MANDATORY AUDITOR ROTATION: A REVIEW AND ANALYSIS OF RESEARCH FROM THE LAST DECADE

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Mandatory Auditor Rotation (MAR)
Ben Foster
Dr. Robert Larson

**What is MAR?**
A proposed change to the current audit environment that would require public companies to rotate their external auditor every five to seven years.

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<th>Current Audit Environment</th>
<th>Proposed MAR Environment</th>
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<td>- Public corporations hire and pay firms to complete audit of financials.</td>
<td>- Would require public companies to rotate their external auditor every 5 to 7 years</td>
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<td>- Corporations are free to retain their auditor as long as they please.</td>
<td>- Drastically shortens average client-auditor relationship</td>
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<td>- There may be a lack of incentives to place shareholder’s interests ahead of the client’s needs since the corporate managers ultimately pay the auditor.</td>
<td>- Firms could no longer rely on clients as a yearly source of income.</td>
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**Arguments Supporting MAR Adoption**
- MAR would prevent auditors from becoming reliant on clients as a source of a long term annuity thus removing the incentive to place a client’s desires ahead of shareholders interests. (Imhoff 2003)
- Auditors are less likely to issue biased opinions under a MAR regime. (Dopuch et al. 2000)
- Under MAR, the general public would perceive auditor independence as higher under MAR than current audit practices. (Moody et al. 2006)
- MAR could work towards breaking up audit market oligopoly that exists amongst the Big 4 by increasing competition for audits. (PCAOB 2011)

**Arguments Opposing MAR Adoption**
- Reductions in audit quality and excessive earnings management are most likely to occur in the first three years of an auditor client relationship. (Carcello and Nagy 2004)
- The sharp reduction that MAR would create in the average length of a client auditor relationships would result in decreased audit quality. (Johnson et al. 2002)
- Experiences of many other countries that use MAR have shown no measurable increase in audit quality. (Cameran et al. 2005)
- MAR adoption will result in unintended costs through higher audit fees and the opportunity cost of time devoted to auditor selection. (Kwon et al. 2010)

**Conclusions**
- Uncertain benefits of MAR do not outweigh the certain costs of MAR adoption at this time.
- Existing provisions of the Sarbanes Oxley Act have helped to increase earnings quality and should be allowed to further develop.

**Suggested Alternatives to MAR**
- Adoption of a rule that would allow the PCAOB to recommend audit firm rotation to an audit committee if the auditor’s independence has been compromised.
- Require large audit firms to publicly report their policies and practices to safeguard independence and audit quality.
- In proxy statement require a discussion of how the audit committee evaluates their auditor’s performance and independence.