Study asserts companies shop for internal control audit opinions

Tammy Whitehouse | May 4, 2016

Audit opinion shopping -- a not-uncommon practice believed to have been cut down in the post-Sarbanes-Oxley era -- remains alive and well in capital markets, and it’s most pervasive in the presence of competition among auditors. That’s the conclusion of academic research recently published by the American Accounting Association.

Four accounting professors representing universities in Missouri and Texas say they have identified evidence that some companies facing unfavorable findings by auditors regarding internal control over financial reporting have switched auditors to avoid an adverse audit opinion. The study also concludes opinion shopping is more likely, not less, in more competitive audit markets, and that switches associated with opinion shopping are more likely later in the reporting year.

The four authors say their research is the first to identify that audit opinion shopping still exists, despite significant reforms under Sarbanes-Oxley and continued regulatory pressure to enforce it. “Our empirical results suggest that clients are successful in shopping for clean internal control opinions,” the authors study says. “In addition, we find evidence that internal control opinion shopping occurs primarily in competitive audit markets. Finally, our results indicate that among auditor dismissal clients, opinion shopping is more likely to occur when dismissals are made relatively late during a reporting period and when audit market competition is high.”

To reach their conclusions, the professors relied on a variety of historical research and established a complex framework to analyze probabilities around internal control opinions, going concern opinions, auditor dismissals, the timing of dismissals, and measures of audit competition. They applied their method to analyze more than 11,000 public company reports from 2005 to 2011.
Co-author Michael S. Wilkins of Trinity University says the study findings suggest companies would receive adverse opinions on internal control even more frequently if not for searching for a more favorable audit opinion. “Note that opinion-shopping doesn’t necessarily mean changing auditors,” he said in a statement. “It can also drive a decision not to switch. In short, our findings suggest that opinion-shopping pays.” The study suggests that internal control concerns have become a major factor motivating opinion-shopping, that companies engage in opinion-shopping to a significant degree, and that competition among auditors makes it more likely to occur, he said.

The study also establishes, according to the AAA, that auditor dismissals late in a reporting period are a sign of trouble and an indicator that the company may be looking for a more favorable audit outcome, especially when a company dismisses a Big 4 firm for a national or regional firm. The findings should be of interest, the authors say, to regulators who have advocated for auditor rotation to increase competition and who are exploring others ways to improve audit quality.