First, disclosure like noted in the next paragraph would be one step up from the current practice. This should be the easiest option. It should the cheapest to implement and raise the fewest objections.

"The Securities and Exchange Commission could require publicly traded companies to disclose in their annual reports which CPA firms conducted their annual financial audit during each of the last 30 years. Investors may be able to make logical inferences from the disclosure. For example, if a company has had the same auditor for 30 years, the investor may decide that the relationship between the company and the CPA firm is too cozy. If a company has changed auditors every 3 to 6 years, the company may be using aggressive accounting practices, which may be causing conflict with their auditors. If such disclosures were required, the information might indirectly push for more appropriate practices."

My hunch is that the CPA firms and publicly traded companies would oppose such disclosure. Why so? It might embarrass both the CPA firms and publicly traded companies. My hunch is that they would want to add words to sugarcoat the 30 year listing. The two parties might feel that such a 30 year listing indirectly presents them in a bad light. Such a listing just seems like transparency that the various stakeholders should know. My hunch is that there are not any legitimate arguments against the 30 year listing. There might be some rather nervous CPA firms and publicly traded companies if the 30 year listing disclosure is required.

The second step up would be disclosure of the 30 year listing plus a requirement to start rotating every seven years anytime within the next ten years. This second option is somewhat tougher.
The third step up would be to require mandatory rotation every seven years with it being phased in by the CPA firms over the next eight years. They would be expected to meet the 50% threshold within 5 years. This third option is the toughest of the three options shown above.

Best of Luck,
Tom Crouch

-----Original Message-----
From: tfcrouch <tfcrouch@aol.com>
To: CISACA-L <CISACA-L@purdue.edu>
Sent: Mon, Aug 15, 2011 10:28 am
Subject: [Cisaca-l] auditor independence & audit firm rotation

http://pcaobus.org/News/Releases/Pages/08112011_PCAOBtoConciderConceptRelease.aspx

Maybe events have moved in a direction that external audit firm rotation will actually get some consideration.

Tom Crouch

Mandatory Auditor Rotation
http://www.auditnet.org/articles/TC%20Mandatory%20Audit%20Rotation.htm

Seven-Year Auditor Rotation

By Tom Crouch, CPA, CIA, CISA, and Attorney
February 5, 2004

During the last few years, many major accounting scandals have been perpetrated by senior management. Permitting senior management to have sole control over external auditor selection and retention is like the fox guarding the hen house. The other stakeholders, such as suppliers, bondholders, customers, shareholders, and non-management employees, are usually denied any input into the selection and retention of the external auditors. A more balanced approach is needed.

A few British business publications have had recent articles supporting mandatory auditor rotation. The Financial Times reported that mid-tier firms have expressed support for compulsory rotation, and rotation every seven years. Accountancy Age (and sister publication Financial Director) published a survey showing that 57% of the financial
directors back auditor rotation.

A GAO report noted that the average Fortune 1000 company has had the same auditor for twenty-two years. Many U.S. companies have had the same external auditors for over forty years. Some auditors believe these cozy relationships create an appearance that the external auditors may not be truly independent. Reducing the cozy relationship between senior management and the external auditors should improve both external auditor independence and shareholder confidence. A higher degree of shareholder confidence should increase investor confidence, and improve share prices.

Many U.S. auditors believe mandatory seven-year auditor rotation should be imposed for publicly traded companies. If this is implemented, the requirement should include seven-year contracts for the annual audits. Such requirements should enhance the independence of the external auditors. These requirements should enable the external auditors to provide more constructive comments. More external auditor independence would provide stakeholders a higher rate of return on the audit fees.

Using seven-year auditor rotation and seven-year annual audit contracts for publicly traded companies, the external auditors could be chosen by:

- senior management,
- audit committee of the board,
- the Securities and Exchange Commission (SEC),
- by the SEC from a list of 5 auditors selected by the audit committee,
- by the key debtors, or
- by a combination of above.

The external auditor selection and retention process should help ensure a high degree of external auditor independence. When external auditor independence is maintained and enhanced, investors are more likely to invest more money.

The key leverage senior management usually has over external auditors is the risk senior management will change auditors. When external auditors handle an accounting and reporting issue contrary to the wishes of senior management, senior management frequently decides to change auditors. For these reasons, many auditors believe senior management’s motives are not pure when they want to replace the external auditors.

If seven-year auditor rotation and seven-year annual audit contracts were implemented, senior management’s leverage with the external auditors would be greatly diminished. Senior management would not be able to influence the possible next auditor contract with the organization. This is because the current external auditors contract renewal would not be on the table for at least seven years. During the time since the earlier contract was executed, senior management or the other stakeholders may have changed.

Some auditors believe senior management would insist on an escape clause if they were forced into seven-year contracts with external auditors. Contract language could specifically set-forth when and how the seven-year contracts could be terminated. The escape provisions should involve the audit committee and stakeholders other than senior management. In essence, senior management’s control over the external auditors could be reduced in a constructive manner. Some auditors believe that when senior management wants to change external auditors before the seven-year contract ends that this should trigger the regulators to select the next external auditor. A combination of these approaches should provide better governance of the auditees.
CONCLUSION

Senior management should have only minor input when determining whether the existing external auditor should be replaced before the expiration of the seven-year audit contract. When senior management is able to control the external auditor selection and retention, the other stakeholders’ interests may not be fairly represented. The seven-year auditor rotation with the seven-year audit contract should provide a more balanced approach for all stakeholders, and enhance the external auditors’ independence. A more balanced approach should improve share prices. Improving external auditor independence really can increase the value of the audit.

Copyright (C) 2004 by Tom Crouch This text may be forwarded via fax or e-mail so long as the copyright is shown. This text may be re-printed anywhere in a constructive manner so long as the copyright is shown. All other rights are reserved.

Disclaimer: The views expressed in the above article do not purport to represent the views of any professional association or the views of any employer.