Past studies have shown that the relationship between an audit firm and their long
term clients affect the quality of audit work. Evidence supports the assertion that
when an auditor has a long term relationship, the auditor usually seeks to obtain
evidence that corroborates rather than challenge the assertions made by
management. According to this PCAOB release, even well intentioned auditors fail to
recognize and guard against their own unconscious biases when auditing a long
term client. This fact has led to the increase in the number of auditors displaying a
lack of professional skepticism in their work.

In my opinion, a mandatory requirement for public companies to rotate their
external auditors will improve auditor independence and objectivity. As John Biggs
said, “had Arthur Andersen in 1996 known that Peat Marwick was going to come in
1997, there would have been a very different kind of relationship between them and
Enron.” This statement explains how auditor rotation could have prevented some of
the major corporate scandals. An audit firm will be more likely to ensure that it has
performed its audit duties to the highest standards if it knows that at some point its
work will be checked by the audit firm that takes over the client.

The cost and benefit analysis involved in auditor rotation shows that there are
significant costs to consider in implementing a mandatory rotation requirement. The
steep learning curve in the first few years of a new client engagement and the high
cost to firms in switching auditors are significant issues that cannot be ignored.
However, the ultimate objective in performing an audit is to assure the users of
financial statements about the accuracy of management assertions. Without a
rotation policy, an audit firm will not be able to be completely independent and
objective. The fact that the audit fees are paid by the audit client is the reason why
auditors find it difficult to become objective. A rotation requirement will enhance an
audit firm’s independence because each new engagement will not be treated as a
potential for long term income from the client. One solution suggested by experts
that we agree with, is to replace the client-payer model with a system of financial
statement insurance. This system will ensure that the audit fees are not paid by the
client but by an insurance company.

The PCAOB release suggested a pilot program should be implemented first. So
that mandatory rotation program could be further studied before the Board
determines whether to make it a permanent requirement. This pilot program could
be focused on a specific industry that has a medium to high risk of material
misstatements. If an improvement is shown in the quality of audits the mandatory
requirement could then be expanded to all public companies.

In conclusion, in light of the recent scandals involving public companies, the PCAOB
has to take steps to ensure that this never occurs again. A mandatory rotation policy has its advantages and disadvantages. Those against it argue that it will reduce the quality of audit work. However, a rotation policy will ensure that auditors are objective and independent in the performance of their work.

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