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Survey Raises Doubts About Mandatory Audit Firm Rotations

When the PCAOB in 2011 floated the idea of forcing public companies to switch audit firms every several years, accounting firms and companies opposed it, and said it would drive up costs without benefitting audit quality.

The critical responses to Concept Release No. 2011-006, Auditor Independence and Audit Firm Rotation, persuaded the audit regulator to back away from its plan. Now research from Europe suggests that the critics of mandatory audit firm rotation may have had a valid point.

The research found that the trust clients have in their auditors and the professional skepticism an auditor demonstrates toward a client are not mutually exclusive.

Supporters of mandatory rotation, who include some investor advocates, believe that long auditor-client relationships can chip away at an auditor's skepticism and independence and ultimately erode audit quality. Term limits, they believe, would counter the tendency by auditors to become too familiar with long-term clients and aid efforts to shore up auditor objectivity and independence.

"Superficially there seems to be a contradiction between being trusting and skeptical, but not if one thinks a little about it," said Ewald Aschauer, a professor at Johannes Kepler University in Austria. "Wouldn't auditors, after all, tend to be trusting of clients that view them as properly skeptical? And to the extent that clients resist professional skepticism, the auditors will tend to become less trusting."

Aschauer studied the issue with his colleague on the Johannes Kepler faculty, Matthias Fink, Andrea Moro of Cranfield University in the UK, Katharina van Bakel-Auer of Vienna University of Economics and Business, and Bent Warming-Rasmussen of University of Southern Denmark. Their paper appears in the Spring 2017 issue of **Behavioral Research in Accounting** published by the **American Accounting Association**.

"The findings suggest that identification-based trust relationships between auditors and their clients do not lead to lower professional skepticism," the study says. "Thus, efforts of regulators to separate the auditor from the client do not seem to further auditors' professional skepticism."

To study the intersection between trust and skepticism, the researchers conducted narrative interviews with auditors and financial directors at clients in order to identify the working definitions of interpersonal trust and professional skepticism. The researchers say the strongest form of trust is “identification-based trust,” which implies a reciprocal understanding of others’ values and standards of behavior. The researchers also separately looked at 233 relationships in Germany between auditors and the CEOs or CFOs of clients.

The mean length of the relationship between audit firms and clients was about 11 years. “What we found, in short, was a healthy balance at the heart of this interpersonal relationship that merits leeway from regulators,” the study said. “As for mandatory rotation, we found no significant relation between auditor skepticism and the length of companies' relationships either with audit firms or engagement partners."