-Cockayne 2009).
While investors and auditors disagree as to whether the identity of the audit partner should be viewed as a piece of diagnostic information, our model does not necessarily require resolution of this debate. The first proposition of our model predicts solely that investors will react to the linking information. Specifically, we propose that disclosure of audit partner identities will increase the likelihood that investor reactions associated to specific events that occur at one entity will influence judgments about other entities sharing the same audit partner, due accounting information transfer.

**Proposition 2: Increased Accounting Information Transfer and Auditor Incentive Misalignment**

The second link in our model suggests that increased accounting information transfer will result in auditor incentive misalignments. Specifically, we contend that investor reaction to partner identity disclosure will fundamentally change the extent to which partners value their professional reputations in comparison with the professional reputation of the firm. As accounting information transfer increases, interested parties (e.g., investors, analysts, business writers, academics) are likely to increasingly document and conjecture about audit partner responsibility for individual audit outcomes. In the debate surrounding the proposal, it is freely acknowledged and expected that audit committees and investors may request, or even demand (directly, and indirectly through investment decisions), the assignment of specific engagement partners based on their assessment of partners’ reputations (PCAOB 2011).

Towards that end, audit partners could be faced with the unprecedented pressure of being held accountable, by name, to parties without detailed confidential client/audit information. Presumably,

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7 For example, deputy CEO of Deloitte, Robert Kueppers, explains, “We go through our process, our consultation process, at the end of all that, of course, they get the position of the firm. I don’t think we should confuse the authority of a partner versus the weight of the whole firm behind the issue,” (PCAOB 2008).

8 Audits offer *reasonable assurance* that the financial statements are free of material misstatements as absolute assurance is cost prohibitive (Messier et al. 2011). That is, it is possible that an audit partner may conduct the audit with professional skepticism and due care, in accordance with Generally Accepted Auditing Standards, following all
this information would be necessary to accurately judge partners’ adherence to professional and regulatory standards during the performance of their audits.\textsuperscript{9} Interested third parties (e.g., investors, academics, the media, watchdog groups) could evaluate and judge audit partners according to metrics (hereafter, “external measures”) that could be misleading as to whether a partner applied professional judgment and adhered to professional standards and regulations on a particular audit.\textsuperscript{10} It is likely that external measures developed and used by interested third parties will directly affect audit firm staffing decisions if these measures result in investors and audit committees seeking (and/or avoiding) specific audit partners based on reputation.

Partner compensation is based partially on performance measures such as billable hours, client load, and business development, (hereafter, “internal measures”). It stands to reason that partners are likely to fair worse on such internal measures if they experience negative reputational effects due to poor performance on external measures. For example, as EY (2009) stated in the quote above, if a partner is repeatedly tasked with handling the toughest of audit engagements, the public may form an inaccurate reputational opinion of the partner due to a perception of guilt-by-association with companies with financial reporting difficulties. Partners in situations such as these might not be considered “in demand” based on investor/audit committee requests, and will have difficulty maintaining their portfolio of clients. Thus, such external measures, generated via partner identity disclosure, may have a substantial, indirect effect on partner compensation.

\textsuperscript{9} This is in contrast to those to whom the audit partner is currently held accountable. In other words, the client, the audit committee, other members of the firm, legal and regulatory bodies would have access to detailed confidential auditor and client information necessary to evaluate an individual audit partner’s performance on a specific audit.

\textsuperscript{10} We note that the PCAOB is also currently seeking comments on a concept release which proposes changes to the auditor reporting model (Docket 034, Release No. 2011-003). To the extent that regulators determine that the benefits of partner disclosure outweigh its risks and proceed with the requirement, the PCAOB may wish to consider whether disclosures required within the audit report should be of a nature so that a reasonable user would have a better ability to assess the audit partner’s use of professional judgment and adherence to professional and regulatory standards.
Baker and Hall. (1988) contend that compensation incentives determine a large extent of individual behavior within an organization. To the extent that external measures developed and used by audit committees, investors, analysts, and researchers affect audit firm’s internal measures (or, to the extent that individual partners perceive that such external measures affect their compensation, promotion, and professional reputation), it is very likely that the partner signature requirement will result in a shift, or misalignment in partners’ incentives. Specifically, our concern is that partner disclosure has the potential to alter partners’ incentives (or their perceived incentives) from being closely aligned with that of the firm, the shareholder and other (non-management) stakeholders, and the general public to being more closely aligned with the incentives of client management. For example, in an environment where the partner’s identity is disclosed, a financial statement restatement is likely to have negative reputational effects for both the restating client and the individual engagement partner.¹¹

Link 3: Auditor/Shareholder Incentive Misalignment and Auditor Independence Conflicts

It is generally accepted that the auditor’s role in financial reporting is to reduce information risk that arises from the combination of conflicting incentives and information asymmetry between management and shareholders (Messier et al. 2011). Professional standards require the auditor to be independent of management in both fact and appearance, and that they should not have conflicting incentives with shareholders (Messier et al. 2011). Extant research acknowledges and cautions, ¹¹

¹¹ In fact, it seems to be a reasonable supposition that is will those situations in which a partner is faced with forming an opinion that requires sensitive judgment (i.e., when the contextual details do not make the course of action required immediately, and precisely, clear) that the auditor might feel also feel the pressure of their externally evaluated reputational concerns coming into play. In other words, in situations where it is most desirable that the auditor acts in a professionally skeptical manner, he or she may, instead, engage in motivated reasoning in order to come to a desired (i.e., a conclusion that has less negative shorter-horizon reputational costs).
however, that auditor bias may be introduced to the financial reporting process dependent upon the auditor’s incentive structure (Koch and Schmidt 2010; Magee and Tseng 1990; DeAngelo 1981). Disclosure intended to increase accountability is typically considered necessary in cases where individuals may be tempted to act in their own self-interest at the expense of some greater interest (Hunton et al. 2011). We contend that, in this particular context, increasing the prominence of the individual audit partner’s professional reputation, in fact, will likely lead the partner to be even more focused on his or her own, individual self-interest. And, in fact, an increased focus on the reputation of individual audit partners may result in an undermining of the auditor’s role with respect to the reduction of agency costs (i.e., by introducing additional, incentive-related conflict of interest between the audit partner and shareholders that is similarly aligned with the conflict of interest that exists between management and shareholders).

In fact, public accounting professional and regulatory bodies specifically recognize that auditors’ incentives should not be aligned with management through their prohibition of the performance of work on a contingent fee basis (Messier et al. 2011). We know that investors and analysts generally react to comparisons of company performance to earnings trends and earnings forecasts and react negatively to events such as losses, restatements, and going concern opinions (e.g., Slovic 1969; Nagy and Obenberger 1994; Jones 1996; Palmrose et al. 2004). Because of this, managers often feel pressure, and have incentives, to manage earnings or misreport in order to meet analysts’ and investors’ expectations (Graham et al. 2005). To the extent that partner disclosure results in the audit partner’s immediate, short-term, incentives being more closely aligned with management’s, the proposed regulation might introduce a new conflict of interest between the audit partner and the shareholder that undermines auditor independence.
For example, academics use archival data to create diverse external measures, such as discretionary accruals, restatements, auditor size, issuance of qualified audit opinions, auditor litigation, and earnings benchmarks, to proxy for audit quality (Caramanis and Lennox 2008; Kinney et al. 2004; Krishnan 2003; Myers et al. 2003; Francis and Krishnan 1999; Becker et al. 1998). Further, many of these same measures are also used in academic research to make inferences about financial statement/earnings quality and/or to make inferences about CEO performance (e.g., Jones 1991; Bartov et al. 2000; Desai et al. 2006; Bergstresser and Philippon 2006; Cheng and Farber 2008). Similarly, it is possible that interested parties will use comparable external measures to evaluate audit partner performance as they currently use to evaluate management performance. In fact, and as mentioned earlier, academics have explicitly expressed the desire and intent to do so in the PCAOB’s Standing Advisory Group’s (SAG) transcripts (PCAOB 2008).

If audit partners are evaluated using measures similar to those used to evaluate management (and dependent upon the extent to which those evaluations affect audit partner incentives), there is the possibility that such external evaluations may increase audit partner accountability and transparency at the expense of auditor independence and, in turn, audit quality. That is, disclosure may create unintended effects, and may even encourage the behavior it is intended to prevent, by creating a moral license for the partner to act in his or her own self-interest (Hunton et al. 2011). Accordingly, we propose that partner disclosure may cause audit partners’ longer-term professional responsibilities, incentives, and reputational concerns to conflict with their individual, more short-term oriented, self-interest.

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12 We do not wish to suggest such proxies are not good for large sample, academic research for making cautious generalizations about audit quality (as they are typically used in academic research). We simply suggest such measures may be less appropriate for examining the extent to which a particular audit partner adhered to professional standards.
III: Testing Audit Partner Identity Disclosure and Increased Accounting Information Transfer

We conduct an experiment to establish that partner identity disclosure is associated with increased accounting information transfer, thereby fostering the creation of external measures. The purpose of our experiment is to examine whether and why, in a situation where there is negative information (i.e., a restatement) associated with a particular audit engagement, investors will react differentially based on the presence/absence of partner disclosure. Restatements are generally perceived negatively; however, there are many circumstances in which a company may be required to restate their financial statements even if the auditor performed the audit with the utmost level of care. As noted previously, it is precisely in such situations that the largest concern exists for partners to be motivated to act in their own immediate, shorter-term, self-interests (e.g., to avoid the reputational effects of a restatement). Thus, in this section, we choose to test the first link in our model, investor reaction to partner disclosure, using the context of a financial statement restatement.

Accounting Information Transfer and Representativeness

As stated previously, existing research refers to a phenomenon in which negative information about one reporting entity leads investors to alter their assessments about a different reporting entity with similar characteristics or qualities as accounting information transfer (Schaub 2006; Gleason et al. 2008). For example, Gleason et al. (2008) find that accounting restatements induce a share price decline for non-restating “peer” firms linked to a restating firm via the same industry. They also find that shared audit firms can induce accounting information transfer. That is, they find a larger effect

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13 Existence of accounting information transfer does not necessarily represent a cognitive bias as the contagious information may have diagnostic value. For example, Schaub (2006) argues that going concern opinion announcements result in negative stock price adjustments to firms in the same industry and concludes that market participants interpret the information provided by the audit opinion as an industry-wide problem.
on the stock price of peer firms (with high earnings and high accruals) when peer firms are linked to a restating firm by way of the same external auditor than it is not so specifically linked.

Further, Huang and Li (2009) find that companies audited by Arthur Andersen’s Houston office experienced negative stock price effects following news reports of workpaper shredding, and Weber et al. (2008) find that audit clients of KPMG Germany experienced negative market effects after a highly publicized accounting scandal. There is also evidence to suggest that accounting information transfer may manifest when firms are linked through an individual person. For example, Chen and Goh (2010) find a contagion effect through common directorships. That is, they find negative abnormal returns, following the date of the restatement, for companies that share a director with a restating firm.

We contend that the representativeness heuristic may help to explain why investors allow negative information from one company to affect their investment decisions related to a (sometimes cursorily) linked company. That is, the more specific the link (e.g., same engagement partner compared to same audit firm), the more representative the object in question will appear to a decision maker. Thus we predict that peer entities linked by way of the same engagement partner are likely to be perceived by investors as being more closely linked to contaminated entities than those linked solely through the same audit firm. Or more broadly stated, we expect that audit partner identity disclosure will be associated with greater accounting information transfer. Formally stated as follows:

\[ H_1: \text{Audit partner identity disclosure will result in increased accounting information transfer.} \]

Modifying the Audit Report to Mitigate Accounting Information Transfer

In the first concept release related to audit partner identity disclosure, the PCAOB (2009) requests commenters to respond with their opinion on the following, “Would requiring the
engagement partner to sign the audit report make other changes to the standard audit report necessary?” Both the PCAOB and members of the PCAOB standing advisory group note that a partner signing the audit firm’s signature is considered evidence that the audit report is a product of the firm, and that the firm as a whole stands behind the report (PCAOB 2009; PCAOB 2008). Identifying the specific partner on the audit report might reduce the extent to which investors understand that the opinion is a product of the firm as a whole.

Gigerenzer and Goldstein (1996) suggest that the representativeness heuristic is relied on more heavily when people make decisions with limited knowledge. Accordingly, reminding investors that the audit is a product of the firm and not simply an individual audit partner, has the potential to increase investors’ contextual knowledge of the audit process, thereby limiting the use of heuristics in decision making. Thus, a modification of the audit report (in which the partner’s identity is disclosed), which reminds financial statement readers that the audit report is a product of the firm, could reduce the extent to which investors perceive that the name of the audit partner is a relevant piece of information for their investment decision(s). While, it is possible, as argued by audit firms, that such a specific modification would only serve to highlight the new information and increase the extent to which investors will attend to it, we predict that such a modification will reduce the extent of accounting information transfer due to disclosure of the audit partner’s identity. We propose the following hypotheses:

H2: Modifying the audit report to highlight the audit firm’s responsibility for forming the audit opinion will reduce a negative contagion effect associated with the presence of a partner’s name on the audit report.
IV. Method

Participants

Three hundred and eighty individuals with investment experience participated in the study. We initially recruited participants through personal contacts of groups known to have investing experience (e.g., the National Association of Investors Corporation); however, we obtained the majority of our participants (approximately 88 percent) using Qualtrics – a survey software and research firm. Qualtrics contacted potential participants using a selection procedure that ensured participants’ demographic information was representative of the US population as a whole (as determined by the most recent US census data) and allowed for matching on selectable criteria (Anagol and Gamble 2011; Wright and Carlucci 2011). Our selection criteria required participants to be college graduates over the age of 25, who were not CPAs, and who had experience actively trading individual shares of stocks or bonds (i.e., 401k and/or mutual fund investing experience was not sufficient). Our average participant was approximately 48 years-old, and had over four years of work experience preparing or analyzing financial information. Approximately 52 percent of respondents were female. Each demographic measure was randomly distributed across conditions (all p-values ≥ 0.744). Results and inferences are robust to the inclusion of the demographic measures as control variables.

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14 Participant type was randomly distributed across conditions (p > 0.83). Whether or not we include participant type as a control variable does not significantly affect results or change the inferences drawn. However, due to numerous differences in the method of identification and contact of participants, we control for it in all reported results.

15 We chose not to include CPAs in our sample because, based on the reaction of public accounting firms and associations to the concept release, such participants would be more aware of the potential amendment. Thus, they are more likely to engage in hypothesis guessing and respond in such a way that would skew our results.
**Task and Procedure**

We created our experimental instrument based on Kida et al. (1998). First, we instructed participants that they would be asked to review and provide their opinions of five hypothetical companies for long-term investment purposes. We also informed participants that they would be provided with performance measures based on each company’s most recent audited annual financial statements. Finally, we noted that each company was publicly traded, within the same industry, located in the same region, and had received an unqualified financial statement opinion from one of the Big 4 accounting firms.

Second, participants received financial data on the five potential investment companies (“American Computers”, “Computer World”, “Electronics USA”, “US Technologies”, and “Wired States”). In each condition, we provided participants with a generic Big 4 audit firm name (e.g., Firm ABC or Firm DEF) and five numerical accounting measures (i.e., current ratio, days sales of inventory, return on assets, profit margin, and market share). Similar to Kida et al. (1998), one firm was markedly better than the other four firms on all of the data dimensions provided. Specifically, US Technologies’ performance metrics were better (in every category) than each of the other four firms listed, making it the optimal investment from a quantitative financial data perspective.

Third, we informed participants that one firm, Wired States, recently restated its prior year audited financial statements. We provided participants with updated performance measures for Wired States. Fourth, we presented participants with a table summarizing the performance measures for all companies, highlighting the updated performance measures for the restating firm (presented in Figure 16).

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16 Though our participants should have been familiar with all of the performance measures we used in the study, we provided each participant with an addendum explaining each performance measure to ensure that participants understood each performance measure, and to unify the definition of each performance measure employed in the case. Participants were free to review the addendum at any time during the case.
3). While we did not make specific mention of it to the participants, participants in every condition should be able to identify that the same audit firm that had audited the quantitatively optimal investment choice (US Technologies) also audited the restating firm (Wired States). For the conditions that contained the engagement partner’s name, participants were also able to identify that Wired States and US Technologies shared the same engagement partner.\textsuperscript{17}

[Please insert Figure 1 about here]

**Design and Independent Variables**

The experiment involved an incomplete 2 x 2 between-participants design. That is, when we presented performance measures to participants, we manipulated the information available as either the audit firm name (“FIRM” condition), or the audit firm name and the partner’s name (“PARTNER” condition). Further, when we presented the partner name, we also manipulated whether the audit report included a note, along with the Wired States restatement information, that stated:

\[ "Each audit firm stresses in its audit reports that while the audit opinion is signed by both the audit partner and the audit firm, the audit opinion represents that of the entire firm. Additionally, each firm notes that the audit involves many firm employees and includes technical guidance and other resources from its national headquarters." \]

Thus, in our third condition (“REPORT_MOD” condition), participants are provided with both the partner name and the audit report modification. We modified the audit report using language similar to that used in the Standing Advisory Board transcripts discussing the first impending concept release (PCAOB 2008).

\[ \textsuperscript{17} \text{The experimental instrument was silent as to whether the engagement partner responsible for the engagement in the prior year (i.e., the year in which Wired States’ financial statements were restated) was the same individual responsible for the current year engagement. We made this design choice in order to ensure that information related to audit partner tenure did not vary by condition. We note that the current PCAOB concept release proposes disclosure of the name of the engagement partner responsible for the most recent period's audit only and we feel that any effect of this design choice would only bias us against finding results.} \]
Dependent and Other Measures

*Dependent Variables.* We use two dependent variables to test our hypotheses. Specifically, we measure (1) participants’ likelihood of choosing US Technologies (i.e., the “contaminated” firm) as their preferred investment choice, and (2) participants’ investment allocation to US Technologies. For the preferred investment choice measure, participants chose the “ONE company that [they] would most likely choose for a long-term investment.” During this portion of the experiment, participants were able to select only one of the five potential investment choices. We code our variable of interest, *INVEST_UST* as 1 if investors chose to invest in US Technologies, 0 otherwise. We use this measure as our primary test of H1 and H2. Specifically, we test for significant differences in the proportion of investors who chose US Technologies as their preferred investment choice, by condition. Following the preferred investment choice, participants were asked to, “Allocate [their] funds on a percentage basis to ONE OR MORE of the companies for long-term investment purposes.” Participants were able to proceed only if the total allocated among the five investments equaled 100 percent. We compare the amount allocated to US Technologies (*ALLOCATE_UST*), across conditions, as a secondary measure for testing H1 and H2.

*Potential Mediating Factor.* As discussed in the development of H1, in the context of audit partner disclosure, use of the representativeness heuristic will likely cause investors to assume that a condition or an event at a contaminated reporting entity (i.e., a restatement) may be representative of conditions or events that are likely to exist at a different, “peer” reporting entities. To the extent that an investment contagion effect is due to reliance on the representativeness heuristic, we expect investors’ perceptions of the likelihood that the peer firm of interest (US Technologies) will experience a restatement in the future to mediate the relation between our independent variables and participants’ investment decisions. Thus, we measure participants’ assessment of the likelihood that
US Technologies will experience a restatement at some point in the next three years (UST_RESTATE) (responses were measured on a 11-point scale where 1 = “very unlikely” and 11 = “very likely”).

**Manipulation/Attention Checks.** We asked participants two questions to assess whether they attended to our manipulations. First, we asked respondents a “yes” or “no” question as to whether the audit partner’s name was disclosed in the information provided (ATTEND_PARTNER). We then asked, “Which of the following statements below best matches the information provided to you in the case about audit reports?” (ATTEND_REPORT_MOD). Response choices included (a) “The audit report stresses that the opinion represents only that of the audit partner,” (b) “The audit report stresses that the audit opinion represents that of the entire firm (the correct response for the report modification condition),” and (c) “The case materials contained no language about how audit firms view individual audit opinions (the correct response for the firm only and partner conditions).” Both responses were coded 1 (0) if participants responded correctly (incorrectly).

We control for both attention measures (ATTEND_PARTNER and ATTEND_REPORT_MOD) in all reported analyses rather than dropping manipulation check failures because our predicted effect depends upon the extent to which participants attend to information.18 We also performed all reported analyses without controlling for the attention/manipulation checks and removing those participants who responded incorrectly to the related questions. Unless otherwise specified, our reported results and inferences are not significantly affected by our treatment of these measures.

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18 When examining the impact of a manipulated message on an outcome, a manipulation check measured at the time of participation in the experiment is unnecessary and likely serves some other purpose, such as an attention check or an assessment of a mediating variable (O’Keefe 2003; Lambert and Agoglia 2011). That is, when determining the impact of a manipulated message, a “failed” manipulation check does not indicate that the manipulation itself “failed”, but that participants did not attend to the information (O’Keefe 2003).
V. Results

Hypotheses Testing

Table 1 presents the results of H1 and H2 testing using our primary dependent measure—investors’ single investment choice (INVEST_UT). Our first hypothesis states that audit partner identity disclosure will result in increased accounting information transfer. Or, more specifically given our context, there will be a larger contagion effect for a peer firm linked to a restating firm via audit partner (i.e., PARTNER and REPORT_MOD conditions) than for a peer firm linked solely through audit firm (FIRM). Panel A of Table 1 presents descriptive statistics and chi-square comparisons between cells. In support of H1, we find that FIRM participants \((M = 67.2)\) were significantly (at a marginal level) less likely to choose US Technologies than PARTNER and REPORT_MOD participants \((M = 58.6, p = 0.08)\). We interpret these results to suggest that investors are less likely to invest their resources into a company linked to a contaminated firm when the link is established through a shared audit partner than when the link is established only through a shared audit firm.

We next perform a logistic regression using the following model:

\[
INVEST_UT = \beta_0 + \beta_1 \text{PARTNER} + \beta_2 \text{REPORT_MOD} + \beta_3 \text{QUAL} + \beta_4 \text{ATTEND\_PARTNER} \\
+ \beta_5 \text{ATTEND\_REPORT\_MOD} + \epsilon_i
\]

\(INVEST_UT\) is the binary variable that denotes whether the investor chose US Technologies as their single investment choice, \(\text{PARTNER}\) indicates whether the partner name was present, and \(\text{REPORT\_MOD}\) identifies whether the participant was informed that the audit report contained additional language explaining that the audit represents the opinion of the entire firm. \(\text{QUAL}\) is a binary variable that denotes whether the participant was recruited through Qualtrics panels. \(\text{ATTEND\_PARTNER}\) and \(\text{ATTEND\_REPORT\_MOD}\) are control variables that indicate whether the
participant correctly identified the presence of the partner name or audit report modification, respectively.

Panel B of Table 1 presents results of our logistic regression. Also consistent with H1, \textit{PARTNER} is a significantly negative predictor of whether investors chose US Technologies as their single investment choice \((b_1 = -0.561; \ p = 0.035)\). This result is consistent with our earlier result that investors are less likely to invest their resources into a company linked to a contaminated firm when the link is established through a shared audit partner than when the link is established only through a shared audit firm.

[Please insert Table 1 about here]

We also use results of the above logistic regression for testing H2, which predicts that modifying the audit report to highlight that it is the audit firm’s responsibility for forming the opinion will reduce information transfer associated with the presence of the partner’s name. Thus, we expect a positive significant coefficient on \textit{REPORT\_MOD}. Inconsistent with H2, the coefficient on \textit{REPORT\_MOD} (Table 1, Panel B) is neither positive nor significant \((b_2 = -0.200; \ p = 0.486)\). Similarly, Panel A shows that there are no differences in the percentage of participants who chose US Technologies as their single investment choice when the audit report was modified than when it was not modified \((57.8\text{ percent vs. } 58.6\text{ percent, respectively; } p = 0.89)\). We conclude that H2 is not supported and suggest that modifying the audit report (in a manner similar to the wording we use in our experiment) will not reduce the extent to which investors react to the disclosure of an audit partner’s name.

Finally, in untabulated analyses, we perform a linear regression using the percentage of funds participants chose to allocate to investing in US Technologies \((ALLOCATE\_UST)\) as the dependent variable (including the same independent and control variables as the model in Table 1, Panel B). In
further support of H1, we find PARTICNER is a significantly negative predictor of the amount of funds that participants chose to invest in US Technologies ($b_1 = -0.118; p = 0.029$). Again, REPORT_MOD is not a significant predictor of fund allocation ($b_2 = 0.036; p = 0.277$).

In summary, we find no support for H2, which suggests that making investors aware of the fact that a financial statement audit is a product of the whole firm (rather than of the individual audit partner) does not appear to alleviate any increase in accounting information transfer due to partner disclosure in our context. We conclude that H1 is supported and provide evidence for the first link in our model of the potential impact of partner disclosure on audit partner independence (and, in turn, audit quality). Specifically, whether or not investors should react to disclosure of the audit partner’s identity, our results suggest that they will.

**Mediation Analysis: Restatement Likelihood**

To further test our model, we perform an analysis to determine whether investors’ perceptions regarding the likelihood that US Technologies (the peer firm) will experience a restatement in the future is the mediating mechanism behind our results supporting H1. That is, we examine whether assessments of the likelihood that the peer firm will experience a restatement ($UST_RESTATE$) mediate the effect of partner disclosure on investors’ decision making. For ease of presentation and parsimony, we eliminate the report modification participants from our mediation analysis (recall that H2 was not supported). Figure 3 presents the results of our mediation analysis, which incorporates a combination of three regression models (Baron and Kenny 1986). We first rerun our regression model from Table 1 without REPORT_MOD. Consistent with our testing of H1, we find support for

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19 Unless otherwise noted throughout our discussion, including the full sample in the mediation analysis does not reduce the significance level of our results or change the inferences drawn.
the first assumption of mediation in that we find a significantly negative PARTNER coefficient (Model I, \( b_1 = -0.559; p = 0.041 \)).

[Please insert Figure 4 about here]

Next, we find support for the second assumption of mediation in that we find PARNTER is significantly correlated with the mediator, UST_RESTATE (Model II, \( b_2 = 0.611; p = 0.057 \)).\(^{20}\)

Further, we find support for the third assumption of mediation as we find that the mediator, UST_RESTATE, affects the outcome variable, INVEST_UST (Model III, \( p < 0.001 \)). Finally, when we include UST_RESTATE in Model I, while the effect of UST_RESTATE remains to be a significant predictor of INVEST_UST (\( b_3 = -0.113; p = 0.022 \)), we find the effect of PARTNER on INVEST_UST reduces to marginal significance (\( b_5 = -0.509; p = 0.059 \)).\(^{21}\) Accordingly, we conclude that investors’ assessments of the likelihood that a peer firm will experience a restatement in the future partially mediates the contagion effect (due to partner disclosure) exhibited by investors in our experiment. To the extent that differences in assessed likelihood that US Technologies will experience a restatement is reflective of use of the representativeness heuristic, we can conclude that reliance on that heuristic partially drives our results.

**Supplemental Analysis: Financial Reporting Experience**

Research suggests that cognitive biases that affect investors’ decision making are often modified or eliminated when the investors are more experienced (e.g., Joyce and Biddle 1981; Kida et al. 2010). To the extent that the contagion effect exhibited in our study is due to bias, investors

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\(^{20}\) Note that this result reduces somewhat in significance (\( p = 0.075 \)) when we run the analysis on the full sample (i.e., including the “report modification” condition). Also, the result is not significant at conventional levels when we do not control for ATTEND_PARTNER and ATTEND_REPORT_MOD (\( p = 0.127 \)).

\(^{21}\) Untabulated analyses demonstrate that the mediation requirements are satisfied using our secondary dependent measure. Specifically, “partner” is a significant predictor of “restatement likelihood” (Model II; \( p = 0.057 \)), “restatement likelihood” is a significant predictor of “allocate US Tech” (Model III; \( p = 0.003 \)), and when we include both variables in the model, the significance of the “partner” variable decreases in significance (\( p = .054 \)).
with more financial reporting related experience should exhibit less of the effect than less experienced investors (Bonner et al. 2003). To investigate whether our results are driven primarily by less experienced investors (and thus, are more likely to be attributable to biased decision making), we conduct additional analyses using participants’ experience working with financial information as a proxy for financial reporting experience. Specifically, we partition the sample between zero and one year (median 0 years, mean 3.69 years) according to the post-experimental question which asks, “How much work experience do you have where you were responsible for preparing or analyzing financial information?” That is, participants who responded with a one, or higher number, of years were designated more experienced (48 percent of the sample), while those who responded with zero years were labeled as less experienced (52 percent of the sample). For this analysis, we remove participants that did not provide experience information.

Panels A and B of Table 2 present results of the model used to test H1 for less experienced and more experienced investors, respectively. We find that our H1 results are primarily due to responses provided by less experienced investors. That is, PARTNER is significantly negative for our pool of less experienced investors ($\beta_1 = -0.890; p = 0.032$), but is not significant for our pool of more experienced investors ($\beta_1 = -0.380; p = 0.241$). We obtain similar results (untabulated) for our secondary dependent measure, the percentage of funds allocated to US Technologies ($INVEST_{UST}$). Specifically, PARTNER is a significantly negative predictor of $INVEST_{UST}$ for less experienced investors ($p = 0.009$), but not for more experienced investors ($p = 0.921$). That is, even though all of

\[\text{\footnotesize 22 Also note that controlling for investor experience in the analyses we perform in order to test our hypotheses (Table 1), does not significantly affect results or change the inferences drawn from them.}\]
our investors had investing experience, only those with less familiarity working with financial information exhibited the contagion effect when partner identity was disclosed.\footnote{We find similar results when we partition the data using other classifications of experience. We separated experience using a mean split of the experience variable (mean = 3.69 years). We also partitioned that data using a median split of participants’ responses to both their familiarity with the financial information presented in this case (median = 8 on an 11-point scale) and their familiarity with auditing procedures (median = 7 on an 11-point scale). In all cases, PARTNER remained significant (p < 0.05 for all cases) for less experienced investors and not significant (p > 0.15 for all cases) for more experienced investors, suggesting that our findings are robust to multiple, alternative, classifications of experience.}

These results shed some interesting light on our finding that investors exhibit a stronger restatement-related contagion effect for firms linked through the same audit partner (than for firms linked through the same audit firm). Specifically, the fact that less experienced investors are reacting to the information while more experienced investors are not, provides indirect evidence that the reaction is more likely to be biased than rational. To the extent that less experienced investors’ reaction is not rational, we provide further support to challenge the assumption that more disclosure always helps to level the playing field between different types of investors (Monin and Miller 2001).

VI. Discussion, Limitations and Suggestions for Future Research

The motivation behind the PCAOB’s potential new requirement for audit partner disclosure is to increase accountability on the part of the audit partner and transparency for interested parties who rely upon the financial statements (ACAP 2008; PCAOB 2008; PCAOB 2009; PCAOB 2011). We present an exploratory model that considers a potentially negative, unintended consequence of such disclosure. Specifically, our model links (1) partner disclosure to an increase in the transfer of potentially biased information, (2) accounting information transfer to a misalignment of audit partner and shareholder incentives, and (3) misalignment of partner incentives to impaired audit independence. Further, we design and perform an experiment to test the first link in our model. In so
doing, we find that investors are significantly less likely to invest in, and are more likely to allocate fewer resources to, a peer firm linked to a contaminated firm in the presence of partner disclosure than when partner identity is not disclosed. Contrary to our expectations, modifying the audit report in order to attempt to reduce the extent of this increased information transfer (based on partner disclosure) does not significantly affect investors’ decisions. Our supplementary analyses show that (a) increased information transfer, in our context, is partially mediated by investors’ perception of the likelihood that the peer firm will experience a restatement in the future, and (b) less experienced investors are more likely to react to partner disclosure. We interpret both of these additional analyses as evidence that the increased accounting information transfer, due to partner disclosure, exhibited in our experiment may be a result of bias rather than rational decision making.

One main limitation of the current study is that we only present empirical evidence which tests the first link in our model. Due to the timeliness of this issue, and the fact that almost none of the debate and discussion surrounding the proposed change to the audit report examines potential auditor independence ramifications, we choose to rely upon existing research to support the second and third link of our model. We expect and encourage future research to further test potential linkages between partner disclosure, accounting information transfer, misalignment of auditor incentives, and auditor independence. We also acknowledge that we only test our first proposition, that partner disclosure will increase accounting information transfer, in one very specific context. Future studies should explore investor reaction to other (positively perceived and negatively perceived) financial reporting events under conditions of partner disclosure.

Finally, we conclude by stating that the conclusions of our study do not indicate that partner disclosure should, definitively, not be enacted. Future research should weigh the potential benefits of such disclosure (i.e., increased accountability and transparency) against the potential costs that we
have outlined in this paper. In addition, future studies should examine additional disclosures that might allow investors, audit committees, academics, and other interested parties to develop better measures in order to assess audit quality. We note that, if audit quality was more easily accessible using publicly available information, then many of the audit independence concerns outlines in this paper would cease to exist.
REFERENCES


FIGURE 1
Model of Audit Partner Disclosure Reaction

Audit Partner Identity Disclosure → Increased Accounting Information Transfer → Auditor / Shareholder Incentive Misalignment → Auditor Independence Conflicts
# FIGURE 2
Final Presentation of Investment Options

<table>
<thead>
<tr>
<th>Company Name</th>
<th>American Computers</th>
<th>Computer World</th>
<th>Electronics USA</th>
<th>US Technologies</th>
<th>Wired States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Big 4 Audit Firm</td>
<td>Firm ABC</td>
<td>Firm ABC</td>
<td>Firm DEF</td>
<td>Firm DEF</td>
<td>Firm DEF</td>
</tr>
<tr>
<td>Audit Partner*</td>
<td>David Lastings</td>
<td>David Lastings</td>
<td>James Keaton</td>
<td>Thomas Edwards</td>
<td>Thomas Edwards</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>2.35</td>
<td>2.25</td>
<td>2.37</td>
<td>2.38</td>
<td>2.23 → 1.97</td>
</tr>
<tr>
<td>Days Sales of Inventory</td>
<td>28</td>
<td>32</td>
<td>27</td>
<td>25</td>
<td>39 → 65</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>12.3</td>
<td>9.8</td>
<td>12.6</td>
<td>12.9</td>
<td>8.1 → 4.8</td>
</tr>
<tr>
<td>Profit Margin</td>
<td>14.5</td>
<td>11.4</td>
<td>14.7</td>
<td>14.8</td>
<td>8.3 → 5.0</td>
</tr>
<tr>
<td>Market Share</td>
<td>8.41</td>
<td>6.74</td>
<td>8.5</td>
<td>8.7</td>
<td>5.53 → 5.22</td>
</tr>
</tbody>
</table>

**Audit Opinion Note.** Each audit firm stresses in its audit reports that while the audit opinion is signed by both the audit partner and the audit firm, the audit opinion represents that of the entire firm. Additionally, each firm notes that the audit involves many firm employees and includes technical guidance and other resources from its national headquarters.**

* Audit Partner name was only included in the two partner conditions.
** The audit opinion note was only present in the report modification condition.
PARTNER is the treatment variable manipulated at two levels whether the firm or partner name were provided in the audit report (0 = firm name; 1 = partner name). Note: for the purposes of this analysis, we exclude the audit report modification condition.

INVEST_UST indicates dichotomously whether a participant invested in US Technologies (1=invested in US Technologies; 0=invested in other choice). US Technologies was audited by the same audit partner (firm) as the restating firm.

RSTMNTLIKE is the participant’s response to the likelihood of US Technologies experiencing a restatement in the near future (recorded on an 11-point scale where 0 = “very unlikely” and 10 = “very likely”).

$b_1$ through $b_5$ are estimated coefficients from the following linear and logit regression equations:

I: $INVEST\_UST = \beta_{0I} + \beta_{1\_PARTNER} + \varepsilon_I$

II: $UST\_RESTATE = \beta_{0II} + \beta_{2\_PARTNER} + \varepsilon_{II}$

III: $INVEST\_UST = \beta_{0III} + \beta_{3\_UST\_RESTATE} + \varepsilon_{III}$

IV: $INVEST\_UST = \beta_{0IV} + \beta_{4\_UST\_RESTATE} + \beta_{5\_PARTNER} + \varepsilon_{IV}$

Note: All regression equations include the following control variables: QUAL, ATTEND_PARTNER and ATTEND_REPORT_MOD. See Table 1 for variable definitions.
### TABLE 1
Investment Choice

#### Panel A: Investment Choice

<table>
<thead>
<tr>
<th>Firm Name</th>
<th>Partner Name</th>
<th>Report Modification</th>
<th>Comparison Between Groups Significance Level</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Computers</td>
<td>10.1%</td>
<td>9.0%</td>
<td>14.1%</td>
</tr>
<tr>
<td>Computer World</td>
<td>3.4%</td>
<td>4.5%</td>
<td>3.9%</td>
</tr>
<tr>
<td>Electronics USA</td>
<td>14.3%</td>
<td>17.3%</td>
<td>18.8%</td>
</tr>
<tr>
<td>US Technologies</td>
<td>67.2%</td>
<td>58.6%</td>
<td>57.8%</td>
</tr>
<tr>
<td>Wired States</td>
<td>5.1%</td>
<td>10.5%</td>
<td>5.5%</td>
</tr>
</tbody>
</table>

(n=119) (n=133) (n=128)

#### Panel B: Logistic Regression on Investment in US Technologies

\[
INVEST_{UST} = \beta_0 + \beta_1 PARTNER + \beta_2 REPORT\_MOD + \beta_3 PART\_TYPE + \beta_4 ATTEND\_PARTNER + \beta_5 ATTEND\_REPORT\_MOD + \epsilon_i
\]

<table>
<thead>
<tr>
<th>Variable</th>
<th>Expected Sign</th>
<th>Coefficient (S.E.)</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td></td>
<td>0.916 (0.519)</td>
<td>0.078</td>
</tr>
<tr>
<td>PARTNER(^6)</td>
<td>-</td>
<td>-0.561 (0.310)</td>
<td>0.035(^3)</td>
</tr>
<tr>
<td>REPORT_MOD(^7)</td>
<td>+</td>
<td>-0.200 (0.287)</td>
<td>0.486</td>
</tr>
<tr>
<td>QUAL(^8)</td>
<td>?</td>
<td>-1.020 (0.473)</td>
<td>0.031</td>
</tr>
<tr>
<td>ATTEND_PARTNER(^9)</td>
<td>?</td>
<td>0.675 (0.277)</td>
<td>0.015</td>
</tr>
<tr>
<td>ATTEND_REPORT_MOD(^10)</td>
<td>?</td>
<td>1.051 (0.519)</td>
<td>&lt; 0.001</td>
</tr>
</tbody>
</table>

1. Percentage breakdown of single investment choice.
2. Firm with the highest ranked performance measures; same audit firm / same audit partner as the restating firm.
3. Restating firm.
4. One-tailed p-value.
5. \(INVEST\_UST\) = a binary variable indicating if investor chose US Technologies; 1 if investors choose to invest in US Technologies, 0 otherwise
6. \(PARTNER\) = indicator variable of whether the partner name was present.
7. \(REPORT\_MOD\) = indicator variable of whether the audit report contained additional language explaining that the audit represents the opinion of the entire firm.
8. \(QUAL\) = indicates whether the participant was recruited through Qualtrics panels.
9. \(ATTEND\_PARTNER\) = indicates whether the participant correctly identified presence of partner name
10. \(ATTEND\_REPORT\_MOD\) = indicates whether the participant correctly identified whether or not the audit report contained the modification language.
### TABLE 2
Logistic Regression on Invested in US Technologies\(^1\) by Investor Experience\(^2\)

\[ \text{INVEST\_UST} = \beta_0 + \beta_1 \text{PARTNER} + \beta_2 \text{REPORT\_MOD} + \beta_3 \text{PART\_TYPE} + \beta_4 \text{ATTEND\_PARTNER} + \beta_5 \text{ATTEND\_REPORT\_MOD} + \varepsilon_i \]

Panel A: Less Experienced Investors\(^2\)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Expected Sign</th>
<th>Coefficient (S.E.)</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>?</td>
<td>1.589 (0.871)</td>
<td>0.068</td>
</tr>
<tr>
<td>\text{PARTNER}(^3)</td>
<td>-</td>
<td>-0.890 (0.481)</td>
<td>0.032(^8)</td>
</tr>
<tr>
<td>\text{REPORT_MOD}(^4)</td>
<td>+</td>
<td>0.273 (0.435)</td>
<td>0.531(^8)</td>
</tr>
<tr>
<td>\text{QUAL}(^5)</td>
<td>?</td>
<td>-1.401 (0.793)</td>
<td>0.077</td>
</tr>
<tr>
<td>\text{ATTEND_PARTNER}(^6)</td>
<td>?</td>
<td>0.891 (0.404)</td>
<td>0.028</td>
</tr>
<tr>
<td>\text{ATTEND_REPORT_MOD}(^7)</td>
<td>?</td>
<td>0.646 (0.871)</td>
<td>0.086</td>
</tr>
</tbody>
</table>

Panel B: More Experienced Investors\(^2\)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Expected Sign</th>
<th>Coefficient (S.E.)</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>?</td>
<td>0.533 (0.716)</td>
<td>0.482</td>
</tr>
<tr>
<td>\text{PARTNER}</td>
<td>-</td>
<td>-0.380 (0.540)</td>
<td>0.241(^8)</td>
</tr>
<tr>
<td>\text{REPORT_MOD}</td>
<td>+</td>
<td>-0.930 (0.500)</td>
<td>0.063</td>
</tr>
<tr>
<td>\text{QUAL}</td>
<td>?</td>
<td>-0.474 (0.635)</td>
<td>0.455</td>
</tr>
<tr>
<td>\text{ATTEND_PARTNER}</td>
<td>?</td>
<td>0.542 (0.502)</td>
<td>0.280</td>
</tr>
<tr>
<td>\text{ATTEND_REPORT_MOD}</td>
<td>?</td>
<td>1.602 (0.431)</td>
<td>&lt;0.001</td>
</tr>
</tbody>
</table>

---

1. \(\text{INVEST\_UST}\) is an indicator variable as to whether the participant invest in U.S. Technologies
2. Investor Type = 294 of the 380 participants provided their experience working with financial information (mean = 4.69 years, median=0 years). This subsample was split so that zero years of experience represents less experienced investors while one or more years of experience represents more experienced investors.
3. \(\text{PARTNER}\) = indicates whether the partner name was present.
4. \(\text{REPORT\_MOD}\) = indicates whether the audit report contained modification language.
5. \(\text{QUAL}\) = indicates whether the participant was recruited through Qualtrics panels.
6. \(\text{ATTEND\_PARTNER}\) = indicates whether the participant correctly identified the presence of the partner name.
7. \(\text{ATTEND\_REPORT\_MOD}\) = indicates whether the participant correctly identified the audit report modification.
8. One-tailed p-value.