Audit Partner Rotation: An Analysis of Benefits and Costs *

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ABSTRACT: The Sarbanes-Oxley Act (SOX) accelerated rotation of the lead engagement partner and extended the required cooling-off period, the consequences of which are potentially significant. Using a combination of semi-structured interviews and surveys, we investigate perceptions of audit partners serving publicly-traded companies about the impacts of rotation and cooling-off; and the SOX-imposed rule changes on audit quality and audit partners' quality of life. Our findings suggest that although rotation enhances auditor independence, it may have an overall negative impact on audit quality through its dilution of client-specific and industry expertise, and its negative impact on partners' quality of life. Most notably, our results point to an immediate threat to audit quality resulting from accelerated rotation as partners report a two-to-three year client familiarization period, and a preference to learn a new industry rather than relocate. Our findings also suggest a number of avenues for future research.

Keywords: Sarbanes-Oxley; Audit Partner Rotation; Auditor Independence; Audit Quality; Quality of Life

Data Availability: The survey instrument is available upon request. Individual audit partner responses are confidential.

I. INTRODUCTION

The Sarbanes-Oxley Act of 2002 (SOX – U.S. House of Representatives 2002) requires the lead audit engagement partner – typically the chief decision maker on the audit engagement – to rotate off audits of public companies every five years, accelerating the previous seven year requirement established by the American Institute of Certified Public Accountants' (AICPA) Security and Exchange Commission (SEC) Practice Section (AICPA 2003; SEC 2003). SOX also requires a five year "cooling-off"[1] period, extending the previous two year requirement, before an audit partner can return to a previous public audit engagement. Pre-SOX, partner rotation requirements applied to the lead partner only; they now extend to concurring partners.[2]

Issues surrounding audit partner rotation were recently brought before the U.S. Department of Treasury's Advisory Committee on the Auditing Profession (TAC). Testimony and commentary before the TAC included arguments that changes in audit partner rotation rules have negatively impacted audit quality and partners' quality of life, and may be particularly problematic for smaller clients, firms, and office locations (U.S. Treasury, 2008c). Brian Jennings, CFO of Energy Transfer Partners, testified before the TAC: [3]

> "For companies located in large markets, those well served by a wide range of audit firms with large experienced audit staff and audit leadership, the transition may be relatively seamless. For companies located in smaller markets, or companies in specialized industries such as energy, the rotation requirement may cause a significant gap in technical

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[1] Terminology coined by the authors.

[2] Under current rules, audit firms with fewer than five publicly-traded audit clients and fewer than ten audit partners are exempt from the policy; and technical, national, or other specialty partners serving on client engagements are not required to rotate (SEC 2003). In July 2009, the Public Company Accounting Oversight Board (PCAOB) adopted Auditing Standard (AS) No. 7 – *Engagement Quality Review* (PCAOB 2009a). The PCAOB indicates AS No. 7 "provides for a rigorous review that will serve as a meaningful check on the work performed by the engagement team" and recognizes "more work may be necessary under the Engagement Quality Review standard than was performed in some concurring reviews under the existing requirements." (PCAOB 2009a, 2)

[3] See testimony of Brian Jennings on February 4, 2008 (U.S. Treasury 2008d) (http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-2-4-08.pdf) and the minutes on page 278 on June 3, 2008 (http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-06-03-08.pdf); and pages 15-16 of public comment letter of Wayne Kolins (BDO Seidman 2008, http://comments.treas.gov/_files/ResponsetoAdvisoryCommittee0627final.PDF).

> and sector experience. The rotation requirement, while well intended, may place the small market companies at a significant disadvantage in securing for their investors the highest quality external audit services. For many employers, transfer and relocation -- synonymous in my generation with promotion and success -- is declining in favor of dual careers, family requirements, and location preference. I believe the five-year rotational requirement will ultimately impact external audit employee development and leadership retention. Mandatory reassignment may ultimately be a disincentive to those that consider the audit career path as a consequence of the uncertainty that reassignment creates. That uncertainty may drive talented audit professionals out of the business. Sector specialization may ultimately be impacted by the individuals who seek to maximize career flexibility."

In comments to the TAC, the Center for Audit Quality (CAQ, 2007) expressed the following related to the impact of accelerated rotation on partners' quality of life issues:

> "…more frequent rotation of partners would pose a significant logistical and human capital challenge for firms. It translates into at least one additional relocation during each partner's career and increased complexity in staffing audit engagements. Smaller firms, in particular, may not have another partner with sufficient industry expertise."

Using a combination of semi-structured interviews with office managing partners (OMPs), and surveys distributed to practicing audit partners, we investigate perceptions of the impact of mandatory partner rotation and the SOX-imposed rule changes on audit quality and partners' quality of life.[4] Identification of the lead engagement partner in the U.S. is currently unavailable, limiting archival evaluation of the study's research questions. Further, as the rotation rule changes were legislated in 2002, their impacts are just now beginning to manifest.

We find that although rotation enhances auditor independence, it may have an overall negative impact on audit quality through its dilution of client-specific and industry expertise, and its negative impact on partners' quality of life. Most notably, our results point to an immediate threat to audit quality resulting from accelerated rotation as partners report a two-to-three year client familiarization period, and a preference to learn a new industry rather than relocate.

[4] Surveys were distributed to 370 practicing audit partners. 170 surveys were returned (46 percent response rate).

Semi-structured interview scripts with practicing audit partners and the survey questions were developed around six research questions (RQs), consistent with the theory that audit quality is the market's jointly-assessed probability of the auditor's ability to both detect and report identified misstatements (DeAngelo 1981). Thus, our study is based on the premise that if partner rotation impacts auditor expertise (directly, or indirectly through their impact on partners' quality of life), or auditor independence, audit quality is likely altered.

We identify three common beliefs among partners. First, partners perceive rotation enhances independence, both in fact and in appearance. However, new assignments require a significant investment in client-specific and, in some cases, industry-specific skills. Partners report requiring two to three years before they are fully effective on new audits, and, to avoid relocation, prefer to specialize in a new industry. Consequently, more frequent rotation appears to increase the likelihood that partners will specialize in multiple industries at the expense of industry depth. Second, partners perceive sufficient firm-level controls are in place to mitigate the direct impacts of rotation on audit quality. Third, the indirect effects of rotation (e.g., quality of life issues) are less controllable and may lead to reductions in audit quality.

As reported by a number of our partner-participants, the impact of rotation policy changes on audit quality is exacerbated when the speed and frequency of other changes in the profession is taken into consideration. One said "Rotation only allows partners to be fully-effective for two-to-three years, and the five year cooling-off period is too long given intervening changes that occur over five years at almost any public company within any industry."

The next section discusses the theory, extant research, and develops the RQs. Section III discusses the methodology. Results of the semi-structured interviews and surveys are discussed in section IV; and section V provides conclusions and suggestions for future research.

II. THEORY, EXTANT LITERATURE, AND RESEARCH QUESTIONS

Theory and Extant Literature

DeAngelo (1981) defines audit quality as the market-assessed joint probability that an auditor will both (a) discover a breach in the accounting system and (b) report the breach; hence, audit quality and financial reporting quality are expected to be highly correlated. The auditor may be more likely to report if rotation gives the auditor a fresh perspective. However, sub-optimal decision making occurs when individuals' fall victim to 'anchoring and adjustment' biases, which describe the tendency of individuals to anchor on one position believed to be appropriate; and to overestimate the probability of conjunctive events and underestimate the probability of disjunctive events, among other biases (Tversky and Kahneman 1974).

The potential for decision making biases suggests some benefits may accrue in terms of audit quality when engagement partners rotate and a "fresh look" is taken. Australian data where partners must sign the opinion, Hamilton et al. (2005) found changes in audit partners are associated with more conservative financial data. However, Carey and Simnett (2006) identified a negative relationship between partner tenure and the likelihood of issuing a going concern opinion, though no association was found for tenure and inappropriate earnings management. Using data from Taiwan, another environment where partners must sign the opinion, Chi et al. (2009) test the benefits of mandatory partner rotation when it was implemented in 2004. They use discretionary accruals as a proxy for audit quality and the earnings response coefficient as a proxy for the market's perception of audit quality. They find no evidence that mandatory rotation enhance either actual audit quality or the market's perception of quality.

One argument that tenure increases the likelihood that misstatements will be discovered is that auditors gain familiarity with a client and thus are better able to identify areas where risk is highest. Carcello et al. (1992) suggest the specific experience of engagement team members are more important than those of the audit firm, and the most important characteristics are industry expertise, client experience, responsiveness, and adherence to GAAS. Brazel et al. (2010) find client-specific experience enhances auditors' ability to respond to fraud indicators.

Solomon et al. (1999) concluded, from an experiment including partner subjects, that deep experience obtained by industry specialists enhances non-error knowledge. Prior literature finds industry expertise at the audit firm level is positively associated with financial reporting quality (e.g., Carcello and Nagy 2004b; Krishnan 2003; 2005).

Johnson et al. (2002) found audit quality is lowest in the first three years of a firm's tenure, and highest in years four through eight; Myers et al. (2003) found financial reporting quality and audit firm tenure are positively related; and Carcello and Nagy (2004a) found Accounting and Auditing Enforcement Releases related to fraud are positively associated with shorter firm tenures. Blouin et al. (2007) compared discretionary accruals of audit clients following Arthur Andersen teams to a new firm with clients that did not, and concluded the absence of improvements of extreme discretionary accruals for firms acquiring new audit teams after the involuntary change is consistent with the argument that mandatory rotation does not improve financial reporting.

Prior research has investigated whether market participants perceive audit quality is enhanced by partner rotation.[5] Results are mixed. Gates et al. (2007) found partner rotation does not incrementally influence stakeholders' confidence in financial statements in the presence of strong corporate governance. aplan and Mauldin (2008) found for non-professional investors,

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[5] These studies, by measuring perceptions of enhanced audit quality, presumably measure some aspect of independence in appearance – whether the partner will report a misstatement. Because it is a perception about audit quality, the research may also be measuring other aspects of audit quality.

partner rotation strengthens perceived auditor independence. Taylor et al. (2003) proposed a framework emphasizing financial statement reliability over auditor independence, and believe auditor expertise should not be sacrificed to enhance independence if financial statement reliability is reduced. We extend these prior findings by investigating perceptions of practicing audit partners about the impacts of mandatory rotation and cooling-off policies on audit quality.

Development of Research Questions

The SEC's rotation rule states "rotating involves balancing the need to bring a 'fresh look' to the audit engagement with the need to maintain continuity and audit quality" (SEC 2003, Section C). The rule acknowledges U.S. generally accepted auditing standards (GAAS) require audit engagements to be staffed with individuals competent to understand the unique issues relevant to a specific audit. The SEC further acknowledges a trade-off between the potential negative effects of audit partner tenure due to entrenchment; and the positive effects of partner tenure due to industry and/or technical expertise and client familiarity; but concludes some level of engagement partner rotation is necessary to ensure auditor independence. Opponents to partner rotation cite potential threats to audit quality such as limited availability of partners with (i) proficiency in U.S. generally accepted accounting principles (GAAP) and GAAS in some countries, (ii) sufficient familiarity with certain industries, and (iii) technical training on certain accounting matters (SEC 2003). Consistent with these observations, we question:

RQ1: In terms of audit quality, what benefits do audit engagement partners perceive result from mandatory rotation and cooling-off policies?

RQ2: In terms of audit quality, what negative effects do audit engagement partners perceive result from mandatory rotation and cooling-off policies?

A long-recognized issue in public accounting is quality of life; related to constructs such as professional and organizational commitment (Aranya et al. 1981; Jeffrey and Weatherholt 1996; Smith and Hall 2008), turnover intentions (Dalton et al. 1997; Pasework and Viator 2006) job related stress (Smith et al. 1993); burnout (Fogarty et al. 2000; Sweeney and Summers 2002), and job satisfaction (Aranya et al. 1982). Audit quality can be affected by these in the long run because of their impact on retention of personnel, job performance, and decision quality.

Hall et al. (2005) present a model of how situational factors are related to professional commitment. The benefits and costs of rotation can impact professional commitment, both for partners and other audit personnel. Better training due to rotation may increase professional commitment. Alternatively, if personnel anticipate multiple involuntary relocations, they may choose to exit public accounting faster.[6] Dalton et al. (1997) found female partners and managers left public accounting more than their male counterparts because of work/non-work conflicts.

The revised rotation rules may exacerbate quality of life issues for partners; and may indirectly impact audit quality due to additional time spent for additional client familiarization, training in a new industry, relocation(s), or commuting. Fogarty et al. (2000) found auditors are subject to burnout. Smith et al. (1993) found job stress factors tested on accountants were positively related to psychological discord and negatively related to relaxation; and further report psychological discord had a positive influence on maladaptive coping behaviors and stress related illness, and had a negative relationship on adaptive coping behavior.

These psychological factors, affected by quality of life, may impact audit decisions. Chung et al. (2008) show audit decisions in an inventory valuation context are influenced by mood. Van Gelder et al. (2008) found affect is a determinant on risky choices. Moizer and Pratt

(1988) found factors influencing performance, quality of life, and the desire to avoid uncertainty, were important to accountants. Bernardi (2003) suggests multiple job assignments and time pressures cause stress for accountants; and job satisfaction is positively correlated with influence orientation and desired level of work effort. Parasuraman et al. (1989) found accountants with a working spouse have lower levels of job satisfaction and a lower reported quality of life than accountants without a working spouse.

Quality of life issues may be exacerbated for partners with working spouses and/or children. Work/life balance issues may also be negatively impacted when partners rotate out of smaller office locations as there may be fewer partners remaining to cover the work load. Commuting may not be a viable alternative to relocation given Jackson et al.'s (1985) finding that commuting contributes to dissatisfaction with job/family congruence. Solomon (2008) met with the CEOs of the Big 4 firms and each said one of the biggest challenges to the profession is the attraction and retention of talent, both in the near-term and the long-term. We question:

RQ3: How do audit engagement partners perceive that mandatory rotation and cooling-off policies impact quality of life issues?

Because quality of life issues resulting from rotation could be related to personnel retention, job performance, and decision quality, we also question:

RQ4: How do practicing audit engagement partners perceive that quality of life issues arising from mandatory rotation and cooling-off policies impact audit quality?

Firms have been successfully operating under mandatory partner rotation for decades and have systems and practices to address many of the issues associated with required partner rotation. As little is publicly known about these policies and procedures, we question:

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[6] Single and Almer (2009) note an increase in the number of personnel in firms at the director level. A potential

RQ5: What auditing firm control mechanisms are in place to reduce the potential negative impact of mandatory rotation and cooling-off policies on audit quality?

Accelerating rotation and extending cooling-off may enhance investors' perceptions of auditor independence; however, it may put additional burdens on partners as they attempt to familiarize themselves with an increasing number of new clients – and potentially new industries. Further, the revised rules may increase the number of relocations or commuting to other offices to cover client assignments. While larger firms or practice locations may have multiple partners having specific industry expertise, smaller firms or practice locations may not have multiple partner experts in all industries. The PCAOB noted a number of GAAS deficiencies for smaller firms arose from a lack of sufficient industry expertise, stating "Firms need to be mindful of situations where these or other industry-specific or specialized accounting principles apply and ensure that their analyses take into account the applicable accounting and auditing requirements" (PCAOB 2007, 6).

These factors suggest partners' quality of life and audit quality issues may be linked due to the shortened number of years that an engagement partner can serve a specific client, and the longer cooling-off period before a partner can resume work on that client. Consistent with the concerns raised in the TAC testimony and commentary, the accelerated rotation and extended cooling-off rules may pose significant human capital and audit quality challenges for firms of all sizes. We question:

RQ6: How has the change in mandatory partner rotation and cooling-off periods from "seven years on, two years off," to "five years on, five years off," affected audit partners' quality of life and audit quality perceptions?

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explanation could be partner rotation and cooling-off requirements.

III. METHODOLOGY

The survey was developed based upon (i) extant literature, (ii) stated intentions of SOX and the PCAOB, and (iii) comments and observations from the profession, regulatory, and oversight agencies (e.g., U.S. House of Representatives 2002; AICPA 2005; Nusbaum 2007; U.S. Department of Treasury 2008a,b,c; Independence Standards Board [ISB] 2000; SEC 2003; Government Accountability Office [GAO] 2003 and 2004; CAQ 2008). We also relied on (iv) input from academics, (v) the RQs, and (vi) input from semi-structured interviews with six OMPs and one office industry leader partners from seven of the eight largest firms.

Consistent with the approach employed by Hirst and Koonce (1996) and Beasley et al. (2009), we used semi-structured interviews - allowing us to delve further into practicing audit partners' responses based on the RQs. We used a standard script to guide the interviews which were conducted in 2008. Each face-to-face interview lasted in excess of an hour, was attended by at least one of the authors, and notes were taken. We explained the purpose of the research and that it was based in part on the TAC issues raised. The partners were interviewed separately, each RQ was asked, and the partners could elaborate on any issue they chose.

The Survey

The survey comprises 87 specific data points (not including demographic data), represented by Likert-scale statements, fill-in the blank, and short answer questions. The survey was pre-tested with four of the seven partners interviewed, colleagues from academia, and two recently retired Big 4 audit partners. The survey, requiring about 20 minutes to complete, was distributed in late 2008 and early 2009, to 370 practicing partners from 14 firms, representing approximately 40 distinct offices. Of those distributed, 170 (46 percent) were returned, comprised of 37 o Big 4 partners (Deloitte & Touche, Ernst & Young, KPMG, and

PricewaterhouseCoopers), 86 (50.6 percent) Next 4 partners (BDO Seidman, Crowe Horwath, Grant Thornton, and McGladrey & Pullen), and 47 (27.6 percent) from other firms' partners (comprised primarily of the other top 25 firms).[7] All participants had current public company audit experience and were with firms subject to the mandatory partner rotation requirements.

Demographics of Survey Participants

Table 1 provides demographic data of the partner-participants.

[Insert Table 1 here]

Responding partners are 80 percent male, 90 percent are married, average 47 years of age, and have been an audit partner for approximately 11 years.[8] Partners reported being experts in an average of 2.6 industries, and served as lead (concurring) partner on an average of 1.7 (1.8) public-company audits during the past year.[9] Partners average 0.43, 0.57, 0.41, 0.78, and 2.14 children in the 0-5, 6-11, 12-17, > 18, and total age categories, respectively. Although interviewed partners report the cost of relocation is borne by their firms, only 3.6 percent of surveyed partners report having to relocate due to mandatory rotation, and only 2.4 percent report maintaining a second residence to accommodate a client (untabulated).[10] Interviewed partners expect relocation to increase in the future as a result of the rotation requirements.

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[7] Instrument coding allows us to distinguish the firm type. We assured our partner-participants anonymity and are unable to identify a particular response with a particular firm or practice location. The response rates by firm size were 56.1 percent, 45.7 percent, and 40.5 percent for the Big 4, Next 4, and other firms, respectively. Our response rates compare favorably with that of other survey-based auditing research such as Bamber and Iyers' (2007) 23 percent response rate from practicing Big Five auditors, and DeZoort and Saltieros' (2001) 20 percent response rate from a sample of Canadian audit committee members. Our response rate is comparable to Brazel et al.'s (2010) 48.8 percent rate. Anecdotally, we received feedback from a number of partner-participants about the importance of the topic. Our favorable response rate may, in part, be driven by this perception.

[8] Implies an average age of approximately 36 upon promotion to partner. This is consistent with results reported by Guinn et al. (2004) and our semi-structured interviews with practicing audit partners.

[9] The interviewed OMPs reported that their individual firms specialized in from seven to fourteen different industries, with sub-specialties in each of these categorizations.

[10] Untabulated results also reveal no significant differences ($p > 0.05$) by firm or office size related to the number of relocations due to rotation, but a positive and significant ($p < 0.05$) correlation based on age.

Significant differences by firm size relate to the number of expert industries ($p < 0.05$), number of public companies served as lead (concurring) partner in the prior year, $p < 0.01$ ($p < 0.001$), and the number of assurance partners ($p < 0.001$) in the local practice. The differences are generally driven by the Big 4 and/or Next 4 as compared to the other responding partners.

The TAC focused primarily on concerns where the burden of rotation was on smaller firms and practice offices. Collectively, participants are in offices averaging just over 11 partners One-third of participants reported five or fewer audit partners in their local practice office, with two-thirds having eight or fewer (untabulated). The Big 4, Next 4, and other partner respondents average (range) 21 (3-120), 8 (1-45), and 8 (2-30) local practice audit partners, respectively.

As the survey is collected as a convenience sample and distributed over time, it is not possible to conduct tests of non-response bias.[11] Thus, the conclusions of the study may only be generalizable to the study participants. However, we believe our participation rate of 46 percent minimizes the likelihood of a strong non-response bias. The results of our study also may not be representative of all partner attitudes as the distribution of partners by office size may not be representative of the general population, and individual firm strategies may be associated with unique participant responses (e.g., PricewaterhouseCooper's focus on Global 1000 companies, KPMG's reporting along industry lines).[12]

IV. RESULTS

[11] It was not possible to distribute the surveys in a single mailing nor in a single time period because of restrictions some firms or offices imposed on releasing partner names or granting access to partners. In these cases, the surveys were hand delivered to the firm or OMP who in turn distributed it to the partners. Some surveys were distributed at annual partners' meetings.

[12] The Center for Audit Quality (CAQ) reports that there were 4,752 audit partners in 2007 for the Big 4, Grant Thornton and BDO. http://www.thecaq.org/publicpolicy/data/TRData2008-01-23-FullReport.pdf (Accessed November 30, 2009). Although we are unable to determine the number of audit partners in an office by firm, we can provide an idea of office sizes for Deloitte because the firm publishes the number of personnel for all services lines in an office for recruiting purposes. It has 33 offices with 125 or fewer people; 19 with offices from 125 to 300

***Benefits of mandatory rotation* (RQ1)**

In general, interviewed partners focused on perceptions of market participants, career enhancement, and a fresh perspective as benefits of rotation and cooling-off. They noted rotation opens career paths to partners at a younger age allowing them to work with more prestigious clients earlier, with one noting this was especially true if the partner was willing to relocate. As presented in Table 2, the survey participants generally concur with findings from the interviews.

[Insert Table 2 here]

Survey participants agree that partner rotation improves independence in appearance and in fact ($p < 0.001$).[13] They also find benefits in terms of audit quality, investor confidence, and a reduced likelihood of inappropriate client attachment (all p-values < 0.001).[14] Individual partner benefits associated with rotation include the potential to enhance training and experience ($p < 0.01$) and increase in overall partner knowledge ($p < 0.001$). However, participants do not agree that rotation increases proficiency in more than one industry ($p < 0.01$), or that clients prefer to work with new partners ($p < 0.001$). The benefits of independence in appearance and enhanced training and experience are positively associated with firm size (significant differences between firm sizes, $p < 0.01$ and $p < 0.05$, respectively).

Short answer questions echoed those of the interviewed partners. Cited benefits of rotation included a fresh perspective, increased depth of experience, increased learning opportunities for staff through exposure to multiple partners, and improved independence in appearance. However, two partners cited trade-offs - believing the costs outweighed the benefits.

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people; 10 with 348 to 500; 8 with 600 to 900; 6 with 1,100 to 2,000 and 3 offices over 3,000 people. http://careers.deloitte.com/united-states/experienced-professionals/offices.aspx. (Accessed November 2009).

[13] All significance values are relative to Likert-scale midpoint values unless otherwise noted.

In terms of audit *firm* rotation, partner-participants collectively agree firm rotation improves independence in appearance ($p < 0.01$). However, they disagree firm rotation improves independence in fact ($p < 0.001$), or that it improves audit quality ($p < 0.001$).[15] Independence in fact and audit quality beliefs are positively associated with firm size (significant differences between firm sizes, each with a p-value < 0.001).

***Costs of mandatory rotation* (RQ2)**

In general, interviewed partners believe partners are not fully effective in the first two years of an engagement. One also noted the engagement partner may not be fully effective in the final year, especially if the partner is auditioning for clients in other locations.[16] Another said new partners are not initially fully effective, even if the partner was within the same industry line, because of differing information technology and other processing systems, client personnel, corporate governance characteristics (especially the strength and expertise of the audit committee), and the time it takes to gain client trust at the senior management and board levels. A number of partners felt rotation, particularly after SOX, increased auditing costs due to inherent inefficiencies, moving costs, start-up time, and shorter amortization periods for these increased costs; but may be worth the cost due to the appearance of increased independence. Two commented their firm is likely to absorb increased costs because of perceived increases in the risk of losing clients, especially in the year of mandated partner rotation, and the pressure to

[14] The independence in appearance and fact statements are positively and significantly ($p < 0.001$) correlated with the audit quality statement. Thus, our responding partners may view independence as an antecedent to audit quality, similar to the suggestion set forth by Taylor et al. (2003).

[15] We did not provide a definition for audit quality in the survey instrument. Although we asked the partners to opine whether independence in fact or appearance was affected by rotation, we did not provide a definition that would require them to consider independence as a component of audit quality. Thus, partners were left to their own views as what constitutes audit quality.

[16] For some clients, the firms select several acceptable partners who are candidates to transition to the audit engagement. The client's audit committee members can interview these partners to determine who they prefer to

perform increasingly efficient audits. One interviewee believes nearly all publicly-traded clients, not just the largest, want their lead partner to be local and available for meetings on short notice. This partner felt commuting long distances was not a good solution because of this expectation, and viewed the primary negative of partner relocation due to mandatory rotation to be a choice between the uprooting of family or, alternatively, extensive time spent away from family.

Table 3 summarizes the views of partners responding to the survey relevant to RQ2.

[Insert Table 3 here]

Responding partners agree there are costs to mandatory rotation and cooling-off policies. A number cited diminished audit quality as a result of having to learn new industries, increased human capital costs, and reduced realization on audit engagements due to more frequent partner start-up costs and shorter amortization periods. Collectively, partner-participants agree partner rotation increases the incoming partner's workload and the workload of the other members of the audit engagement during the first year of rotation (both *p*- values < 0.001). The impact on other members of the engagement team differs significantly by firm size ($p < 0 .01$), and is positively related to firm size.

Partner-participants disagree increased client burdens associated with rotation decrease audit quality ($p < 0.001$); but agree client specific knowledge is lost due to partner rotation ($p < 0.001$). They also agree longer partner tenures are associated with higher audit quality ($p < 0.05$). In addition, they believe clients are more likely to switch firms in the year of partner rotation ($p < 0.001$), and audit quality is higher when the partner does not commute ($p < 0.001$). Consistent with Geiger and North (2006) who report financial reporting quality is lowest in the first year of a CFO's tenure, our participants also believe the risk of a decline in audit quality is

work with in the next five year cycle. We also thank Scott Showalter for the observation that incoming partners may greater when partner rotation is concurrent with a new CFO ($p < 0.001$). While respondents were neutral as to whether partner rotation *per se* increases fees ($p > 0.05$), there are mean differences by firm size ($p < 0.05$), suggesting the smallest firms may be more likely to pass along fees.

While collectively participants did not believe ($p > 0.05$) partner rotation contributed to a decline in audit quality due to increased burdens on the firm, Next 4 participants did believe these contributed to a decline in audit quality ($p < 0.05$), a significant difference among the firms ($p < 0.05$), possibly reflecting different perceptions in the likelihood of having to learn new industries as suggested by written comments provided by the participating partners.

One partner stated, "My biggest issue with the current rotation issue relates to the need to completely learn a new industry and clients to which we have little familiarity and industry knowledge." Another viewed a cost of partner rotation as "a loss of industry knowledge that goes against the intent of the new risk assessment standards [designed] to gain an enhanced understanding of clients' business." One partner viewed human capital costs to be the biggest cost of rotation including, "personnel turnover, family distress, illness, relocation, travel, and longer decision-making time on client questions and issues. Learning time is increased and leads to more early retirements." Other comments indicated that rotation does not enhance professional skepticism, increases relocation costs that must be passed to the client, and results in less familiarity with the client; ultimately resulting in higher audit risk because of greater errors.

***Anticipated personal and quality of life impacts of rotation* (RQ3)**

In general, the interviewed partners were consistent in their views that mandatory rotation negatively affects quality of life and creates negative perceptions about partners' quality of life among non-partners - especially as these personnel progress in their careers. One partner indicted

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also 'shadow' the outgoing engagement partner in the year prior to rotating on to a new audit engagement.

three factors causing resistance to relocation. First are societal differences, with Generation X and Y, and the way each generation values quality of life over compensation. Second, there is a reluctance to move children out of school systems, which may now happen up to three times in a partner's career. Third, there is increasing spouse equality in terms of education and pay.

One OMP suggests rotating partners are often faced with the dilemma of choosing to either relocate within their area of industry expertise to retain lead partner responsibility on flagship clients; or learn a new industry locally, often assuming responsibility for less prestigious companies and reducing the likelihood of further promotion due to resume dilution. Another said, commuting partners suffer due to travel fatigue, client dissatisfaction of not having the partner local, and the toll commuting takes on relationships. This partner noted commuting by plane creates work inefficiencies because of fatigue and client confidentiality issues.[17] Table 4 summarizes the views of partners participating in the survey relevant to RQ3.

[Insert Table 4 here]

Participants perceive periodic audit partner rotation increases the likelihood of relocation ($p < 0.01$), and that relocation has a negative impact on partners' quality of life ($p < 0.001$). Our participants believe it is unlikely they will be able to be the primary engagement partner on clients in the same industry and in the same geographic location when required to rotate ($p < 0.01$), and would be very unsatisfied if asked to relocate because a client with their industry expertise was not available locally ($p < 0.001$).[18] They would be similarly unsatisfied if asked to

[17] An interview with a different Big 4 partner (conducted after the study was completed) indicates his firm now counsels partner candidates to anticipate the possibility of multiple relocations due to the accelerated rotation and extended cooling-off rules imposed by SOX. We also received an anecdotal example (not from a participant) of a Big 4 partner with two important client assignments in different states. Neither client is located in the partner's state of residence. Instead, the partner has chosen to commute four or five days a week.

[18] Only 39 percent of respondents expressed some level of agreement that accelerated rotation would increase the frequency of relocation during their career, while 67 percent expressed some level of agreement that the new rules will lead to an increased likelihood of needing to gain new industry expertise.

service a less prestigious client locally if an equally prestigious client was not available locally upon rotation ($p < 0.001$). Participants report the potential for relocation or commuting discourages some employees from pursuing careers as audit partners ($p < 0.001$).

Fifty percent of respondents (not tabulated) have learned a new industry due to rotation requirements. Responding partners collectively report commuting by air to manage their engagement responsibilities an average of 9.4 percent of the time; and an average of 13.4 percent of their time is spent telecommuting (not tabulated). Less than three percent have yet relocated (Table 1). However, as the rotation cycle is shorter, and at least one firm now prohibits partners from returning to a publicly-traded audit client, it appears inevitable that relocations will increase in the future. The only significant differences between firm sizes (not tabulated) relate to the likelihood of relocation ($p < 0.001$) and level of satisfaction if asked to service a less prestigious client locally ($p = 0.009$). Mean responses for Big 4, Next 4, and other partners for the relocation statement are 5.64, 4.52, and 3.43 (p-values ranging from < 0.001 to 0.004), and for the less prestigious client statement are 2.45, 3.20, and 2.96 (between Big 4 and Next 4; $p = 0.007$).

Written comments also address concerns about the difficulty of balancing personal quality of life concerns with career aspirations. For example, one partner stated, "Relocation is extremely difficult from a personal perspective; requiring a balance of career progression versus family every five years if the current arrangement is continued," and another reported, "[rotation] puts the cart before the horse. No matter the amount of professional success, the personal quality of life drives professional decisions." Commenting on the impact of quality of life and audit quality, one participant noted, "Relocation with a family is a large disruption to quality of life. Learning new industries as a partner is not good for the partner or the profession." Another said, “Engagement partner rotation should not dictate where a partner lives. There is a huge risk of highly qualified partners leaving the profession if this were to remain the standard.”

Several partners commented in this section on the impact of partner rotation on audit quality: “It takes several years normally to establish relationships with key executives of an audit client. These relationships aid in the partners’ understanding of their client’s businesses which enables them to better identify risk and, as a result, adjust the audit approach to address these risks. Therefore, audit quality can be negatively impacted when a key member of the engagement team who has gained special knowledge of a client is removed from the team.” Another said, “You spend a large part of your career (pre-partner) developing industry expertise and then face the prospect of not being able to practice in an industry to which you’ve devoted your professional career due to rotation.” One partner felt, “It’s extremely costly for firms to manage partner rotation requirements and not leave partners ‘on the deck’ waiting for opportunities. It creates a lot of uncertainty for the individual and the firm.”

Perceptions of the impact of human resource issues on audit quality **(RQ4)**

Interviewed partners perceive the primary way audit quality is affected by human resource issues is that auditors will manage their careers by limiting relocation to minimize the impact on their personal life. This can be accomplished by having a greater breadth of industry specialization – potentially at the expense of depth of industry specialization. More relocations and other quality of life issues may deter highly-qualified personnel from seeking partner status.

Several interviewees noted current partners, in lieu of relocating, are opting to focus on a new industry, which requires significant start up costs. One OMP observed audit seniors and managers are now showing an increased reluctance to focus on one industry in an effort to reduce relocations upon achieving partner status; in turn potentially increasing audit risk and reducing audit quality over the long-term. Another noted some highly qualified senior managers had declined to stand for partnership because of the relocation potential, and said this could have significant implications in the future on the ability to attract and retain top partnership talent.

Results of the survey relevant to RQ4 are summarized in Table 5. No short answers were solicited in this portion of the survey.

[Insert Table 5 here]

Partners did not believe relocation reduces audit quality ($p < 0.05$); however, participants strongly agree that if a partner is required to learn a new industry that audit quality declines ($p < 0.001$). Respondents were collectively neutral ($p > 0.05$) on the influence that telecommuting has on audit quality (means of 4.48, 4.17 and .372 for Big 4, Next 4 and other firms, respectively), however there were significant differences between the Big 4 and other firms ($p<0.05$).

In spite of prior concerns regarding rotation's impact on the willingness of employees to pursue careers as partners, participants reported that the rotation requirements do not hinder their ability to *attract* the best and brightest employees ($p < 0.001$). However, they were neutral ($p > 0.05$) on the influence that rotation has on their ability to *retain* these employees.

***Firm mechanisms to reduce negative impacts of rotation and cooling-off* (RQ5)**

Interviewed partners reported their firms have policies to ensure that partners have adequate training and experience upon rotation. Assignments for the lead engagement partner, concurring partner, and other senior members of the audit team are planned well in advance of required rotation so members are not rotated simultaneously. Some firms have policies that specify the qualifications of the partner assigned to client engagements. Depending on the engagement, regional or national office approval may be required on partner assignments. One OMP indicated firm policy does not allow a partner to be a concurring partner before being a lead partner. Another indicated his international firm now has a policy that does not allow partners to ever return to a former public client unless the national office agrees to make an exception based on extenuating circumstances.

An important element of mitigating the negative aspects of rotation is ensuring partners are properly trained. One OMP noted the path to partnership is now approximately 13-15 years, primarily driven by the complexity of GAAP. Another noted many senior managers rotate to larger practice offices or the national office for training before standing for partnership.

The survey asked partners to indicate how far in advance their firm plans internally, and how far in advance they coordinate with clients for the transition of partners. We also asked for a description of policies, procedures, and coordination efforts designed to ease the transition and maintain audit quality. Results (not tabulated) indicate the mean (standard deviation) for internal planning is 1.63 (0.92) years, and is 1.14 (0.74) years for client coordination.

In addition to the items mentioned by interviewed partners, other frequently cited policies include partner assignments considering industry expertise, technical requirements, and cultural fit. Other less cited items include having a consistent audit methodology, partners rotating onto engagements are required to gain an understanding of the client's issues and audit risk approach in the year prior to rotation, firm has detailed tracking of rotation and cooling-off periods, area practice directors with advisory roles (and not subject to rotation rules) are aware of all high-risk client issues (and are available for consultation), and the successor partner is assigned as concurring partner one-year in advance of rotating on as lead engagement partner.[19]

To see what firms do in the absence of regulation, we asked responding partners to indicate if their firm has a mandatory audit partner rotation policy for non-public clients.

Seventy-eight percent of Big 4 partners indicated their firm had such a policy. However, only nine percent of Next 4 partners, and four percent of other partners, reported their firms had a non-public rotation policy. The mean (s.d.) number of years for non-public rotation for Big 4 firms is 9.72 (1.10).

***Perceptions of impacts of accelerated rotation and extended cooling-Off* (RQ6)**

The accelerated rotation and extended cooling-off rules are generally viewed by the interviewed partners as being harder on practice management as it contributes to more frequent relocations and increases the likelihood of losing clients in the year of rotation. It is also viewed as detrimental to audit quality due to the more frequent need to get familiar with new clients and the increasing frequency of changes in standards. Another partner shared that accelerated rotation has contributed to additional fee pressures as engagements must generally absorb new partners' start-up costs, and these costs must now be amortized over a shorter time period.

One partner expressed that the rapid changes in GAAP and PCAOB mandates, combined with the extended cooling-off period, contribute to a decline in audit quality as it takes longer to understand related client-specific intervening changes. An OMP with one of the Big 4 viewed the new rules to be most onerous for offices with fewer partners, especially within industry lines. Another observed that market participants are only seeing the "tip of the iceberg," since the first impacts of the revised rules are just now being seen. This partner indicated that as a result of the revised rotation rules, some senior managers are declining partnership nomination and an increasing number of senior managers and partners are voluntarily leaving public accounting. The partner notes the next five year rotation cycle will really begin to tell the tale of the impact of the rule change on audit quality and partners' quality of life.

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[19] Note that under the current SOX mandates, year(s) served as a concurring partner prior to assuming lead partner

Panel A of Table 6 summarizes the general perceptions of partners responding to the survey related to the SOX-imposed accelerated partner rotation and extended cooling-off rules.

[Insert Table 6 here]

Contrary to perceptions regarding the benefits of partner rotation *per se*, our partner-participants generally perceive little to no value related to the new rule changes. Participants disagree that accelerated rotation improves investor confidence, independence in fact, and audit quality (all p-values < 0.001). However, participants do believe that independence in appearance is enhanced as a result of accelerated rotation ($p < 0.05$). The participants also do not believe the extended cooling-off period benefits independence in fact ($p < 0.001$) or overall audit quality ($p < 0.001$); and are neutral in terms of its impact on independence in appearance ($p > 0.05$).

Participants strongly disagree the concurring and lead partners should have the same rotation and cooling-off requirements ($p < 0.001$). This is the only statement with significant (not tabulated) differences ($p < 0.05$) between firm sizes with means of 3.40, 3.72, and 2.93 for the Big 4, Next 4, and other firms, respectively, a collective mean of 3.44. The difference is only significant ($p < 0.05$) between the Next 4 and other firms.

Panel B of Table 6 summarizes the participants' personal perceptions related to the accelerated rules. Participants did not report beliefs that accelerated requirements *per se* would increase the likelihood they would be required to relocate during their careers ($p > 0.05$); however, they report the revised rotation and cooling-off rules would require them to gain new industry expertise (p-values < 0.001). They also report the new rules have created hardships in managing local office partner assignments (p-values < 0.001).

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responsibility count towards the five years of client service triggering mandatory rotation.

One-sample t-tests (not tabulated) reveal responding Big 4 partners strongly agree (all p-values < 0.001) the accelerated rotation and extended cooling-off rules increase the likelihood of relocation and the need to gain new industry expertise. Next 4 partners are similar (p-values < 0.001) with respect to gaining new industry expertise but not on the likelihood of relocation (p-values of 0.94 and 0.93, respectively).

Significant differences between firm sizes exist for all six statements regarding personal perceptions related to the SOX-imposed rules. Panel C of Table 6 summarizes these differences. Note there is a monotonically increasing level of agreement with each statement when comparing other firms, the Next 4, and the Big 4, respectively. The Big 4 and Next 4 are not significantly different (not tabulated) from each other with respect to the four statements related to gaining industry expertise and creating hardships in managing partner assignments (p-values ranging from 0.491 to 0.991). Nearly every other comparison reveals very strong and significant differences between the three firm sizes (p-values, not tabulated, generally < 0.001).

Analyses between small and large practice locations

The number of partners in each practice location ranged from one to 120 (Table 1).[20] We compare responses from offices with one to four partners (26 percent) with offices comprised of ten or more partners (30 percent). Results (not tabulated) reveal partners from larger offices felt more strongly that mandatory rotation improves independence in appearance (mean of 6.00) compared to smaller offices (mean of 5.57), a significant difference ($p < 0.05$). Larger offices felt more strongly that firm rotation does *not* improve independence in fact (mean of 2.78 versus

[20] 26.7 percent of responding audit partners report being in offices with four or fewer audit partners and 67.3 percent report being in offices with eight or fewer partners. We believe the relatively large number of responding partners from smaller practice locations lends additional credence to our results - given the TAC testimony suggesting accelerated rotation and extended cooling-off requirements mandated by SOX may be more onerous for smaller firms and practice locations than for larger firms and practice locations.

3.50 for smaller offices, $p < 0.05$). No other significant differences by office size exist for the benefits and costs of mandatory rotation (p-values > 0.05).

There were no significant differences between small and large office respondents for the anticipated personal impacts of rotation (Table 4). However, partners from larger offices disagree that relocation has a negative impact on audit quality (mean of 3.12) as compared to those from smaller offices (mean of 3.86, $p < 0.01$, untabulated).

We find significant mean differences by office size (all untabulated) when analyzing responses related to the rule revision. Large office partners disagreed more strongly (2.50) versus those from small offices (3.10) that the rule change does not improve independence in fact. Respondents from larger offices also felt significantly ($p < 0.01$) stronger (2.82 vs. 3.79) that the concurring partner should not have the same rotation requirements as the lead engagement partner. Partners from larger offices felt significantly stronger that accelerated rotation (5.09 vs. 4.34) and extended cooling-off requirements (5.04 vs.4.29) have created hardships in managing audit partner assignments in local practice locations (both p-values <0.05).[21]

Consistent with the views of the CAQ, other testimony to the TAC, and Francis and Yu (2009), our results suggest smaller office locations may be particularly at risk related to potential negative impacts of mandatory audit partner rotation, especially with respect to the possibility of increased involuntary relocations. To avoid relocation, our results indicate that prefer to gain new industry expertise in lieu of relocating.

Other reports and comments

[21] Panel C of Table 6 reveals monotonically increasing levels of agreement with perceptions of accelerated rotation and extended cooling-off by the other, Next 4, and Big 4 firms, respectively. Our supplemental analyses are designed to further examine perceptions of large and small offices without respect to *firm* type.

Respondents' views on related audit quality issues were gathered. We asked participants to provide an estimate of the time required to become fully effective on a new client, from the perspective of maximizing the quality of audit judgments. Our participants reported an average (standard deviation) of 2.54 (0.734) years (not tabulated), a finding consistent with the semi-structured interviews, and the results of Johnson et al. (2002) who find audit quality is lowest in the first three years of an audit firm's tenure. One partner said, "The size of the engagement relative to the engagement partner's practice has an impact on independence and audit quality more so than duration of service." Several suggested the value of rotation is overstated, with one observing "the current rules are not enhancing quality and are putting partners' livelihood at risk as they 'lose' responsibility for significant clients."

Partner-participants were afforded the opportunity to provide additional comments at the end of the survey. Specifically addressing the issue of accelerated rotation, one partner reported "Overall, I believe it takes at least three years for an audit partner to become intimately familiar with a new client, and the five year rotation requirement actually reduces the quality of the audit. If anything, I believe the rotation requirement should be after ten years." Another commented, "Rotation and cooling-off period changes as a result of SOX have not increased audit quality. The volume of change (in business practices, GAAP, GAAS, and SEC rules) is overwhelming and decreases audit quality, but regulators and standard setters ignore this. Reasonable steps to reduce unnecessary change, such as decreasing rotation requirements, would help." One responding partner "agrees with the concept of audit partner rotation, but believes the service period should be seven years, not five, before required rotation."

V. CONCLUSIONS AND SUGGESTIONS FOR FUTURE RESEARCH

Conclusions

Several themes are evident from the study. First, firms have policies and procedures in place to ensure compliance with rotation and cooling-off rules, and to limit the negative effects. Although partners believe rotation and cooling-off enhances auditor independence in fact and appearance, they do not think the SOX changes created additional benefits. Instead, there is strong evidence suggesting the overall effect of the changes is a decrease in industry and client-specific expertise. Our survey indicates partners require at least two years to gain familiarity with a client. Our partners reported that, in lieu of relocating, many opt to specialize in one or more new industries, potentially at the expense of industry depth.[22]

Critical to the interpretation of the study's result is the partner's definition of audit quality. We ask the interviewed OMPs to provide a definition of audit quality, each of which referred to not having restatements, getting the correct opinion, and not having findings on a PCAOB inspection. Evident in these reports is that auditor independence is viewed either as an antecedent or separate from audit quality.

The relationship between CFO turnover, auditor rotation, and financial reporting quality is also important (McCann 2008).[23] Our observations, and the findings of Geiger and North (2006), suggest audit quality may suffer most when the CFO and partner simultaneously change, assuming the CFO has primary responsibility for financial reporting. The acceleration of engagement partner rotation increases the likelihood the partner may be required to rotate coincident with a CFO change. Participants report clients are more likely to change firms in the

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[22] A potential limitation of the study's results is that our responding participants may be more averse to relocation than the population of practicing audit partners. We believe this risk is minimal given that change management theory suggests that individuals are generally resistant to change (Jones, 1995), suggesting that our results are likely not sample-specific.

[23] This article reports the tenure of a CFO at a Fortune 1000 company is less than three years.

year of the partner rotation. As prior literature has established lower audit quality for short tenured firms, this suggests an unintended consequence of accelerated audit partner rotation.

In addition to the direct impacts of the rule changes on audit quality, partner quality of life appears to be negatively impacted by the SOX mandates. Partners report they must devote time to learning new clients and industries. Greater likelihood of relocation and/or commuting increases the probability of having to make difficult career and family choices. These factors may contribute to job stress and burnout which others have found to be associated with reduced performance (e.g., Smith et al. 1993; Fogarty et al. 2000; Sweeney and Summers 2002). Partners report quality of life issues make retention more difficult, and management of assignments is particularly problematic for Big 4 and Next 4 partners

Our survey results offer additional evidence suggesting that, although accelerated rotation and extended cooling-offs may positively impact auditor independence – in fact and in appearance - it may have the unintended effect of reducing auditor expertise – directly by diluting industry and client-specific experience, and indirectly by negatively impacting audit partners' quality of life and the ability to attract highly qualified talent to the partner ranks.

Suggestions for Future Research

Our results suggest potential research avenues regarding the relationship between audit partner tenure, industry specialization, and audit quality. The revised rules may also impact organizational and professional commitment. Questions deserving attention include: Do rotation policies impact partners' level of professional commitment? Have these polices impacted senior managers' willingness to stand for partner? Our survey results also have implications for organizational commitment: Will some partners leave public accounting or seek other positions where mandatory rotation is not required? What are the characteristics of these partners?

Accelerated rotation and extended cooling-off may also affect partner burnout and job related stress causing us to question: Are partners learning new industries more likely to face burnout? Are commuting partners more likely to face burnout? One surveyed partner was dissatisfied with having to give up his book of business after developing it for five years. Partner quality of life and business may be related to how satisfied they are with choices they have upon mandatory rotation (Grant et al. 2001).[24] For example, if accelerated rotation and extended cooling-off cause the prestige of the next client to change, does that impact job satisfaction? How do partners view various rotation outcomes as impacting their future prospects in the firm?

Although there have been numerous studies investigating audit quality and firm rotation, it is not feasible to disentangle the conclusions of *firm* research from the issue of partner rotation as firms and partners are simultaneously rotated. Our results suggest that partners, on average, do not believe that they are fully effective until about two and one-half years into the audit tenure. If true, this corresponds with the archival research on firm tenure, and may indicate the archival research is in part measuring the partner's tenure with the client rather than the firm's tenure.

Ferguson et al. (2003) provide an excellent discussion of how expertise may be either firm or office specific. By extension, it may also be partner specific. Although research indicates audit quality is highest when the firm has industry expertise, the expertise may in fact lie in the partners assigned to the engagement rather than the firm or office. Our results indicating clients consider switching firms when partners rotate, suggests clients may view partner expertise to be paramount to that of the firm. If this is true, and if audit quality does in fact follow firm and partner tenure, this has significant implications for audit quality. A logical question arises – do audit committees feel switching costs are more likely to arise from changing partners or firms?

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[24] Grant et al. 2001 address the issue of territory design of salespeople, analogous to audit partners' client service.

What are the switching costs from changing partners that make the client more likely to solicit bids in the year of a partner change? The extent to which expertise lies with the firm, office, or partner is an important empirical question that could provide valuable insight in the role of both firm and partner rotation in simultaneously optimizing the benefits of auditor independence and audit quality. Collectively, this suggests the extant firm tenure and specialist research should be reevaluated with consideration of partner tenure and specialization in the post-SOX era.

These observations also suggest a potential benefit of knowing partners' identities. The TAC recommended that partners personally sign the audit report (U.S. Treasury 2008c); and the PCAOB recently issued a concept release on identifying U.S. engagement partners signing the audit report (PCAOB 2009b). Such data, whether in the report or other documents, would help determine if audit quality is driven by partner factors such as rotation, tenure, and industry experience. Currently, audit partner information is available in some locations outside of the U.S. Although foreign data may help address some of the issues about partner versus firm expertise, it may be limited in addressing whether audit quality suffers under SOX mandates and in smaller audit markets.[25] The availability of partner identity data in the U.S. would provide information for research that could assist policy makers in optimizing audit quality.

The testimony before the TAC suggested smaller firms and practice offices were subject to greater impact from the SOX rules. Francis and Yu (2009) found audit quality is related to office size[26] with larger offices more likely to issue going concern reports and constrain aggressive earnings management behavior. One explanation offered is the lessened effect of

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[25] Ferguson et al. (2003) note the Australian market is concentrated in five cities. Thus, there may not be enough smaller audit markets to test using Australian data.

[26] Francis and Yu (2009) measure big 4 office size by yearly revenue and number of public clients. The first quartile in revenue $M (number of public clients) ranges from $2.89 to $5.76 (five to eight) and the third quartile ranges from $21.65 to $45.185 (27 to 42).

partner rotation in larger offices. Our findings support this explanation as we find rotation policies have created incentives for partners to specialize in additional industries to avoid involuntary relocations. Our findings, those of Francis and Yu (2009), and proposals to identify partners suggest a link that future research can empirically test.

Our results also suggest the role of quasi-rents and industry reputation may be altered under an accelerated rotation and extended cooling-off regime. If client switching has changed under SOX, then the quasi-rents represent a five year annuity for clients who switch firms. This could have an impact on partner behavior in managing risk and audit pricing. Also, if the partner knows the client relationship may end every five years, the result may be end-of-game strategies and behaviors. Thus, optimal rotation and cooling-off periods could be examined experimentally. Decision quality may be lower when the engagement partner is not in the same geographic location as the client. This has implications for firm policies on relocation and commuting. Confirming or refuting research would be insightful.

Experimental studies may be able to address how investors' view these trade-offs, and what market mechanisms might mitigate the threats to overall audit quality. To maximize audit quality, should expertise or independence be weighted more? What mechanisms would allay investor concerns about independence if partner rotation (cooling-off) were eliminated or if the time period was expanded (reduced)? Possibilities include audit committee disclosures regarding why an audit firm and/or partner were retained or shareholder ratification of the firm or partner.

There are clearly trade-offs to audit quality from audit partner rotation and cooling-off mandates. Our study more clearly identifies what these trade-offs are – at least in the minds of practicing audit partners making complex auditing and accounting judgments; and subject to the SOX-imposed accelerated rotation and extended cooling-off mandates.

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TABLE 1

Demographic Data of Participating Audit Partners

The number of responses for the individual statements may be less than the overall number of partners responding due to responses left blank. (n = 170)

	Big 4[a] n = 37	**Next 4[b] n = 86**	**Other[c] n = 47**	**Total N = 170**	**Sig. Diff. by Size[d]**
Age, Expertise and Experience	Mean (s.d.) [range]	Mean (s.d.) [range]	Mean (s.d.) [range]	Mean (s.d.) [range]	F-stat *p*-value
Age in years (n = 167)	44.6 (6.9) [34-62]	47.8 (8.7) [33-65]	46.3 (8.4) [33-66]	46.7 (8.3) [33-66]	1.94 0.15
Years as an audit partner (n = 167)	9.4 (6.2) [2-22]	11.9 (9.4) [1-38]	10.2 (9.4) [1-34]	10.9 (8.8) [1-38]	1.14 0.32
Calculated age at partner (n = 167)	35.2 (3.8) [32-54]	35.9 (3.9) [26-48]	36.1 (4.9) [22-50]	35.8 (4.2) [22-54]	0.58 (0.56)
Number of expert industries (n = 166)	2.1 (0.9) [1-5]	2.8 (1.3) [0-8]	2.5 (1.1) [1-6]	2.6 (1.2) [0-8]	3.99 0.02
Times relocated due to mandatory rotation (n = 166)	0.11 (0.39) [0-2}	0.02 (0.15) [0-1]	0.02 (0.15) [0-1]	0.04 (0.23) [0-2]	1.99 0.14
# of lead partner public-company audits last year (n = 166)	2.1 (1.5) [0-5}	2.1 (1.7) [0-10]	0.64 (1.43) [0-7]	1.7 (1.7) [0-10]	13.51 0.00***
# of concurring partner public-company audits last year (n = 166)	1.5 (2.2) [0-7]	2.5 (3.2) [0-25]	0.73 (1.69) [0-7]	1.8 (2.8) [0-25]	6.62 0.00**
# of audit partners locally (n = 165)	21.2 (29.1) [3-120]	8.1 (7.3) [1-45]	8.4 (6.6) [2-30]	11.0 (15.8) [1-120]	10.75 0.00***
Other Demographics n = 170					
	Female	**Male**			
Gender (n = 166)	20.0 %	80.0 %			
	Single	**Married**	**Cohab.**	**Divorced**	
Personal status (n = 166)	5.4 %	90.4 %	1.8 %	2.4 %	
Age of children in years (n=166)	**0-5**	**6-11**	**12-17**	**> 18**	**Total**
Mean (s.d.) # of children by age	0.43 (0.73)	0.57 (0.78)	0.41 (0.71)	0.78 (1.18)	2.14 (1.15)
	Yes	**No**			
Maintained second residence for client service (n = 167)	2.4 %	97.6 %			
	Big 4[a]	**Next 4[b]**	**Other[c]**		
Firm type (n = 170)	21.8 %	50.6 %	27.6 %		
Response rate (n = 170)	56.1 %	45.7 %	40.5 %		

[a] Deloitte & Touche, Ernst & Young, KPMG, and PricewaterhouseCoopers.
[b] BDO Seidman, Crowe Horwath, Grant Thornton, and McGladrey & Pullen.
[c] All other firms, primarily top 25 firms not categorized as Big 4 or Next 4.
[d] ***, **, ***** denote significance at < or = 0.05, 0.01, and 0.001 levels, respectively (two-tailed).

TABLE 2
Perceptions of Benefits of Mandatory Rotation (RQ1)

Scale: 1 = *Strongly Disagree*, 4 = *Neutral*, 7 = *Strongly Agree*

The number of responses for the individual statements may be less than the overall number of partners responding (N = 170) due to responses left blank. Bracketed difference values indicate disagreement, while non-bracketed values indicate agreement, relative to neutral.

Panel A: Perception of Benefits	**Big 4[a] n = 37**	**Next 4[b] n = 86**	**Other[c] n = 47**	**Total N = 170**	**Sig. Diff. by Size[d]**
Statement	Mean (s.d.) [Diff-Ntrl][e]	Mean (s.d.) [Diff-Ntrl][e]	Mean (s.d.) [Diff-Ntrl][e]	Mean (s.d.) [Diff-Ntrl][e]	F-stat *p*-value
Improves appearance of independence	6.19 (0.91) 2.19***	5.71 (1.13) 1.71***	5.30 (1.55) 1.30***	5.70 (1.25) 1.70***	5.53 0.005**
Improves independence in fact	4.81 (1.39) 0.81***	4.42 (1.41) 0.42**	4.17 (1.75) 0.17	4.44 (1.52) 0.44***	1.88 0.16
Improves audit quality	4.46 (1.50) 0.46	4.33 (1.29) 0.33*	4.32 (1.53) 0.32	4.36 (1.40) 0.36***	0.13 0.88
Improves investor confidence	4.59 (1.14) 0.59**	4.34 (1.23) 0.34*	4.32 (1.42) 0.32	4.39 (1.26) 0.39***	0.62 0.54
Improves partner training/experience	4.86 (1.40) 0.86***	4.25 (1.54) 0.25	4.06 (1.61) 0.06	4.33 (1.55) 0.33**	3.11 0.05*
Reduces complacency in decision making	4.24 (1.44) 0.24	4.09 (1.45) 0.09	4.26 (1.55) 0.26	4.17 (1.47) 0.17	0.24 0.79
Improves staff training and experience	4.32 (1.51) 0.32	4.19 (1.26) 0.19	3.85 (1.56) [0.15]	4.12 (1.41) 0.12	1.35 0.26
Decreases partner attachment to client	4.76 (1.52) 0.76**	4.48 (1.22) 0.48***	4.70 (1.35) 0.70***	4.60 (1.32) 0.60***	0.73 0.48
Improves overall partner knowledge	4.59 (1.38) 0.59*	4.31 (1.37) 0.31***	4.34 (1.49) 0.34	4.38 (1.41) 0.38***	0.57 0.57
Partner gains new industry proficiency	3.57 (1.57) [0.43]	3.87 (1.47) [0.13]	3.36 (1.70) [0.64]*	3.66 (1.57) [0.34]**	1.72 0.18
Firm rotation improves independence in appearance	4.35 (1.81) 0.35	4.20 (2.02) 0.20	4.81 (1.78) 0.81**	4.40 (1.92) 0.40**	1.56 0.21
Firm rotation improves independence in fact	2.68 (1.86) [1.32]***	2.98 (1.76) [1.02]***	3.70 (1.81) [0.30]	3.11 (1.82) [0.89]***	3.89 0.02*
Firm rotation improves audit quality	2.08 (1.34) [1.92]***	2.60 (1.41) [1.40]***	2.98 (1.39) [1.02]***	2.59 (1.42) [1.41]***	4.33 0.02*
Clients prefer a new partner periodically	2.84 (1.26) [1.16]***	2.77 (1.30) [1.23]***	2.57 (1.23) [1.43]***	2.73 (1.27) [1.27]***	0.52 0.59

[a] Deloitte & Touche, Ernst & Young, KPMG, and PricewaterhouseCoopers.
[b] BDO Seidman, Crowe Chizek, Grant Thornton, and McGladrey & Pullen.
[c] All other firms, primarily top 25 firms not categorized as Big 4 or Next 4.
[d] ***, **, ***** denote significance at < or = 0.05, 0.01, and 0.001 levels, respectively (two-tailed).
[e] Difference from neutral value of 4.

TABLE 3
Perceptions of Costs of Mandatory Rotation (RQ2)

Scale: 1 = *Strongly Disagree*, 4 = *Neutral*, 7 = *Strongly Agree*

The number of responses for the individual statements may be less than the overall number of partners responding (N = 170) due to responses left blank. Bracketed difference values indicate disagreement, while non-bracketed values indicate agreement, relative to neutral.

	Big 4[a] n = 37	**Next 4[b] n = 86**	**Other[c] n = 47**	**Total n = 170**	**Sig. Diff. by Size[d]**
Statement	Mean (s.d.) [Diff-Ntrl][e]	Mean (s.d.) [Diff-Ntrl][e]	Mean (s.d.) [Diff-Ntrl][e]	Mean (s.d.) [Diff-Ntrl][e]	F-stat. *p*-value
Rotation increases incoming partner workload in first year	6.22 (0.98) 2.22***	6.13 (0.78) 2.13***	6.06 (0.97) 2.06***	6.14 (0.85) 2.14***	0.31 0.73
Rotation increases outgoing partner workload in first year	4.49 (1.57) 0.49	4.14 (1.53) 0.14	3.81 (1.61) [0.19]	4.09 (1.56) 0.09	1.96 0.14
Partner rotation increases risk that audit quality declines	4.38 (1.46) 0.38	4.17 (1.42) 0.17	3.68 (1.43) [0.32]	4.07 (1.46) 0.07	2.81 0.06
Risk of audit quality decline greater with new client CFO	4.81 (1.85) 0.81*	5.13 (1.48) 1.13***	4.94 (1.82) 0.94***	5.04 (1.64) 1.04***	0.523 0.59
Partner rotation increases workload of others on audit	5.88 (0.97) 1.88***	5.48 (1.07) 1.48***	5.04 (1.35) 1.04***	5.43 (1.14) 1.43***	4.90 0.01**
Partner rotation increases fees charged to clients	3.41 (1.79) [0.59]*	4.00 (1.48) 0.00	4.45 (1.72) 0.45	4.01 (1.64) 0.01	4.38 0.01**
Clients more likely to switch audit firms in year of rotation	5.73 (1.10) 1.73***	5.78 (1.02) 1.78***	5.04 (1.46) 1.04***	5.59 (1.19) 1.59***	6.45 0.00***
Client specific knowledge is lost due to partner rotation	5.89 (1.10) 1.89***	5.65 (1.07) 1.65***	5.32 (1.39) 1.32***	5.61 (1.17) 1.61***	2.57 0.08
Rotation decreases audit quality due to more client burdens	3.78 (1.36) [0.22]	3.76 (1.28) [0.24]	3.30 (1.37) [0.70]***	3.63 (1.34) [0.37]***	2.10 0.13
Rotation decreases audit quality due to more firm burdens	4.03 (1.48) 0.03	4.35 (1.35) 0.35*	3.68 (1.46) [0.32]	4.10 (1.44) 0.10	3.46 0.03*
Longer partner tenure results in a higher quality audit	4.47 (1.65) 0.47	4.42 (1.48) 0.42**	3.89 (1.61) [0.11]	4.26 (1.56) 0.26*	2.08 0.13
Audit quality is higher in year of audit firm change	3.83 (1.38) [0.17]	4.03 (1.25) 0.03	4.09 (1.10) 0.09	4.02 (1.24) 0.02	0.47 0.63
Audit quality is higher in year of partner change	3.69 (0.92) [0.31]	3.92 (0.92) [0.08]	4.15 (0.83) 0.15	3.94 (0.91) [0.06]	2.64 0.08
Audit quality higher when partner/client in same location	4.86 (1.48) 0.86***	5.26 (1.18) 1.26***	4.74 (1.36) 0.74***	5.05 (1.28) 1.05***	2.74 0.07

[a] Deloitte & Touche, Ernst & Young, KPMG, and PricewaterhouseCoopers.
[b] BDO Seidman, Crowe Chizek, Grant Thornton, and McGladrey & Pullen.
[c] All other firms, primarily top 25 firms not categorized as Big 4 or Next 4.
[d] ***, **, ***** denote significance at < or = 0.05, 0.01, and 0.001 levels, respectively (two-tailed).
[e] Difference from neutral value of 4.

TABLE 4
Anticipated Personal Impacts of Rotation (RQ3)

The number of responses for the individual statements may be less than the overall number of partners responding (N = 170) due to responses left blank. Bracketed difference values indicate disagreement, while non-bracketed values indicate agreement, relative to neutral.

Statement	**Endpoints, Midpoint**	**Mean (s.d.)**	**Diff. from Neutral[ab]**
Audit partner rotation increases the likelihood of relocation in my career (93>4; 50<4)	1 = *Very Unlikely* 4 = *Neutral* 7 = *Very Likely*	4.45 (1.81)	0.45**
Likelihood of being able to be lead partner in same industry and geography upon rotation (46>4; 83< 4)	1 = *Very Unlikely* 4 = *Neutral* 7 = *Very Likely*	3.64 (1.55)	[0.36]**
Satisfaction if asked to relocate because a client with your industry expertise unavailable locally(8>4; 148<4)	1 = *Very Unsatisfied* 4 = *Neutral* 7 = *Very Satisfied*	2.21 (1.12)	[1.79]***
Satisfaction if asked to service a less prestigious client locally if an equally prestigious client not local upon rotation (12>4; 110<4)	1 = *Very Unsatisfied* 4 = *Neutral* 7 = *Very Satisfied*	2.98 (1.20)	[1.02]***
Satisfaction if asked to gain new industry expertise upon rotation if client with your industry expertise not local (59>4; 61<4)	1 = *Very Unsatisfied* 4 = *Neutral* 7 = *Very Satisfied*	3.86 (1.40)	[0.14]
The potential for relocation and commuting discourages employees from pursuing an audit partner track (97>4; 41,4)	1 = *Strongly Disagree* 4 = *Neutral* 7 = *Strongly Agree*	4.47 (1.52)	0.47***
Impact on your quality of life if you were to relocate to become lead partner for a new client (11>4; 127<4)	1 = *Very Negative* 4 = *Neutral* 7 = *Very Positive*	2.65 (1.20)	[1.35]***

[a] Difference from neutral value of 4.
[b] ***, **, ***** denote significance at < 0.05, 0.01, and 0.001 levels, respectively (two-tailed).
FN: 68 partners reported 5 or greater on likelihood of moving and 3 or less on a negative impact on the quality of life if asked to move.

TABLE 5
Perceptions of the Impact of Rotation on Human Resources and Audit Quality (RQ4)

Scale: 1 = *Strongly Disagree*, 4 = *Neutral*, 7 = *Strongly Agree*

The number of responses for the individual statements may be less than the overall number of partners responding (n = 170) due to responses left blank. Bracketed difference values indicate disagreement, while non-bracketed values indicate agreement, relative to neutral.

Statement	**Mean (s.d.)**	**Diff. from Neutral[ab]**
When audit engagement partners are required to relocate, audit quality declines	3.73 (1.24)	[0.27]**
When audit engagement partners are required to gain new industry expertise, audit quality declines	4.36 (1.34)	0.36***
When audit engagement partners are required to telecommute, audit quality declines	4.08 (1.35)	0.08
Audit engagement partner rotation requirements hinder an audit firm's ability to <u>attract</u> the best and brightest employees	3.62 (1.37)	[0.38]***
Audit engagement partner rotation requirements hinder an audit firm's ability to <u>retain</u> the best and brightest employees	3.98 (1.41)	[0.02]

[a] Difference from neutral value of 4.
[b] ***, **, ***** denote significance at < 0.05, 0.01, and 0.001 levels, respectively (two-tailed).

TABLE 6
Perceptions of SOX-Mandated Accelerated Rotation, Extended Cooling-Off Impacts (RQ5)

Scale: 1 = *Strongly Disagree*, 4 = *Neutral*, 7 = *Strongly Agree*

The number of responses for the individual statements may be less than the overall number of partners responding (N = 170) due to responses left blank. Bracketed difference values indicate increases, while non-bracketed values indicate decreases, relative to neutral.

Panel A: General Impacts

Statement	**Mean (s.d.)**	**Diff. from Neutral[ab]**
Accelerated audit engagement partner rotation requirement (5 years) improved investor confidence	3.45 (1.47)	[0.45]***
Accelerated audit engagement partner rotation requirement improved auditor independence in fact	2.87 (1.41)	[1.13]***
Accelerated audit engagement partner rotation requirement improved auditor independence in appearance	4.28 (1.48)	0.28*
Accelerated audit engagement partner rotation requirement improved overall audit quality	2.98 (1.27)	[1.02]***
Increasing the cooling off period from 2 years to 5 years before an audit engagement partner can rotate back to a client improved independence in fact	2.80 (1.37)	[1.20]***
Increasing the cooling off period from 2 years to 5 years before an audit engagement partner can rotate back to a client improved independence in appearance	3.97 (1.60)	[0.03]
Increasing the cooling off period from 2 years to 5 years before an audit engagement partner can rotate back to a client improved overall audit quality	2.67 (1.20)	[1.33]***
The quality review (concurring) partner should have the same rotation requirements as the primary audit engagement partner	3.44 (1.74)	[0.56]***

TABLE 6 (continued)
Perceptions of SOX-Mandated Accelerated Rotation, Extended Cooling-Off Impacts (RQ6)

Scale: 1 = *Strongly Disagree*, 4 = *Neutral*, 7 = *Strongly Agree*

The number of responses for the individual statements may be less than the overall number of partners responding (N = 170) due to responses left blank. Bracketed difference values indicate increases, while non-bracketed values indicate decreases, relative to neutral.

Panel B: Personal Impacts

Statement	**Mean (s.d.)**	**Diff. from Neutral[ab]**
The change in mandatory audit engagement partner rotation policy from 7 to 5 years significantly increased the frequency you will have to relocate in your career	4.00 (1.58)	0.00
The change in mandatory audit partner rotation policy from 7 to 5 years significantly increased the likelihood you will have to gain new industry expertise during your career	4.70 (1.40)	0.70***
The change in the cooling off period from 2 to 5 years significantly increased the frequency you will have to relocate in your career	4.05 (1.51)	0.05
The change in the cooling off period from 2 to 5 years significantly increased the likelihood you will have to gain new industry expertise during your career	4.73 (1.34)	0.73***
The change from the 7 to the 5 year partner rotation requirement has created hardships in managing audit partner assignments in my local office	4.86 (1.59)	0.86***
The change from the 2 to 5 year cooling off period has created hardships in managing audit partner assignments in my local office	4.88 (1.52)	0.88***

[a] Difference from neutral value of 4.
[b] ***, **, ***** denote significance at < or = 0.05, 0.01, and 0.001 levels, respectively (two-tailed).

TABLE 6 (continued)
Perceptions of SOX-Mandated Accelerated Rotation, Extended Cooling-Off Impacts (RQ6)

Scale: 1 = *Strongly Disagree*, 4 = *Neutral*, 7 = *Strongly Agree*

The number of responses for the individual statements may be less than the overall number of partners responding (N = 170) due to responses left blank. Bracketed difference values indicate increases, while non-bracketed values indicate decreases, relative to neutral.

Panel C: Significant Differences by Firm Size

Statement	**Big 4 Mean (s.d.)**	**Next 4 Mean (s.d.)**	**Others Mean (s.d.)**	**Sig. Diff. by Size[ab] F (*p*-value)**
The change in mandatory audit engagement partner rotation policy from 7 to 5 years significantly increased the frequency you will have to relocate in your career	5.22 (1.17)	3.99 (1.34)	3.07 (1.63)	24.24 (< 0.001)
The change in mandatory audit partner rotation policy from 7 to 5 years significantly increased the likelihood you will have to gain new industry expertise during your career	5.26 (1.07)	5.02 (1.13)	3.70 (1.56)	21.03 (< 0.001)
The change in the cooling off period from 2 to 5 years significantly increased the frequency you will have to relocate in your career	5.26 (1.25)	3.99 (1.22)	3.26 (1.63)	21.99 (< 0.001)
The change in the cooling off period from 2 to 5 years significantly increased the likelihood you will have to gain new industry expertise during your career	5.11 (1.06)	5.01 (1.04)	3.93 (1.68)	12.98 (< 0.001)
The change from the 7 to the 5 year partner rotation requirement has created hardships in managing audit partner assignments in my local office	5.31 (1.45)	5.20 (1.35)	3.84 (1.68)	14.56 (< 0.001)
The change from the 2 to 5 year cooling off period has created hardships in managing audit partner assignments in my local office	5.31 (1.37)	5.22 (1.31)	3.89 (1.62)	15.16 (< 0.001)

[a] Difference between firm sizes.
[b] ***, **, ***** denote significance at < or = 0.05, 0.01, and 0.001 levels, respectively (two-tailed)