

This series presents the PricewaterhouseCoopers Point of View on a range of auditing, accounting and regulatory issues affecting our clients and our profession. These positions represent the collective view of our network of firms.

Mandatory rotation of audit firms

What are the issues?

Audit firms typically have long-term professional relationships with their audit clients. Some have suggested that such relationships may be perceived to threaten the audit firm's objectivity and independence because of the 'familiarity' of the audit firm with the client. Mandatory rotation of audit firms has been suggested by some regulators and interested parties as a response to this concern because it would not permit audit personnel to build familiarity over time with their clients. Auditors and other interested parties who oppose mandatory audit firm rotation believe it reduces audit quality, increases the cost of audits and eliminates the choice of audit committees.

What is our response?

We are opposed to mandatory rotation of audit firms as we do not believe it is in the best interests of shareholders, companies or users of financial statements.

Effective auditing depends on an auditor's ability to develop a detailed understanding of a client's operations and industry. It also depends on effective working relationships with management, audit committees and boards of directors. Knowledge is cumulative and is built up over a number of years by the entire audit team. Mandatory rotation undermines, and ultimately destroys, the accumulation of this knowledge. Experience shows that 'problem' audits occur more frequently when the auditor lacks a solid base of experience with the client's business, operations and systems. We believe that forcing auditor change is likely to have an adverse affect on audit quality.

We believe safeguards are already in place to maintain auditor objectivity and skepticism without the negative impact on audit quality and investor confidence including:

- mandatory audit partner rotation resulting in the person with the closest relationship with management and the responsibility for significant audit judgments being rotated before over-familiarity threatens objectivity and independence
- mandatory rotation of other senior members of the audit team
- quality review partners on public interest entities
- internal quality control procedures

- auditors report directly to the audit committee instead of management
- required audit committee communication and pre-approval of professional services
- external regulatory oversight of audit firm work

These safeguards provide sufficient protection to maintain audit firm objectivity and independence and achieve a proper balance between the need for an in-depth knowledge and understanding of the client's business and its risks and the 'familiarity' risk of the audit firm with the client. In addition, mandatory rotation increases audit costs because of the tender and start-up time incurred by both management and the new audit firm. The impact of mandatory rotation on audit costs is even greater for large group audits where separate, stand-alone statutory audits are required in numerous countries. Effective audit committees/boards of directors are best placed to judge whether a change in auditors is appropriate. Mandatory rotation precludes selection of the best qualified audit firm.

Mandatory rotation has been considered by regulators in various countries in recent years. In virtually all cases, the conclusion reached has been that mandatory rotation is not necessary to promote or ensure audit quality. We also note that of the various external studies on the subject of mandatory rotation, almost all recognise that there are significant disadvantages to mandatory rotation.

What does this mean?

We will continue to support standards and regulations that contribute to audit quality in an effective and cost efficient manner. We will continue to oppose standards and regulations that require mandatory rotation. We will continue to support the right of audit committees/boards of directors to exercise choice in the selection of auditors. In the few countries where mandatory rotation is required, we will express our point of view that mandatory rotation makes it much more difficult to achieve audit quality and increases costs.

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