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Audit Firm Rotation - Its Impact on Auditor Independence: An Irish Perspective

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DECLARATION

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Abstract

Auditor independence is a cornerstone of the auditing profession and recent challenges of the audit independence assumption have impelled the accounting profession to consider ways of improving the credibility of audit reports. This study examines the perceived impact of audit tenure on auditor independence and whether audit firm rotation should be introduced in Ireland. The associated benefits and drawbacks of the audit firm rotation are analysed, and possible recommendations for improvements to potentially further enhance an auditor's independence are suggested. The results, based on a survey of the top 20 accounting firms and interviews with 3 of the Irish accounting bodies and two audit regulators, shows that audit firm rotation could be an excellent way to enhance the perceptions of an auditor's independence. However, it was found that the associated benefits would not outweigh the costs of having this as a requirement. The findings would also suggest that there is a need to develop alternative measures to safeguard auditors' independence, as there are evidently some weaknesses within the standards that are in place today, otherwise, none of the corporate scandals would have occurred. Further research should be considered regarding other possible recommendations for enhancing the independence of auditors. Some examples include, appointment of company auditors by the state or an independent oversight body, reducing the 10% fee threshold that an auditor must not exceed in relation to audit and non-audit services. Another possible enhancement for independence would be to introduce a government approved body to verify the auditors' work year after year to ensure they are carrying out their duties to their full capability.

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List of Abbreviations

ACCA	Association of Chartered Certified Accountants
AICPA	American Institute of Certified Public Accountants
APB	Audit Practice Board
CONSOB	Commissione Nazionale per le Società e la Borsa
CPA	Certified Public Accountants
CVM	Comissão de Valores Mobiliários
ES	Ethical Standards
FRC	Financial Reporting Council
GAAP	Generally Accepted Accounting Principles
GAO	General Accountability Office
IAASA	Irish Auditing and Accounting Supervisory Board
ICAEW	Institute of Chartered Accountants in England and Wales
ICAI	Institute of Chartered Accountants
IIPA	Institute of Incorporated Public Accountants
IOSCO	International Organisation of Securities Commission
POB	Public Oversight Board
SOX	Sarbanes-Oxley Act
UK	United Kingdom
USA	United States of America

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Chapter 1
Introduction

1.1 Introduction

Recent accounting scandals, including Enron, WorldCom and Qwest have brought about substantial change in the audit industry, most notably the dissolution of Arthur Anderson (Certified Public Accountants), the auditor for the collapsed company, Enron, in 2002. The scenario has become all too common where a large, publicly traded corporation receives an unqualified report from an auditor, and shortly thereafter collapses with the news that the financial statements are grossly misstated (Tackett et al, 2004). Why and how does this occur time and time again? Is it due to the procedure by which companies are audited, as auditing is perceived by many users as having a purpose of detecting accounting irregularities and mistakes or is there something else at play here? Such are the questions going through the minds of the public and regulatory community (Comunale and Sexton, 2005).

There has yet to be a major accounting scandal to be brought to light in Ireland, however, there have been questions surrounding the work of auditors recently in the current financial crisis, mainly in the banking sector. For example, in the case of Anglo Irish Bank, there have been questions raised around Ernst & Young's performance as they 'failed to notice' the substantial loans that were hidden from their Balance Sheet. Ernst & Young have defended its handling of the bank's accounts; saying all of the audits they have conducted for the bank's shareholders were done 'in accordance with the appropriate auditing standards' (Irish Times, August 2009). This brings us to the question as to whether the standards need to be developed even further in order to clamp down on such scandals before they can happen and help make the auditors' role more efficient.

Porter et al (2008) describes an external audit as an examination of an entity's financial statements to provide evidence supporting the information contained in those statements. If users of the financial statements are to believe and rely on the auditor's opinion, it is essential that the auditor is, and is perceived to be, independent of the entity, its management and all other influences. If the auditors are considered not to be independent of the client, their opinion will carry little credibility and users of the financial statements will gain little, if any, assurance from the auditor's report about the truth and fairness (or otherwise) of the financial statements. As a consequence, the audit will have little purpose or value.

In order to enhance the perceptions of auditor independence and the credibility of their function, regulators such as the Auditing Practice Board (APB) and the accounting profession have established measures designed to ensure that auditors are, and remain, independent of their audit client (Porter et al 2008). The APB was established in April 2002, as part of the Financial Reporting Council (FRC), and currently requires the rotation of audit engagement partners and their review partners as an attempt to improve attitudes towards the independence of auditors.

The APB is continuously attempting to develop their standards to add value to the audit function. They also draw attention to the dangers posed to that independence, particularly as a result of auditors becoming too familiar with their audit clients' managements, and being dependent on those managements for their continued appointment (Porter at al, 2008).

This requirement of simply rotating personnel has been questioned by many whether it is enough to protect the familiarity threat that auditors face (Arel et al, 2005). Due to the numerous unexpected collapses in the corporate world, many have suggested a number of different proposals in order to reduce the level of threats auditors face today, one being the introduction of mandatory audit firm rotation.

Cameran et al (2005) claims that the introduction of mandatory audit partner rotation is a means of strengthening independence, reducing the incidence of audit failure and improving the quality of audits. Regulators require auditor rotation out of concern that long tenure may erode auditor independence and/or hinder the auditor's ability to develop creative and innovative audit programmes due to complacency or over-familiarity (Carey and Simnett, 2006; cited by Bamber and Bamber, 2008). Due to the long association an auditor may have with the client, it may have the effect of reducing the fresh point of view that auditors should have in the first years of the engagement. The requirement of firm rotation can also lead the market to competition based on the quality of services, which can lead to a growth in the number of competent firms.

Currently, the Sarbanes-Oxley Act (SOX) in the United States (US) mandates the rotation of audit partners. However, in 2003 they required the General Accountability Office (GAO) to carry out a study on the 'Potential Effects of Mandatory Audit Firm Rotation'. This found that firm rotation might not be the most efficient way to strengthen auditor independence and improve audit quality. On the other hand, they suggested additional future research could potentially add value to the prospect of mandatory audit firm rotation.

1.2 Research Aims and Objectives

The research question is:

> ***What impact would audit firm rotation have if it was introduced in Ireland; and would such audit firm rotation add value to an auditor's independence?***

The research objectives include:

- To outline the literature regarding auditor rotation and its link with auditor independence.
- To examine legislation/regulations from different countries who have introduced compulsory audit firm rotation.
- To establish the arguments for and against making firm rotation mandatory.
- To ascertain opinions regarding the impact that audit firm rotation may have if it was mandated in Ireland.

- To identify possible recommendations that could enhance the perceptions of the auditors' independence in the future.

The first, second and third research objectives were answered by the literature review which is outlined in chapter two; however, the views of the accounting bodies and firms were also used to answer objective three. The fourth objective was aimed at ascertaining the views of the interested parties on how the requirement should be implemented and what they believed to be the pros and cons of introducing it in Ireland. This was also analysed from the review of the literature, along with objective five, of which the interviewees also gave their personal perceptions on how an auditor's independence could be enhanced.

1.3 Justification for the research

The evolution of the auditing sector has been a subject of interest for the past number of years. With corporate scandals blackening the auditing sector, much emphasis has been placed on improving the current ethical standards. It has been questioned whether these regulations are enough to overcome the many threats that can arise, or whether further regulatory changes, such as a system of mandatory audit firm rotation is needed. Many interested parties have suggested this, as it would not permit audit personnel to develop a close relationship with clients over time. There has been a call for further research on this topic by both the international standard setters and academics (GAO 2003; Nagy, 2005; Jackson et al, 2008).

In addition, the researcher found no previous peer reviewed studies on audit firm rotation in Ireland, therefore, this study attempts to bridge the gap left in the research by ascertaining the views of the stakeholders concerned with the auditing profession on how to enhance independence in Ireland. The findings from this study can then be compared with the findings of similar studies conducted in other countries around the world.

1.4 Potential uses of this study

Firstly, the Irish accounting bodies and regulators could use this research, as needed to facilitate recommendations produced for enhancing an auditor's independence. The accounting bodies are there to offer their members support and information, such as advising them on any independence issues that may arise. This research will offer them possible suggestions on how an auditor can improve their independence.

Accountings firms may also use this research; particularly firms which may have felt the negative effect of the many corporate collapses that have occurred and these were deemed to have occurred due to independence issues.

This research may be of value to several parties, and the results of this research will be important for the progression of the accounting industry. In completing the research, it was hoped to add to the current academic body of knowledge, by reviewing it from an Irish context.

1.5 Limitations of the Research

"As with any study, there are factors that limit general application of the results" (Nickerson, 1993, p.30). This research has several limitations, many of which stem from the constraints of the research. The researcher had the following constraints:

- Interview constraints: The use of interviews for data collection also entailed certain constraints, mainly the fact that they were mostly conducted via telephone which meant that it was impossible to read any facial expressions or body language that can sometimes add to the replies of the interviewees (Opdenakker, 2006). Another interview constraint was that many of the interviewees made it clear that their responses were their personal interpretations and did not represent those of the organisation. In addition to this, one of the main accounting bodies were unavailable for an interview at the time of the research, however, this was overcome by the questionnaire due to the fact that the majority of the respondents from this were affiliated with the unavailable accounting body.
- Questionnaire constraints: The main limitations associated with the use of questionnaires include the following factors: the researcher is never sure who completed the questionnaire nor are they sure that the respondent was not

frivolous when completing the questionnaire. Both these issues have the potential to affect the credibility of the findings. Questionnaires prevent the exploration of the meanings that lie beneath the responses, while the answers provided may have influenced the participants contributing to researcher bias. Additional comments boxes were associated with each question to allow the respondent to add further comments on each of the questions so that these could be taken into account when appraising the responses.

- Time: Undertaking the research, while also studying full-time, limited the time available to interview every concerned stakeholder on the area. To counteract this time constraint, a questionnaire was issued to the 'Top 20' accounting firms in an attempt to ascertain the perceptions of a broader population on the topic audit firm rotation.
- Financial: This study was privately funded which meant that any extra costs associated with the collection of the primary and secondary research where incurred by the researchers. To overcome this constraint, it was decided to deliver the questionnaires using an online survey tool to eliminate the costs of postage and conducting the interviews by telephone and via email to reduce the cost of travelling.

1.6 Chapters outline

A review of the literature on auditor independence and the rotation requirement is provided in chapter two. The research methodology is outlined in detail in chapter three and the findings and analysis of the semi-structured interviews and questionnaires are described in chapter four. Finally, the conclusions and recommendations are discussed in chapter five.

Chapter 2
Literature Review

2.1 Introduction

This chapter outlines the current academic literature on the audit rotation requirement and in particular it looks at auditor's independence, the APB's ethical standards and legislation from other countries regarding the rotation of auditors. It also evaluates both the positive and negative outcomes of audit rotation.

2.2 Auditor Independence

Auditor independence has been defined as the ability to resist client pressure (Pany and Reckers 1980, Pearson and Ryan 1982, Knapp, 1985, cited by Strohm, 2005). Similarly, the APB (Standards and Guidelines, 2008; pg 6) defines auditor independence as having:

"... freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired".

Independence is traditionally regarded as being one of the fundamental principles underlying the reliability of an auditor's report. An auditors' report would not be deemed credible and investors and creditors would have little confidence in it, if auditors were not independent in both fact and appearance (Alleyne and Devonish, 2006; Arens et al, 2006; Beattie et al, 1999).

The independence of auditors has been a major concern for some time. In recent years, it has become even more distinctive, given the collapse of Enron, which resulted in the closure of Arthur Andersen, one of the major international accounting firms (Vinten, 2003; cited by Law, 2008). Andersen's audit of Enron may have been the most notable failure of auditor independence, but it was by no means the first, the largest, or the last

(Moore et al, 2006). Enron was a very important client of Andersen's, and due to its long association with the company, Andersen's auditors failed to uncover the wrongdoing that went on at Enron as soon as it had occurred (Tackett et al, 2004; Toffler, B.L, 2005).

People rely extensively on the advice of experts. Often, these experts face conflicts of interest between their own self-interest and their professional obligation to provide good advice. A central concern in the Enron post-mortem has been to explain why Enron's auditor, Arthur Anderson, failed to act as an independent gatekeeper of reliable and transparent financial information (Kershaw, 2006; Moore et al, 2006).

To be credible, an auditor's opinion must be based on an objective and disinterested assessment of whether the financial statements are presented fairly in conformity with Generally Accepted Accounting Principles (GAAP). If this is complied with to the auditor's best ability, this, in turn, will mean that users will have more confidence in audited financial statements and that there will be greater certainty in the capital markets (Firth, 1978, Estes & Reimer, 1977, cited by Firth, 1980).

Ernst & Young became the latest auditors to come under fire after "*the court-appointed examiner in the Lehman Brothers Holdings Inc bankruptcy said the audit firm did not challenge accounting gimmicks that allowed Lehman to hide some $50 billion in assets in 2008, while claiming it had reduced its overall leverage levels"* (The Economic Times, 2010). Also, Richard P. Scalzo, of PWC, was Tyco International's lead auditor for many years and has been barred from working on any part of a public company's finances as he had been overlooking material facts in his audit of Tyco. Investigators were left wondering how Tyco's auditor for eight years, could have "*missed the hundreds of millions of dollars in unreported, misappropriated and misrepresented compensation doled out among Tyco higher-ups during the tenure of ex-Chairman L. Dennis Kozlowski*" (Weinberg, 2003).

These revelations brought the accounting profession under the scrutiny of many regulators including the APB and Irish Auditing and Accounting Supervisory Authority (IAASA). The scrutiny increased after apparent audit failures were reported at WorldCom, Xerox, Global Crossing and more recently Lehman Brothers Holdings Inc. Lawmakers believe that the accounting profession has failed to regulate itself in a manner that promotes confidence in the published financial statements of public corporations (Tackett et al, 2004).

In light of these scandals, Congress in the US passed the SOX Act to prescribe new requirements and restrictions for auditors of publicly traded companies (Congress of the United States of America, 2002). Although there have been no comparable failures, brought forward as of yet in the United Kingdom (UK) or Ireland, where the regulatory framework has been claimed to be more robust (Hinks, 2002), public reassurance was needed. The UK Government rapidly instigated reviews of key aspects of the UK regulatory framework and a key concern was highlighted regarding the adequacy of the framework for auditor independence (Fearnley and Beattie, 2004).

To improve audit quality and ensure auditor independence and objectivity, there are now more regulators, such as the FRC who set up the APB in an attempt to rectify the threats that face auditors today. The APB have been continuously updating their auditing ethical standards, since they were first introduced as guidelines for auditors in December 2004, in an attempt to overcome the auditor independence issues that are worldwide. The updated auditing ethical standards functions are to:

- Limit the likelihood that auditors will succumb to independence pressure (Kershaw, 2006)
- Establish high standards of auditing
- Meet the developing needs of users of financial information and
- Ensure public confidence in the auditing process (APB, 2010).

The following section provides a brief synopsis of the ethical standards that are in place today.

2.3 Ethical standards (ES) (APB, 2010)

2.3.1 ES 1 – Integrity, objectivity and independence

This standard requires the audit engagement partner to identify and assess the circumstances, which could adversely affect the auditors' objectivity (threats), including any perceived loss of independence, and to apply procedures (safeguards), which will either:

- Eliminate the threat; or
- Reduce the threat to an acceptable level

2.3.2 ES 2 – Financial, business, employment and personal relationships

This standard provides requirements and guidance on specific circumstances arising out of financial, business, employment and personal relationships with the audited entity, which may create threats to the auditors' objectivity or perceived loss of independence.

2.3.3 ES 3 – Long association with the audit engagement

This standard provides requirements and guidance on specific circumstances arising out of long association with the audit engagement, which may create threats to the auditor's objectivity or perceived loss of independence.

2.3.4 ES 4 – Fees, remuneration and evaluation policies, litigation, gifts and hospitality

This standard provides requirements and guidance on specific circumstances arising out of fees, economic dependence, litigation, remuneration and evaluation of partners and staff, as well as gifts and hospitality, which may create threats to the auditor's objectivity or perceived loss of independence.

2.3.5 ES 5 – Non-audit services provided to audit clients

This standard provides requirements and guidance on specific circumstances arising from the provision of non-audit services by audit firms to entities audited by them, which may create threats to the auditor's objectivity or perceived loss of independence.

2.3.6 ES – Provisions Available for Small Entities

This standard provides alternative provisions for auditors of Small Entities to apply in respect of the threats arising from economic dependence and where tax or accounting services are provided and allows the option of taking advantage of exemptions from certain parts of the requirements in APB's Ethical Standards 1 to 5 for a Small Entity audit engagement.

Much of this research has focused on Ethical Standard 3 – Long Association with the Audit Engagement, and how this guideline could be improved so as to safeguard the auditors even further by enhancing their independence.

2.4 ES 3 – Long Association with the audit engagement

ES 3 outlines the provision for long association with the audit engagement, which was revised as recently as October 2009. This outlines that in the case of listed companies: the audit engagement partner has a time limit of five years in which they can audit any one firm. The audit committee can agree to retain their auditor for a further two year period if they are fully satisfied that this is in the best interest of the quality of audit received. In addition to this, the engagement quality control reviewer must not audit a specific entity for a period longer than seven years.

For non listed companies, the standard outlines that once an audit engagement partner has held its role for a continuous period of ten years, careful consideration should be given as to whether a reasonable and informed third party would consider the audit firm's objectivity and independence to be impaired.

The concept of mandatory audit firm rotation is that a company's auditors should provide services for a defined period only, after which they would be replaced by a different firm of auditors. This brings us to the ultimate question as to whether such a concept could enhance audit quality, and if so, at what cost? The following section outlines potential threats that auditors may encounter.

2.4.1 Threats to independence

Although auditors are required to maintain their objectivity and independence, there are incentives that might induce auditors to compromise their independence. These threats can include:

- Self-Interest – this can occur as a result of the financial or other interests of a professional accountant or of an immediate or close family member.
- Self-Review – this can occur when a previous judgement needs to be re-evaluated by the accountant originally responsible for that judgement.
- Advocacy – this can occur when an accountant promotes a position or opinion to the point that subsequent objectivity may be compromised.
- Familiarity – this can occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others.
- Intimidation – this can occur if a professional accountant is deterred from acting objectively by threats, actual or perceived.

It has been questioned whether the current guidelines are enough to overcome these threats, or whether further regulatory changes, such as a system of mandatory audit firm rotation is needed. Many interested parties have suggested this, as it would not permit audit personnel to develop a close relationship. There has been call for further research on this topic by both the international standard setters and academics (GAO, 2003; Nagy, 2005; Jackson et al, 2008).

The researcher found that internationally there have been significant developments towards enhancing an auditor's independence through rotation requirements. Policies from other countries are described in the next section.

2.5 Legislation from other countries

2.5.1 Europe

The European Commission issued a recommendation for auditors, which does not require mandatory rotation of firms but does require mandatory partner rotation on listed clients after seven years. It differs in some respects from the Irish and UK requirements, namely:

- It allows a return after two years (not five years as with the Republic of Ireland and the UK)
- It applies to 'public interest clients', not just listed clients
- In a group context, it extends to key audit partners other than the audit engagement partner

No country within the EU, with the exception of Italy, currently has a system of mandatory audit firm rotation (Institute of Chartered Accountants in England and Wales, (ICAEW) 2002). Some examples of approaches adopted worldwide are shown below.

2.5.2 Italy

Italy has required mandatory audit firm rotation of listed companies since 1975 in which the audit firm may compete to provide the audit services for a company every 3 years and the same public accounting firm may serve as the auditor of record for a maximum of 9 years. In addition, there is a minimum time lag of 3 years before the predecessor auditor can return. The mandatory audit firm rotation requirement was intended to safeguard the independence of public accounting firms.

In a meeting with the International Organisation of Securities Commissions (IOSCO) Standing Committee, the Italian representative from Commissione Nazionale per le Societa e la Borsa (CONSOB), the Italian securities regulator, indicated that Italy's experience with mandatory audit firm rotation has been a success, noting that mandatory audit firm rotation gives the appearance of independence, which is considered very important to maintaining investor confidence. (ICAEW, 2002; GAO, 2003; Cameran, 2005).

2.5.3 Brazil

Brazil enacted a mandatory audit firm rotation requirement in May 1999 with a 5-year maximum term and minimum time lag of 3 years before the predecessor auditor can return. The Comissao de Valores Mobiliarios (CVM), which is the Brazilian Securities Commission, indicated that the primary reason mandatory audit firm rotation was enacted was to strengthen audit supervision following accounting fraud at two banks (Banco Economico and Banco Nacional). Brazil does not have a partner rotation requirement, as the CVM believes that the requirement of rotating audit firms is stronger than changing partners within firms (GAO, 2003; Comunale and Sexton, 2005).

2.5.4 Singapore

Starting in March 2002, the Monetary Authority of Singapore stipulated that banks incorporated in Singapore should not appoint the same public accounting firm for more than 5 consecutive financial years. While a "time out" period is not stipulated, banks incorporated in Singapore shall not, except with the prior written approval of the Monetary Authority of Singapore, appoint the same audit firm for more than 5 consecutive years. In addition, listed companies are required under the Listing Rules of the Singapore Exchange to rotate audit partners-in-charge every 5 years.

The primary reason Singapore instituted mandatory audit firm rotation for local banks was to promote the independence and effectiveness of external audits. In addition, mandatory audit firm rotation for local banks was cited by Singapore's officials as a measure to help (1) safeguard against public accounting firms having an excessive focus on maintaining long-term commercial relationships with the banks they audit, which could make the firms too committed to the banks, (2) maintain the professionalism of audit firms - where, with long-term relationships, audit firms run the risk of compromising their objectivity by identifying too closely with the banks' practices and cultures, and (3) bring a fresh perspective to the audit process - where, with long-term relationships, public accounting firms might become less alert to subtle but important changes in the bank's circumstances (GAO, 2003; Lai and Cheuk, 2005).

2.5.5 Countries where mandatory rotation has ceased

In Austria, the Commercial Law of 2004, required a mandatory audit firm rotation every 6 years with a minimum time lag of 3 years before the previous auditor can be reappointed. However the implementation of this rule was postponed awaiting developments at EU level. In 2005, it was finally dropped by the company law that changed the articles of Austrian Commercial Law on auditing.

In 1990, Spain introduced the system of mandatory audit firm rotation with a maximum term of nine years, however, this system was abolished in 1995, four years before the first rotation was due to take place (Cameran et al, 2005). Firm rotation in Spain has been said to have had a negative impact on the quality of auditors' work and on the structure of the audit market (Arrunda and Paz-Ares, 1995; 1997; ICAEW, 2002). However, even though this has been implied, it is clearly evident that Spain cannot be held up as a proven practical example of the failings of mandatory audit firm rotation as they did not give this requirement sufficient time to materialise.

Based on the different policies summarised above, it is evident that all countries reviewed express concerns surrounding the introduction of rotation rules as they found that there is higher risk of audit failures, fraudulent financial reporting and lawsuits in the earlier years of the engagement. Only one study conducted in Italy, concludes definitely in favour of the rotation requirement as they support the validity of this rule as a means of enhancing auditor independence. This is discussed further below.

2.6 Rotation as a means of enhancing independence

Defond et al (2002) and Geiger and Raghunandan (2002) argue that the audit report is the final outcome of the audit process, and is the only external communication of what the auditor has done and concluded during the audit. The decision on what type of audit report to render to the client is the final cumulative audit decision, and is subject to a considerable amount of professional judgement and negotiation with the client. As such, it captures the possible influence that close audit-client relationships might have on the auditors' professional judgement and their behaviour in the negotiation.

If the auditors sacrifice some of their independence when facing the clients they have been working with for a long time or the ex-colleagues from their former audit firms, this will be reflected by a reduced professional scepticism or a soft behaviour in audit conflict situation, leading to a lower tendency to issue a qualified audit opinion. In contrast, if auditor independence remains in spite of the personal relationship between auditors and clients, the auditor should be able to have an unbiased opinion concerning the client's financial statements.

This is accompanied by the view that auditors might smooth over problems due to the financial rewards of maintaining a long-term relationship with a client. Entities could easily threaten to find another auditor if the present auditor did not agree with managements opinion.

The ICAEW (2002) report on mandatory rotation found that the idea of firm rotation enhancing independence was originally put forward by a variety of individuals and committees, including the Cadbury Committee, the Irish Review Group on Auditing and the American Institute of Certified Public Accountants (AICPA). However, the groups all subsequently concluded that the perceived benefits of rotation are outweighed by the associated costs. The AICPA (1992) also explains that this suggestion has been studied by a number of influential bodies in the US, including the Public Oversight Board, Commission on Auditors' Responsibilities and the National Commission on Fraudulent Financial Reporting, all of whom drew similar conclusions.

The following is an analysis of the numerous drawbacks which are associated with the rotation requirement as found from the literature.

2.7 Disadvantages of audit firm rotation

An examination of the major audit failures that have occurred show that they were caused by the auditor neglecting to apply the auditing rules and techniques that already exist (Tackett et al, 2004). It has been argued that by simply enacting more rules and auditing standards it seems unlikely to make any meaningful reduction in the likelihood of audit failure (Meyer at al, 2007; Manry et al, 2008; Calderon and Ofobike, 2008).

It is argued that a newly appointed auditor might fail because of a lack of a thorough understanding of the client. Usually high quality auditors can profit from their learning curve effect in the detection of a material error or breach. This idea is reflected in the fact that there appears to be more litigation cases against auditors with a relatively short relationship with their client (DeAngelo, 1981; O' Keefe et al, 1994; Vanstraelan, 2000).

GAO (2003) concluded that mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence and improve audit quality because of the additional financial costs and the loss of institutional knowledge of the public company's previous auditor of record. This is consistent with many of the authors' conclusions that were reviewed (see Jackson et al, 2008; Porter et al, 2005; Bamber et al, 2009; Carcello and Nagy, 2004).

A substantial body of academic literature identifies negative issues related to shorter audit firm – client relationships. For example, many researchers used the value of discretionary accruals as a measure; Johnston et al (2002) found that short relationships (two to three years) are associated with lower quality financial reports. This is also evident from Geiger and Raghunandan (2002) who found significantly more audit reporting failures in the earlier years of audit firm – client relationship. Also, Carcello and Nagy (2004) and Manry et al (2008) failed to find any evidence that fraudulent financial reporting is more likely given longer audit firm tenure.

Audit firm tenure has been found to affect market perceptions of earnings quality, with longer tenure appearing to be considered positively. Ghosh and Moon (2005) found that audited financial statements and reported earnings are perceived as more reliable for audit clients with longer audit firm tenure.

Although, there are many flaws associated with the rotation requirement, it is also evident that there are also many strong contrary arguments, which are analysed in the next section.

2.8 Advantages of introducing audit firm rotation

Under the current standards, accounting firms auditing publicly traded companies require peer reviews of their work. However, judging by the many recent audit failures, these peer reviews do not appear to be effective at preventing audit failures. The problem with the current peer review process is that it is conducted by people working in the same firm and they may give favourable reviews due to the fact that they may be well acquainted (Bazerman, 2002; Tackett et al, 2004; Comunale and Sexton, 2005).

According to Shockley (1982), a long auditor-client relationship can cause complacency, lack of innovation, less rigorous audit procedures and a learned confidence in the client may arise after long association. DeAngelo (1981) assumed that auditors have economic incentives not to disclose material errors or breaches in view of retaining their client. This practice results from the need of the auditor to protect his investment in client-specific expertise that is gradually built up during the years of co-operation. In a similar way, it was suggested that long auditor tenure is not desirable because it gives `*the audit firm time to develop a close relationship with the auditee*' (Whittington et al, 1995; pg. 177). Thus, the auditor's incentive to preserve independence declines over time.

The quality and competence of auditors work can decline over time as auditors become over-familiar with their audit clients and, as a consequence, begin to lose their professional scepticism and make unjustified assumptions. Arel et al (2005) explain this situation and the benefit of audit firm rotation in the following terms:

"Repeat audit engagements allow auditors to rely on judgements of previous auditors in deciding whether a management estimate is in accordance with GAAP. Mandatory audit firm rotation will periodically force new auditors to view managements representation for compliance with GAAP and may force management to adopt more-conservative accounting practices" (pg 37).

Porter et al (2008) argues that, as a consequence of the financial rewards associated with maintaining a long-term relationship with an audit client, auditors may be tempted to 'overlook' or to 'accommodate' management's viewpoint on financial reporting issues. Similarly, Bazerman et al (2002) observes that auditors have strong business reasons to remain favourable to the client and as a result approve their accounts. Firm rotation would reduce this possibility as it frees up the audit firm to challenge their client's questionable practices.

Mandatory audit firm rotation would also increase the public's perceptions of auditors' independence as it provides a distancing between audit firm and audit client personnel. For example, due to the fact that Arthur Anderson's staff were so long with the Enron Corporation, many could not distinguish between Enron personnel and those of Arthur Anderson.

Also, according to Porter et al (2008) the costs associated with mandatory rotation are significantly less than the costs associated with audit failures. Healey (2004), for example, notes that Morgan Stanley estimates the loss in market capitalisation resulting from the failures of WorldCom, Tyco, Qwest, Enron and Computer Associates alone to be about $460 billion. He compared this with his estimate of the annual cost of rotation by the Big 4 accounting firms of, assuming rotation occurs every five years, approximately $1.2 billion.

In summary, there are a range of strong arguments in favour of audit firm rotation and also many reasons to suggest audit rotation does not in fact improve audit quality and can even lead to suboptimal audit quality.

2.9 Conclusion

The study found that the introduction of mandatory rotation of audit firms is considered as a means of adding to the independence of auditors, however, many argued that the advantage of introducing it would not outweigh the costs associated with switching audit firms every few years. In spite of this, there are increasing calls for audit committees to consider voluntary firm rotation as a means of enhancing audit quality (Carcello and Nagy, 2004).

Despite the GAO study in 2003 concluding that the benefits of introducing this as a requirement would not be the most efficient way to strengthen auditor independence, they still requested that further studies be taken in this area to determine whether mandatory audit firm rotation could potentially add value for enhancing auditor independence and audit quality.

In light of the current financial crisis the global economy is facing and how the role of the auditor may be affected from this downturn, there have been some media calls for mandating audit firm rotation in an effort to '*prevent the chance of any relationship developing between client and auditor which could colour judgement and independence'* (The Irish Times, 2010).

In conclusion, a case for and against the rotation of audit firms has been presented. The literature revealed both positive and negative arguments for mandating audit firm rotation. This research determines which of these viewpoints are supported most in Ireland by seeking answers to the objectives outlined above in section 1.2. The findings are discussed in chapter four.

Chapter 3
Methodology

3.1 Introduction

This chapter outlines the methodology that was applied in conducting this research. Firstly, a definition of the research methodology is presented after which the aims of the research are specified in addition to the objectives which needed to be accomplished to achieve those aims, along with details of the research design, philosophies and approaches employed and participants involved in the research. Also included is a discussion on the processes employed for collecting and analysing the data and an outline of the rationale for using the chosen research design tools. The chapter concludes with a discussion of the study’s qualities and limitations, a chapter summary and a preview of the remaining chapters.

3.2 Definition of research methodology

Saunders et al (2009) describes "research methodology" as the theory of how research should be undertaken, including the theoretical and philosophical assumptions upon which research is based and the implication of these for the method or methods adopted.

Remenyi et al (1998) refers to research methodology as “the procedural framework within which the research is conducted. It describes an approach to a problem that can be put into practice in a research programme” (pg. 28).

3.3 Research Design

Hair et al (2007) states that research design “provides the basic directions or “recipe” for carrying out a project” (pg. 151). It has been described as the master plan, which specifies the main methods and procedures to be used in the collection and analysis of the required information. This is a view supported by the work of Kallet (2004) who believes that the aims of the research section “should describe what was done to answer the research question, describe how it was done, justify the experimental design, and explain how the results were analysed” (pg. 1229).

The research design section is subdivided into five main categories; firstly the research approach, then the research philosophy, followed by the research focus; fourthly the research tools and lastly the instruments to be used for the data collection process. These categories are described in more detail within the following subsections.

3.3.1 Research Approach

Research approaches involve the use of theory and, according to Saunders et al (2009), there are two main research approaches involving the utilisation of theory. The form of research can vary substantially between the deductive approach and the inductive approach. The deductive approach is when a conceptual and theoretical structure is developed and tested by theoretical observation; therefore involves the development of a theory that is subjected to a rigorous test (Hussey and Hussey, 1997). The inductive approach concentrates on the development, building and understanding of a theory from a new or unknown phenomenon. It involves the collection of data and the examination of that data to develop theories that will subsequently relate to the literature (Saunders et al, 2009), for example, establishing the arguments for and against audit firm rotation or the possible recommendations for enhancing an auditor's independence.

For the research presented in this thesis the inductive approach was considered to be the most suitable, mainly because the research strategy was developed to seek the opinions of parties concerned or associated with enhancing the independence of auditors rather than on scientific fact, an underlying assumption of the deductive approach and therefore not compatible with the objectives of this research.

3.3.2 Research Philosophy

The two most common categories to consider when identifying the most suitable research philosophy include positivism and interpretivism. These philosophies provide contrasting views regarding the development of knowledge and the acceptability of the knowledge being developed (Collis and Hussey, 2003). The adoption of one philosophy over the other is important as it underpins the research strategy and the methods chosen as part of that strategy in order to gather the required data.

3.3.2.1 Positivism research

Positivism is a structured approach to data gathering and tends to be analysed and interpreted in both a factual and statistical manner. A key distinction of positivism is that the researcher should remain independent of the survey sample chosen, a view supported by Saunders et al (2009), who characterises the positivist researcher as one who adopts an approach enabling them to collect and analyse data independently and objectively.

According to the work of Jankowicz (2000), positivism is based on the theory that there is only one truth and that there is no alternative to this truth. It implies that the researcher is ‘‘working with an observable social reality and that the end product of such research can be the derivation of laws or law-like generalizations similar to those produced by the physical and natural scientists’’ (Remenyi et al., 2003, p.32).

3.3.2.2 Interpretive Research

Interpretive research is a flexible approach to data gathering, which focuses on the meanings and patterns behind the research, rather than measuring just the facts associated with the research. Interpretive research, in contrast to positivism research, is based on the theory that there can be more than one truth on a particular subject matter (Remenyi et al, 1998).

According to Walliman (2001) interpretive research seeks to understand the subjective reality of those being studied, making sense of their motives, actions and intentions in a way that is meaningful to the research participants. This is also referred to by Saunders et al (2009, pg 107) who highlights that it involves the individuals having to enter the “social world of our research and understand their world from their point of view”. Collis and Hussey (2003) also state that this approach is concerned with generating theories to produce qualitative data using smaller samples.

3.3.2.3 Research Philosophy Adopted

An interpretive philosophy was considered to be the most appropriate for this study, given the benefits that it can provide in terms of enhancing our understanding of the probable effects of introducing mandatory audit firm rotation in Ireland. For example, a particular aim of this study was to gain an understanding of opinions which can not necessarily be derived based on the measurement of facts, which is the core ethos of the positivism philosophy. The advantage of using the interpretive philosophy is that it provides the potential of gaining a greater understanding of the data collected, the pros and cons of the collection methods as well as enabling the researcher to be more aware of changes that occurred during the research process.

3.3.3 Research Focus

According to Kumar (1999), research can be carried out using three main classifications including exploratory, descriptive and explanatory research. The classification chosen depends on the nature of the information, which was collected in order to answer the research question. Multiple methods may be used depending on the areas of research on which the researcher intends to focus their attention.

3.3.3.1 Exploratory Research

The main objectives of exploratory research are to gain background information, to define terms, to clarify problems, to establish research priorities and finally to develop questions to be answered Hair et al, 2007). Robson (2002, pg. 59) commented on how exploratory research is a valuable means of finding out “what is happening: to seek new insights; to ask questions and to assess phenomena in a new light”. This is appropriate to use where little information is known about a topic.

3.3.3.2 Descriptive Research

The purpose of descriptive research is to address the "what, when, who, where, why and how" questions of the research and therefore data collection is often carried out using interviews or questionnaires (Saunders et al, 2009). This approach was supported by Kumar (1999), who describes the research as a systematic attempt to describe a problem, situation, phenomenon, service or attitude towards an issue.

3.3.3.3 Explanatory Research

Explanatory Research, as defined by Saunders et al (2009, pg. 598), is “research that focuses on studying a situation or a problem in order to explain the relationships between variables”. This is also cited by Kumar (1999), who suggests that explanatory research attempts to clarify how and why there is a relationship between two aspects of a situation or phenomenon.

3.3.3.4 Research Focus Adopted

The research focus of this project is mainly exploratory and to some extent descriptive. The descriptive element mainly came from the literature that was reviewed when attempting to answer objectives one and two in section 1.2. However, primarily the aim of this research was to gain an insight into the opinions of the parties concerned with the auditing profession and what they deemed as important in terms of developing and enhancing the independence of auditors.

3.3.4 Research Tools

The research tools section deals with the nature of the data required, explaining the main data collection methods available and highlighting the methods, which are to be used for this particular study.

3.3.4.1 Data Required

The research procedure of any study can involve a quantitative or qualitative approach to data acquisition and analysis, although the data required will dictate the research tool adopted. "Both research methods have their own individual strengths and weaknesses. These need to be recognised so that the most suitable method can be applied to a research project" (O' Neill, 2006, pg. 84).

The information required in this study was qualitative research as this approach is based on meanings expressed through words and collection methods including tools such as interviews, focus groups, surveys, case studies etc. (Dey, 1993). This method is subjective as it involves the individual's interpretation of events rather than focusing on facts and evidence.

3.4 Population

It was decided that the most appropriate target group for this study were the parties that are most concerned with auditors' independence. The objective was to ascertain the views of the various officers involved – namely the three out of the four professional accounting bodies. It was also considered appropriate to interview two officers from regulatory bodies, who would have authorisation over the accounting profession, however, in both cases these interviewees explicitly stated that it was their personal views on the topic rather than that of their organisation.

Accounting firms that would be most affected by the introduction of audit firm rotation were also considered to be an important group who would have an opinion on this area; therefore it was decided to seek the views of these parties. Accounting firms, especially the most successful, were considered to have the most insight and opinions on the effects of audit firm rotation, therefore, the top 20 accounting firms in Ireland were also included in the study.

3.5 Data Collection Methods

Research data can be acquired through both primary and secondary sources. The most appropriate method to adopt depends on the type and purpose of the research.

3.5.1 Secondary Data

Secondary data is information that has been previously collected on a topic, and can include both quantitative and qualitative data (Saunders et al, 2009). Kumar (1999) comments on how the value of secondary data will vary depending on the availability, format and quality of the data.

Many peer reviewed literature articles with relevance to this study were identified, although, evidence of bias was discovered in certain aspects of the literature; this was overcome by including contrary facts and opinions. To the best of the author's knowledge, no previous peer reviewed studies on the requirement of audit firm rotation in Ireland are available. The intention was to address this shortcoming by collecting the relevant data through primary data sources instead, which included interviews, questionnaires and relevant newspaper articles which commented on audit firm rotation.

3.5.2 Primary Data

Primary data can be collected using several methods such as interviews, questionnaires, case study analysis, action research analysis and focus groups (Patton, 2002). Kumar (1999) argues that the method chosen will depend on factors such as the purpose of the study, the resources available, and the skills of the researcher. Each method has its own specific benefits and limitations and thus selection of the most appropriate methods to answer the research question had to be undertaken, while also considering the constraints of the other available methods.

3.5.2.1 Case Study Analysis

Robson (2002, pg. 370) defines case study analysis as "a strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using sources of evidence". The aim is to provide an analysis of the context and processes, which illuminate the theoretical issues being studied (Cassell and Symon, 2004). As this study was mainly done through exploratory research and as a significant amount of primary research was required from multiple stakeholders, it was decided that a case study analysis on a single organisation would not provide adequate and accurate information.

3.5.2.2 Action Research

Action research is "research in which the researchers work explicitly with and for people rather than undertake research on them" (Meyer, 2000; pg. 179). It is often a collaborative activity among colleagues searching for solutions to everyday problems. This was deemed as an inappropriate method of data collection for this project as it was intended to ascertain the views of certain stakeholders on how to enhance an auditor's independence and this would have been impossible using this method.

3.5.2.3 Focus Groups

The focus group method of data collection is a technique of group interviews that generates data through the opinions expressed by participants individually and collectively (Kitzinger, 1995). Whilst focus groups are a very effective method of collecting data due to offering the potential to record immediate and spontaneous responses from the group, there can be bias, as opinions of one member of the group may influence the opinions of others. Therefore, this method was disregarded and it was decided that the most appropriate methods to collect the data required were interviews and questionnaires.

3.5.2.4 Interviews

An interview can be described as a market research tool used to gather valid and reliable data during a purposeful discussion between two or more people (Kahn and Cannell, 1957). According to Walliman (2001), interviews are particularly suitable for gathering qualitative data, but may also be used in circumstances where quantitative data is required. There are three main types of interviews, which can take place –

structured, unstructured and semi-structured interviews.

3.5.2.4.1 Structured Interviews

Structured interviews are questionnaires based on a predetermined and standardised or identical set of questions. The interviewer reads out each question and then records the response on a standardised schedule, usually with pre-coded answers (Saunders et al, 2009).

3.5.2.4.2 Unstructured Interviews

Unstructured interviews go further in the extent to which emphasis is placed on the interviewee's thoughts. The researcher's role is to be as unintrusive as possible; to start the ball rolling by introducing a theme or topic and then letting the interviewee develop his or her ideas and pursue his or her train of thought (Denscombe, 2005).

3.5.2.4.3 Semi-Structured

In semi-structured interviews, the researcher will have a list of themes and questions to be covered. This format of interview allows questions to be asked in no particular order. Additional questions may also be asked, as the interviewer sees fit, to examine associated issues that arise in the course of the interview (Smith, 2003).

3.5.2.5 Questionnaires

Questionnaires are a useful way of collecting primary data that is descriptive in nature. These can be used to measure the behaviour, attitude, awareness and characteristics from a large sample. Using a questionnaire allows the surveyor to standardise the wording and sequence of the questions, which will then allow the data to be recorded quickly and accurately (Saunders et al, 2009).

3.5.3 Research Tools Adopted and Justification

After reviewing the various research tools available, the researcher decided that a combination of interviews and questionnaires were most appropriate to address the research aims and objectives outlined in section 1.2. As outlined in the previous subsections, there are many different types of data collection tools available however, based on the aims and objectives of the research and the requirements that these entail only a subset of methods were deemed appropriate as the others did not meet the required in-depth analysis necessary for the chosen sample.

Interviews were identified as an appropriate method of data collection for this study, given the research objectives and nature of the information required, i.e. qualitative opinions. It was decided to perform a series of semi-structured interviews on the auditing regulators and three out of the four Irish accounting professional bodies.

Interviews can provide very valuable information and were thus considered very suitable for this study however conducting interviews can be a time consuming data collection exercise, requiring lot of effort if a large sample size is required therefore; it was decided that the use of questionnaires would also be useful to gain an additional insight on the opinions and perspectives of audit firm rotation. A questionnaire (see appendix 1) was sent to the audit ethics partners of the Top 20 accounting firms in Ireland, enabling the collection of a representative analysis of the parties that audit firm rotation would impact on if mandated in Ireland.

Four of the interviews were conducted over the telephone to accommodate the busy schedule of the interviewees. The remaining two interviews were conducted via email. The questions for both the interviews and questionnaires were developed based on the review of the literature presented in chapter two and also adjusted from the study conducted on behalf of the SOX Act in the U.S. on mandatory audit firm rotation.

Prior to conducting the interviews and administering the questionnaires, the questions were firstly appraised by the researcher’s supervisor and by the course director who has a small accounting practice that carries out audits. An advantage of this pilot test is that any issues or problems with formatting, comprehensibility or structure can be identified before delivering the questionnaire and subsequently questions can be deleted or revised.

The questions were also refined further after the first interview was conducted (based on valuable feedback provided by the interviewee) which resulted in some of the questions being changed or omitted and new questions added. It is very important to ensure that the interview questions are of a quality that maintains the interviewees’ interest and that the format is such that the interviewees do not get confused about the purpose of the research. The interview questions (presented in appendix 2) have been developed to ensure the quality that is needed meets these objectives.

3.6 Data Analysis

The data was stored on the online survey tool surveymonkey.com and analysed using Microsoft Excel®, with the responses being transformed into meaningful categories (Parasuraman et al, 2004). As most of the questions are closed in the questionnaire, they were already categorised. In total, there were seven survey questionnaires returned, which in total represents a response rate of thirty-five percent. This was deemed an acceptable amount due to the fact that it has been said that response rates of between fifteen and twenty-three percent may be adequate to make scientifically sound judgements (Berger et al, 2005; Dilliman, 2000; cited by Kramer et al, 2008). The responses to the open questions employed in the semi-structured interviews were categorised around the research objectives described in section 1.2.

3.7 Ethical Considerations

Good ethical practice requires that all research is conducted on the basis of respect for and adherence to regulatory guidelines and internationally accepted ethical norms focusing on the welfare of the study participants (LYIT ethics form, 2010). The research undertaken was approved and governed by the LYIT School Research Ethics Committee.

3.8 Conclusion

This research was carried out in an attempt to ascertain whether mandatory audit firm rotation should be introduced in Ireland. The research took the form of interpretive research using the inductive approach. It was descriptive to an extent but mainly exploratory and the data collected was qualitative in nature. The research process consisted of the circulation of 20 questionnaires to the 'Top 20' accounting firms along with interviews with the professional bodies and the audit regulators. This chapter has outlined the reasons for the approach taken, based on research into best practise. The findings from the research are discussed in chapter four.

Chapter 4
Research Findings and Analysis

4.1 Introduction

This chapter outlines how the objectives outlined in section 1.2 were accomplished based on the analyses of the results produced by the research methods adopted for this study. The analysis involved an examination of the survey responses and a review of the transcripts from the interviews carried out in order to ascertain the views on the research topic. The implications of these results are discussed in chapter five along with the conclusions drawn from them.

4.2 Analysis of survey results and interview findings

Semi-structured interviews were conducted with representatives from three of the professional accounting bodies and two regulatory bodies as outlined in section 3.6. The purpose of these interviews was to ascertain opinions on the concept of introducing audit firm rotation in Ireland as a method of enhancing an auditor's independence. Out of six interview requests, five responded. The interviewees were assured that they would remain anonymous; therefore, they will be referred to as interviewee one, two, three, four and five. A list of the questions that were used as a guideline is included in appendix 2.

The questionnaires were sent to the top 20 accounting firms of which a thirty-five percent response rate was achieved. The main findings are discussed below and a copy of the questionnaire can be found in appendix 1.

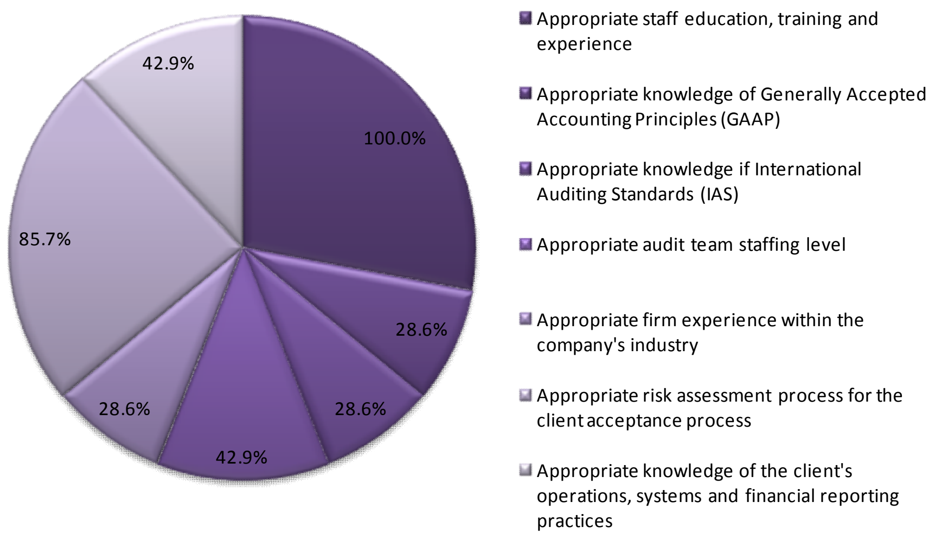
4.2.1 Study demographics

From the responses of the questionnaire, the majority of respondents were members of the Institute of Chartered Accountants (85.7%) with the remainder being associates of the Association of Chartered Certified Accountants. These ratios were expected due to the fact that 50 per cent of the firms from the questionnaire population are members of Chartered Accountants (ICAI webpage; 2010).

Each subsection below is based around a question that was posed in the survey and in which the results and a discussion of results are provided.

4.2.2 Important factors affecting an auditor’s ability to detect financial reporting issues

Figure 4.1



Source: Analysis of Survey Data

As shown in Figure 4.1, 100% of respondents regarded appropriate staff education, training and experience as being of very great importance with regard to the auditors ability to detect financial reporting issues, however, only 28.6% rated *Appropriate Knowledge of International Auditing Standards*, *Generally Accepted Accounting Principles and appropriate firm experience* within the client’s industry as being of high importance.

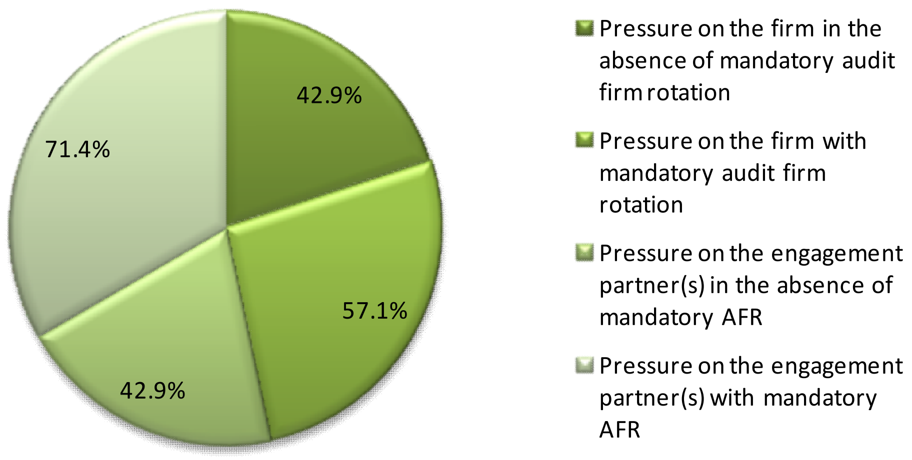
This differs from what was found with the interview responses, as many of them commented on the importance of experience and knowledge of a company’s industry and how this is a requirement under ISA 315, *Understanding the Entity and It’s Environment and Assessing the Risks of Material Misstatement*, which states that “obtaining an understanding of the entity and its environment is an essential aspect of performing an audit” (Standards and Guidance, 2009; pg. 400).

In many of the publications reviewed, the aspect of knowing your clients’ industry and background was also referred to as a drawback of audit rotation as this is a “hidden cost” in the first years of an audit. One interviewee stated that the main reason that auditors would find mandatory rotation "irritating to the auditing profession is because it probably requires about three times the cost and the time in the first year of an audit to achieve the knowledge required; and then the contract would be lost to another tendering firm a few years later" therefore potentially not being very cost effective to the auditing firm and/or company.

Furthermore, all respondents to the survey said that, during the first year of an auditors term, there tends to be less client-specific knowledge than in the later years of tenure, however, two of the interviewees claimed that, if an auditor is complying with the standards there should be no lack of knowledge in any area of the clients specific operations whether it is years one or ten.

4.2.3 Affects of continuous pressure on accounting firms to retain clients

Figure 4.2



Source: Analysis of Survey Data

As shown in the above figure, the majority of respondents claimed that there was little pressure on the engagement partner(s) to retain clients by a means of not dealing with any financial reporting issues appropriately. This coincides with the response of interviewee one who stated that "for any accountant not to deal with any financial reporting issue appropriately carries severe consequences in terms of regulatory action and reputational risk".

However, one interviewee claimed that “if a firm had a client paying fees of approximately ten thousand euro and the managers of the company wanted the auditor to delete a few sentences from their audit report, they may not want to go against them in case they would lose them so you might just do what they say in order to retain them".

Similarly, another interviewee said that "there is major pressure on accounting firms to retain their clients, claiming that “in the current market of over-supply and under-demand – there are far too many accountants....therefore, every client you have is precious and you don’t want to lose any of them so to retain the fee you will maximise you effort so as not to issue an adverse audit opinion”.

4.2.4 Rotation as a means of enhancing independence

The research has shown that there can be a higher risk of being able to uncover any issues in the earlier years of an auditor’s tenure, as the new firm may not have fully developed and applied an in-depth understanding of the firm’s financial reporting practices. Both arguments for and against this way of thinking were expressed from the interviewees.

One interviewee conveyed that, in most cases, “auditors are probably more likely to find ‘the bad stuff’ at the beginning of their tenure as they are supposed to be looking at everything”. In contrast to this, another interviewee stated that “there is always a possibility of missing something in the first year as you may not know enough about the entity, but of course, it is common knowledge that it is virtually impossible for an auditor to check everything, so they should be able to find out the same things in year one as you would in year ten”.

From analysis of the questionnaire, 57.1% of respondents claimed that there is a significant likelihood that a new auditor will have initially less specific knowledge of the clients operation than the previous auditor, with the same number claiming that there is only a slight possibility that a new audit firm would not detect material misstatements in the financial statements in the first year of tenure.

4.2.5 Issues with familiarity

As stated in the literature review, the quality and competence of an auditors work tends to decline over time as auditors become over-familiar with their audit clients and, as a consequence, begin to lose their professional scepticism and make unjustified assumptions (Arel et al, 2005). Conversely, from the survey responses, 57.1% generally disagreed that the risk of an audit failure is likely to increase as the audit tenure period increases due to the "comfort level" that accumulates with the audit firm's long-term relationship with client-management.

An interviewee stated that "even though the long established auditor can become too comfortable and the familiarity threat can arise with the long established auditor, you must see the upside in this. For example, if the small accountant firm in Letterkenny has been auditing the same pub for the past ten years, they will be the firm to notice if something is different or something doesn't change when it is supposed to change – these will be the people that will know the business inside out!"

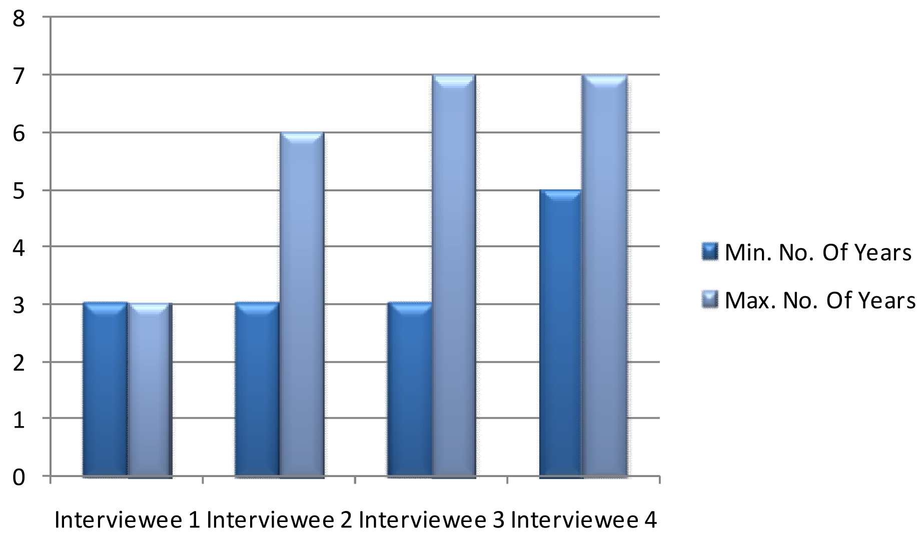
Currently, Ethical Standard 3, as described in section 2.4 is the guideline that has been prescribed as the "way to overcome" the familiarity threat and this was agreed with by interviewee four who stated "the safeguards to the familiarity threat should be implemented in full and therefore this issue will not arise". This was also agreed with, to a certain level, by interviewee three who had the opinion that the risk of familiarity can be "mitigated to some extent by partner rotation within a firm......[However] a complete fresh perspective of an audit periodically, by a new audit firm, may lend a hand to uncovering risks that may have not been spotted by the previous auditors as they may tend to focus on the 'known' risks".

Interviewee five believes that the feared comfort level "nearly always arises" after a long term relationship with a client's management. "You can see a lot of things going wrong when a comfort level exists. Every audit should be gone into with a professional scepticism – but as we all know, this is not always the case. You just cannot help but have the human intervention......You can become too trusting and complacent".

4.2.6 Views on implementing audit firm rotation

4.2.6.1 Suggested limit on an auditor's tenure

Figure 4.3



Source: Analysis of Survey Data

In Figure 4.3 it can be seen that there were mixed views on the aspect of limiting the audit firms audit tenure period. An interviewee claimed that the tenure should "be no more than three years" and when asked whether he felt if this may be too short of a time, he claimed "that any longer than three years and the comfort level kicks in, this is when you begin to get to know the client a bit better and next thing you know you'll have something like an Arthur Andersen case to deal with".

This corresponds with what was found in the literature as "due to its [Arthur Andersen's] long association with the company [Enron], Andersen's auditors failed to uncover the wrongdoing that went on at Enron as soon as it occurred" (Tackett et al, 2004; Toffler, 2005). Enron went down because of their many "off-shore accounts" which were unidentified by Andersen at that time. It was also noted by numerous authors that due to the fact that Arthur Andersen's staff were so long with the Enron Corporation, many people could not distinguish between Enron personnel and those of Arthur Andersen (Matinis et al, 2009; Porter et al, 2008; Healey, 2004).

Another interviewee was of the opinion that, if firm rotation was mandated in Ireland, "it would probably make more sense to keep it aligned with the existing standard for engagement partners who must rotate every five to seven years". A similar argument was also made by another interviewee who stated that "every seven years would probably make most sense as per ethical standard 3 for engagement partners." This coincides with what was found from the survey analysis, where 57.1% of respondents stated that between five and seven years should be the limit on every auditing entity. This was also found in the same survey that was carried out in the U.S. (GAO, 2003). However, another interviewee stated, "this is a question that can only be answered after in depth consultation with the profession, regulators and audit clients" suggesting seven is not the "magic number" that everyone would agree on.

The general feeling amongst all interviewees was that there would need to be a "cooling off period" before the audit firm should be allowed to return to the client after rotating off. One interviewee stated that "twelve months would be a sufficient time-out for any auditor to be away from a client". The other interviewees along with the majority of the respondents suggested that there should be at least two or three years before they should come back to the same client so that they "have adequate time to de-familiarise themselves before they go back to the same client again".

4.2.6.2 How mandatory firm rotation should be introduced

If mandatory audit firm rotation were required, a number of implementing factors affecting the structure of the requirement would need to be decided by policy makers, however, some opinions from the interviewees and survey respondents are included below.

Many comments were received regarding how the implementation should occur if it was required in Ireland, most of which corresponded with the findings of the same survey that was carried out in the U.S. (GAO, 2003). For example, when asked the question regarding whether the requirement should be introduced over a number of years, a staggered introduction or brought in immediately, the general response was to implement it "straight away...there is no point in dragging standards out". However, interviewee four suggested, "there should be a blanket time so as to avoid a significant number of companies changing auditors simultaneously".

Two of the interviewees believed that firm rotation, if it was introduced, should not be applied uniformly to all firms regardless of nature and size. One respondent mentioned that "this requirement would probably be most suited to public interest entities" with another implying that it may be suited to "auditors with smaller clients , paying less fees, as they might not miss their clients as much as the larger firms".

4.2.6.3 Advantages of audit firm rotation

4.2.6.3.1 Independence

Corresponding with the literature provided, many interviewees agreed that mandating audit firm rotation would enhance independence; nevertheless, the question "at what cost?" arose after that. One interviewee stated that "it would probably be great for the independence issue but I don't think anyone has ever failed solely because of their independence".

Another interviewee claimed that audit firm rotation would "ensure that sufficient space is created between an auditor and their client. It will guarantee a fresh perspective on audit issues after the changeover". Interviewee three stated that "the whole concept of rotating the firms around would have to naturally improve independence and the standards that are associated with it".

4.2.6.3.2 Increased competition

Many interviewees discussed how the competition would more than likely increase for the smaller firms, as "there would be tenders put out every few years and everyone would have as much of a chance as the next to get the clients". In contrast to this, one interviewee claimed that "as the number of larger firms is limited and the smaller firms would not always have the capacity to take on the larger audits, this may leave a void in the market".

This fact was also referred to other interviewees who both discussed the fact that only two of the accounting firms in Ireland can audit the bigger banks. This is because of resource issues and also the fact that they may need to have branches in other countries and this would not be possible from the mid-tier or remaining two of the big four accounting firms. "Audit firm rotation would probably only work within a limited number of firms, for example, it would probably only be the big four and BDO Simpson Xavier that would have the resources to audit the listed companies so they would have to rotate amongst each other every few years".

4.2.6.3.3 Fresh look that a new auditor provides

Many of the interviewees commented on the advantages associated with the fresh look that a new auditor provides. One interviewee suggested that one reason for requiring a fresh look is "relationships become more relaxed, auditors get too comfortable and they tend to trust more and place more reliance on management". It was also said "that there should be a fresh pair of eyes at the head of every audit – for a job to be done right!"

Interviewee one commented on the fact that "a fresh perspective would be invaluable, however, this would be an issue for the company, its board and shareholders, as to whether the additional costs incurred make it worthwhile". However, another interviewee stated that "all firms must be prepared to incur this additional cost in year one if the audit is to be done right" and that "it is in the standards that you must understand your clients entity and its environment, so this should be done regardless".

4.2.6.3.4 Successor auditor reviewing the work of their predecessor

One distinct advantage of introducing audit firm rotation is the fact that when a new auditor takes over the original auditor's client, they will be reviewing the financial statement judgements made by their predecessor. This, in turn, should reduce the likelihood that the original auditor may be tempted to overlook any accounting irregularities that may exist, and thus focus the auditors' attention on not being too complacent.

Interviewee five commented on this fact by stating that "when you know someone else may be checking your working papers next year, you will more than likely up your game! Pride alone will make you want to do better. The reality is that no one would want anyone to pick fault with the work they have done so they would probably do the work without any imperfections".

Similarly, interviewee one expressed an opinion by stating that "an auditor will conduct a more thorough and cynical audit, and will be more inclined to put right any problems encountered, if they knew that another auditor would be scrutinising their work in the near future".

4.2.6.3.5 Overcoming the familiarity threat

As found in the literature, if an audit firms tenure was reduced to a specific number of years, this would give the audit firm less time to become over comfortable and too complacent with the management of the client's firm. As Bazerman et al (2002; pg. 99) observe, "auditors have strong business reasons to remain in their clients' good graces and are thus highly motivated to approve their clients' accounts". Audit firm rotation would overcome this, as audit firm would not risk future loss of a client if the queried questionable accounting practices.

Interviewee two claims that a comfort level "nearly always arises" between management and the audit team after a long-term relationship. He also commented on how "you can see a lot of things going wrong when a comfort level exists. Every audit should be gone into with professional scepticism; however, this is not always the case. You cannot help but have that human intervention when you are working alongside the same people for a long period of time". The interviewee agreed that audit firm rotation would overcome this threat.

A problem that was identified based on a review of the literature (Porter et al, 2005) suggested that when there is a long standing relationship between the audit firm and client, as well as the auditor becoming familiar with the clients business, the client can begin to realise how the audit firm conducts their checks, for example, the client will know what the auditor looks at year on year and this can leave room for manipulation.

Another interviewee claimed that "along with knowing what controls the auditor will be looking at, they will also know what materiality level is and the staff of the client are likely to take advantage of this". He used an example of how he had been working with an auditor whose client's balance sheet was around €70 billion and they rounded their figures down to the nearest million. When he queried how this may affect the final balance sheet, the auditor said that nearly every year the client's books are out by around €4 million and this would be overlooked, stating that "on the overall scale of things this was not a material amount”. The interviewee expressed concern surrounding this matter, claiming that “it may not have been material in relation to the overall scheme of things, however, staff may use this as an opportunity of manipulation or stealing, knowing that this would be overlooked by that auditor as €4 million would be a small amount when compared to what they might be looking for”.

4.2.6.4 Disadvantages of audit firm rotation

4.2.6.4.1 Loss of client-specific knowledge

There is a substantive amount of literature regarding “the amount of time it takes an auditor to gain a thorough knowledge of a business, its policies, operations, accounting system, internal controls, key personnel, and so on – an essential requirement for an effective audit in today’s environment” (Porter et al, 2003; pg. 84). An interviewee claimed that “it is inevitable that an audit firm may need a couple of years to fully come to terms with a new clients business, especially if it is complex and/or diverse. Audit firm rotation may lead to a less effective audit process”.

As stated in the review of the literature, it has been argued that a newly appointed auditor might fail because of a lack of a thorough understanding of the client. This was observed by interviewee four, stating that “at the beginning of an audit, it takes so much time to gather all the information needed to ensure that you can truly verify that the accounts give a true and fair view, sometimes one might tend to rely on management representatives for information or be tempted to cut corners and obviously this is not good audit practice even though, every now and then, it might be the only way to get the audit completed”.

This was also suggested by interviewee two, who claimed that “when you do all this work to get to know your client in the first place, the last thing you want to do is to lose all the knowledge that you accumulated over the years by rotating off the client every few years”.

4.2.6.4.2 Cost associated with rotating audit firms

Each of the interviewees referred to the cost of rotating auditors every few years. This coincides with the literature, where it was repeated in numerous studies of how the cost associated with rotating audit firms would exceed the benefits that would be derived from it. Interviewee five stressed the fact that "in many cases the auditor is usually prepared to make a loss in years one and two of their tenure with a client due to all the additional work that is needed in the first few years. They do not mind making this loss as it usually would be compensated for in the later years of their tenure. With audit firm rotation, this cost would have to be redeemed as soon as possible therefore increasing the cost at the beginning of the audit".

Interviewee four commented on how it can be costly for the client as well as the audit firm saying how "it takes the client a long time to get familiar with the auditor and showing the auditor their business and operations and so on, which can be time consuming and expensive for the client to be giving up time to do this". Interviewee two referred to "how irritating it could be for clients, who have answered all the questions that their original auditor had asked them, just to answer the same ones again with the successor auditor".

4.2.6.4.3 Lack of resources

Two of the interviewees referred to how only two of the accounting firms in Ireland would be able to compete for the audits in the big banks. Both of them stated that it is mainly "down to a resources issue" and how "it would be pointless to be rotating between two audit firms every few years". It was also commented on how only the Big 4 and one other firm would have the resources to conduct the audit of any of the Irish PLCs". Due to these reasons, it was said that "maybe when the rotation period is due, there may be a lack of companies to tender for the clients and prices may go up or the client may have to choose a firm with a lack of expertise or resources which could harm the company".

4.2.6.4.4 Loss of clients

The general consensus between the interviewees was that the smaller firms would be the most affected by audit firm rotation. Interviewee one talked about how "the smaller firms may have one larger client that they have been working with for years and then to have to give up this client through a mandatory rotation scheme may be detrimental to their company's existence". Interviewee four stated that "as clients become familiar with their auditor they tend to be more open about giving information to the auditor, however, when a new auditor comes in, it may be a while before the client feels comfortable about giving away the required data".

4.2.6.5 Alternatives methods for enhancing independence

4.2.6.5.1 Reducing the 10% fee threshold

Currently, ethical standard four does not allow the fees of any one client, from both audit and non-audit services, to exceed 10%`of the annual fee income of the audit firm. Interviewee one believes that the biggest threat to an auditor's independence is the fees that they receive. This interviewee commented on how he "couldn't stress enough the fact that reducing the 10% threshold for fees would probably be the best way to enhance an auditor's independence". He referred to how he believes that "10% from only one client seems to be far too much and the standard setters could probably reduce this to half of that and even that might not be enough".

4.2.6.5.2 Regulatory monitoring by a government body

Another suggestion was to introduce a "direct regulatory monitoring system by a government body who would review each auditors work year after year to ensure they are fulfilling their duties to a certain standard. A government approved body would make investors happier knowing that the auditor themselves do not choose who reviews their work". This was also referred to by interviewee two who said that "even if they had a better monitoring and enforcement system for the existing standards there may not be as many audit failures occurring".

4.2.6.5.3 Appointment of auditors by the state

A proposal of appointing auditors by the state was also suggested as a means of enhancing independence. Interviewee four referred to how "an auditor may be under pressure from their client when the client holds full responsibility on whether the auditor should be reappointed or not". If the client had no say in the matter, the auditor may not feel under obligation to agree with the client in conflicting matters.

4.2.6.5.4 Independent oversight body

Having an independent oversight body was suggested by two of the interviewees and was also found in the review of the literature. Interviewee five claimed that "if you had someone else continuously checking your work you would ensure that everything you did was to the best quality". She also mentioned how "in nearly every profession there is a snobbery factor and people take pride in the work they do, therefore auditors may go that extra mile if they knew there would be a hot review involved". Similarly, interviewee two stated that "if there were surprise visits every so often by an independent party to check the papers of an auditor, there would most likely be no deficiencies in the work they have done".

4.2.6.5.5 Rotation of audit team

Another proposal of rotating the audit team rather than only the engagement partner might make the auditors work more independent. Interviewee one claimed that "it doesn't make a big difference in rotating the engagement partner every few years from a client. It would make much more sense to rotate the whole team from clients every few years, as these are the ones that ask all the questions and tick all the boxes so they would probably get more acquainted with the client's staff".

4.3 Conclusion

This chapter analysed and discussed the findings of the semi-structured interviews and the survey questionnaire that was carried out by the researcher. It was found that there were mixed reviews on audit firm rotation, however, all interviewees agreed that audit firm rotation would enhance an auditor's independence but they also suggested alternative methods that may not be as taxing to the audit profession. In summary, the findings have answered the research question and met the research objectives and the overall conclusions and recommendation of the study is outlined in chapter five.

Chapter 5
Conclusions and Recommendations

5.1 Introduction

This chapter summarises the findings of the research, provides recommendations and includes suggestions for further areas of research based on the findings of the secondary and primary research conducted for the project and detailed in the previous chapters. Conclusions help determine and examine whether the aims and objectives of this research have been met.

A review of literature revealed a lack of information on the impact of the possibility of introducing audit firm rotation in Ireland. A review of the literature was undertaken to develop the research strategy and construct appropriate questions, which led to a well defined set of research aims and objectives outlined in section 1.2.

5.2 Overview of the main findings

5.2.1 Link between auditor rotation and auditor independence

A review of the literature established that audit partner rotation was introduced initially as a method for enhancing an auditor's independence by overcoming the familiarity threat. As found in many previous studies, the association between auditor tenure and audit judgments has long remained an issue of concern for regulators and others (Rama, 2004). The Metcalf Committee report (U. S. Senate, 1976; cited by GAO, 2003) notes that "long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client's management that truly independent action by the accounting firm becomes difficult."

All interviewees agreed with the fact that as "the length of auditor tenure increases, there is increased likelihood of auditors going along with the wishes of the client in accounting matters". This is aligned with the findings presented in the GAO study in the US. However, even though this statement may be true, there is specific guidance on the fact that an auditor must go into every audit with professional scepticism and an objective mind (as per the APB's guidelines).

It is therefore concluded that, even though there is guidance on how an audit should be conducted with integrity and objectivity, this is not always the case. As many of the interviewees clearly stated “it is quite impossible to be working with a client year after year and not become over familiar and begin to make assumptions regarding the internal controls, management reps and so on”. Due to the fact that independence may be impaired with a long established auditor, it was felt that ethical standard three (see section 2.4) could be improved on, by perhaps, changing partner rotation to firm rotation.

5.2.2 Legislation from other countries regarding auditor rotation

From the analysis, it was found that Italy and Brazil has mandatory audit firm rotation for public companies and Singapore introduced the requirement for banks that are incorporated in Singapore. Spain reported that they previously had mandatory audit firm rotation required; however, from reviews of the literature from Spain (see Ruiz-Barbadillo et al, 2009) the time given to actually enabled audit firm rotation to have a measureable impact was not sufficient. They got rid of the rule four years prior to the first proposed audit changeover.

Generally, reasons reported for requiring mandatory audit firm rotation related to auditor independence, audit quality, or increased competition for audit services. The main reason described for abandoning audit firm rotation related to its lack of cost effectiveness. This is also how the GAO concluded in their report regarding rotation of audit firms in the U.S., stating that they found that the cost of introducing such a requirement would not exceed the benefits that are associated with it.

5.2.3 Overall views on mandatory audit firm rotation

From the respondents to the questionnaire and interviewees, the general consensus was that currently there are a sufficient number of standards that impose the necessity for auditors to be independent of the client; however, one interviewee stated that “rotating audit partners is good, but firms would probably be better”. The authors reviewed broadly concluded that audit firm rotation would enhance independence, however, it is more than likely that it would be extremely difficult to implement, due to the costs of rotating an auditor every few years. A respondent from the survey stated that they “do not believe the fresh look benefits outweigh the loss of company-specific knowledge and knowledge of the quality and integrity of the key financial and control personnel".

5.2.4 Impact of introducing audit firm rotation

From the primary research, the main conclusion drawn is that audit firm rotation should be introduced uniformly for all audits regardless of size and nature. However, there was some disagreement with this as some respondents deemed that introduction over a staggered basis should be applied. It was felt that this would give companies a chance to prepare themselves with the changeover.

It is thus concluded that, as with all other standards and guidance for auditors, there should be a time and date set for audit firm rotation and a clear set of guidelines on how this can be achieved efficiently and within the time frame allowable. Auditors should have sufficient time to come to terms with the proposed requirement, as this is usually how the standards are introduced.

5.2.5 Arguments for and against audit firm rotation

The general arguments for and against mandatory audit firm rotation are concerned with auditor independence, audit quality and increased audit cost which conforms with the review of the literature outlined in sections 2.7 and 2.8.

Those who supported mandatory audit firm rotation contended that pressures faced by auditors to retain their clients, especially in today's environment, coupled with the auditors comfort level with management developed over time, can adversely affect the auditors actions to appropriately deal with financial reporting issues that materially affect the company's financial statements.

Those who were against audit firm rotation argued that the new auditors lack of knowledge of the company's operations and industry-specific knowledge and the time needed to acquire that knowledge, increases the risk of an auditor not detecting financial reporting issues that could materially affect the company's financial statements in the initial years of the new auditors tenure.

In addition, those who oppose mandatory audit firm rotation believe that it will increase costs incurred by both the accounting firms and their clients. It was believed that the increased risk of an audit failure and the added costs of audit firm rotation outweighs the value of a periodic “fresh look” by a new auditor. In contrast, those who support audit firm rotation believe the value of the “fresh look” to protect the stakeholders who rely on the financial statements outweighs the added costs associated with mandatory audit firm rotation.

Many inconsistencies were found among the literature reviewed; many authors included advantages that other authors considered as shortcomings. This was also the observed from the analysis of the responses from the interviewees. For example, many stated that a fresh pair of eyes is good in any situation, whereas, others believed that a fresh pair of eyes are at a distinct disadvantage as they would be lacking in client-specific knowledge and are unable to avail of the learning curve.

Another example of these inconsistencies is the fact that many authors believed that the cost associated with audit firm rotation would not exceed the benefits of the requirement, while one author stated that Morgan Stanley estimates the loss in market capitalisation resulting from the failures of WorldCom, Tyco, Qwest, Enron and Computer Associates alone to be about $460 billion. He compared this with his estimate of the annual cost of rotation by the Big 4 accounting firms of, assuming rotation occurs every five years, approximately $1.2 billion.

In summary, there are a range of strong arguments in favour of audit firm rotation and also many reasons to suggest audit rotation does not in fact improve audit quality. There are a range of conflicting views which make it difficult to specifically recommend a particular strategy to ensure auditors independence however a range of recommendations are outlined below.

5.2.6 Alternatives for enhancing an auditor’s independence

There were many suggestions for enhancing an auditor’s independence as outlined in section 4.2.6.5. The researcher feels that reducing the 10% fee threshold from audit and non-audit services would be an excellent way to improve the perceptions of an auditor’s independence as, at the end of the day, the auditor may rely on the fees of a particular client and may do anything in order to retain that client but there is clear evidence to suggest this may lead to complete audit failure. If the fee threshold was reduced to, for example, 5%, the auditor may not be so inclined to become attached to any particular client.

There is also the possible introduction of independent third party reviews, which would be a good way to improve the quality of an auditors work along with the fact that they may be forced to act more sceptical towards the client in an attempt to uncover any issues before the third party can detect anything. In agreement with interviewee five, the researcher believes that there is always “a snobbery factor and people take pride in the work they do; therefore auditors may go that extra mile if they knew there would be a hot review involved”.

5.3 Overall conclusion

This research aimed to ascertain whether mandatory audit firm rotation should be introduced in Ireland and to determine whether this requirement could potentially add value to an auditor’s independence. The research process consisted of reviewing the vast range of literature available, the circulation of 20 questionnaires to the ‘Top 20’ accounting firms along with interviews with professional bodies and the audit regulators.

The research topic was deemed to be of significant importance given that studies in other jurisdictions found that the introduction of mandatory rotation of audit firms is considered an appropriate means of adding to the independence of auditors, however, many argued that the advantage of introducing it would not outweigh the costs associated with switching audit firms every few years. It was found that there are increasing calls for audit committees to consider voluntary firm rotation as a means of enhancing audit quality, emphasising the need for more research in the area, hence this study. Research of the literature was undertaken to reveal both the positive and negative arguments for mandating audit firm rotation. This research has determined which of these viewpoints is supported most in Ireland.

The findings of the research concluded that, in Ireland, even though audit firm rotation would enhance an auditor’s independence, this requirement would be time consuming and costly for both the auditor and client. The time consumption would be a result of the audit firm starting from scratch with each new audit client to acquire the client-specific knowledge required to conduct the audit and this would create a large initial cost in the first years of an auditor's tenure.

Although the research evidence would suggest that this requirement should not be introduced due to the aforementioned consequences, this could still be considered a viable option to increase the regulation on the auditing profession to prevent serious issues in the future. Just because a solution to a problem is complex or is costly to implement, it does not mean it is not a feasible solution.

For example, the most recent corporate scandal where "Lehman attempted to conceal its losses with the help of Ernst & Young" (Kim, 2010), may have been avoided if Ernst & Young had not been with the Lehman Brothers since 1994. Ernst and Young were also brought to light in 2004 because of their independence by American Express. One report commented that "after a string of issues with independence that threatened their credibility and ability to accept new audit work, American Express unceremoniously dumped them and hired PricewaterhouseCoopers" (taxguru, webpage; 2010).

Even with the current standards and guidance that are available for auditors, there are obviously many shortcomings associated with them; otherwise, the auditing scandals, such as those outlined in section 2.2, would not have occurred. Therefore, even though audit firm rotation may not be the most appropriate answer to independence issues, as is evidenced by the results of this study, it is believed that some derivative of audit firm rotation, which is not as taxing on the auditors or their clients, would enhance an auditors independence. A number of strategies of how this may be achieved are proposed below.

5.4 Recommendations to improve this study

The researcher recommends that this research should be repeated and expanded to include the entire population of accounting firms in Ireland, rather than just the top 20. Also, the researcher would recommend interviews with the professional indemnifiers of auditors, as these are who will be sought after, if legal action is taken against the auditors for malpractice, misconduct or substandard auditing.

5.5 Recommendations for further research

Many suggestions were put forward regarding the enhancement of an auditor's independence as outlined in section 4.2.6.5. The researcher believes that further research could be conducted surrounding the areas of making a reduction in the 10% threshold for fees relating to audit and non-audit services. Also, an investigation into whether hot file reviews by an independent third party to improve the quality of the auditors work, could be conducted.

Another subject that would merit further research would be the suggestion that government bodies appoint the auditors for each company. It is believed that this would strengthen independence given the fact that a client will have no say in whether or not to retain their clients; therefore, the auditor will feel under no obligation or have no incentive to issue a qualified report in order to retain their client.

In addition to this, further research could be conducted on ascertaining whether auditors religiously apply the existing standards. Some of the authors of the literature and the interviewees referred to how there are enough standards already in place to ensure an auditor's independence is unimpaired, however, time and time again there are major corporate scandals that raise the question, 'How independent is the auditor from their client?'. Perhaps the existing standards are sufficient but maybe there should be continuous monitoring to ensure that all auditors are in full compliance.

Overall this study has addressed the research question and provided a clear overview of the opinions of the author. It is hoped that the findings of this research has added a valuable insight to the stakeholders outlined in section 1.4 into how audit firm rotation would impact on an auditors' independence.

Appendices

Appendix 1 - Survey Questions

This is a representation of the questions asked but the questionnaire was presented through an on-line survey package available at www.surveymonkey.com to improve presentation and user friendliness.

Should Audit Firm Rotation be introduced in Ireland?

1. Audit Firm Rotation

1. Which body is your accounting firm currently a member of?

- Institute of Chartered Accountants (ICAI)
- Association of Chartered Certified Accountants (ACCA)
- Certified Public Accountants (CPA)
- Other (please specify)

2. In total, how many employees are working in your firm?

- 0-50
- 51-100
- 101-150
- 151-200
- 201-250
- 250+

3. Based on company audit clients your firm served during last year, what is your estimate of the average period for which the firm has served your company clients as auditor?

- 0 years
- 1-5 years
- 6-10 years
- 11-15 years
- 16-20 years
- 21-25 years
- More than 25 years

In total, how many companies did your accounting firm serve as auditor last year?

4. In your opinion, how important are each of the following factors in affecting the auditors ability to detect financial reporting issues that may indicate material misstatement in a company's financial statements?
Please tick one section in each row.

	Very Great Importance	Great Importance	Moderate Importance	Some Importance	Little or No Importance
Appropriate staff education, training and experience					
Appropriate knowledge of Generally Accepted Accounting Principles (GAAP)					
Appropriate knowledge if International Auditing Standards (IAS)					
Appropriate audit team staffing level					
Appropriate firm experience within the company's industry					
Appropriate risk assessment process for the client acceptance process					
Appropriate knowledge of the client's operations, systems and financial reporting practices					

5. If there were mandatory audit firm rotation, how would you rank the following?

	Significant likelihood	Strong likelihood	Moderate likelihood	Little likelihood	No likelihood
The likelihood that a new auditor would detect financial reporting issues that may materially affect a company's financial statements.	○	○	○	○	○
The likelihood that a new auditor is likely to have initially less specific knowledge of the clients operations than the previous auditor of record.	○	○	○	○	○
The likelihood that a new audit firm (with less client specific knowledge) would not detect material misstatements in the financial statements during the first year of the auditors tenure?	○	○	○	○	○

6. How would you rate the pressure on your accounting firm and the engagement partner(s) to retain clients as a factor in whether or not they appropriately deal with financial reporting issues that may materially affect a company's financial statements?

	Significant factor	Strong factor	Moderate factor	Small factor	No factor
Pressure on the firm in the absence of mandatory audit firm rotation					
Pressure on the firm with mandatory audit firm rotation					
Pressure on the engagement partner(s) in the absence of mandatory audit firm rotation					
Pressure on the engagement partner(s) with mandatory audit firm rotation					

7. In your opinion, how would establishing a limit on an accounting firm's tenure as a company's auditor affect the perception of the auditor's independence held by the following:

	Significantly increase	Somewhat increase	Neither increase nor decrease	Somewhat decrease	Significantly decrease
Perceptions of auditor independence held by capital markets					
Perceptions of auditor independence held by institutional investors					
Perceptions of auditor independence held by individual investors					

8. Do you agree with the following statements?

	Strongly agree	Generally agree	Neither agree nor disagree	Generally disagree	Strongly disagree
The risk of an audit failure is higher in the early years of an audit tenure period as the new accounting firm is more likely to have not fully developed and applied an in depth understanding of					

	Strongly agree	Generally agree	Neither agree nor disagree	Generally disagree	Strongly disagree
the new client's operations and financial reporting practices.					
The risk of an audit failure is higher in the early years of an audit tenure period because the new accounting firm is more likely to place heavy reliance on information provided by client management.	○	○	○	○	○
The risk of an audit failure is likely to increase as the audit tenure period increases due to the "comfort level" (familiarity with client management and the desire to retain the client over many years) provided by the public accounting firm's long-term relationship with client management.	○	○	○	○	○
In the first year of an audit, an accounting firms costs significantly exceed the firms subsequent annual audit costs.	○	○	○	○	○
The risk of an audit failure is likely to increase as the audit tenure period increases due to client management becoming too familiar with the auditor's approach and procedures.	○	○	○	○	○

9. If mandatory rotation of accounting firms were required....

	Three to four years	Five to seven years	Eight to ten years	Greater than 10 years
What should be the limit on the	○	○	○	○

	Three to four years	Five to seven years	Eight to ten years	Greater than 10 years
number of years an accounting firm can audit any one entity?				
After what period of time should the incumbent firm be permitted to once again compete for audit services?	○	○	○	○

10. Do you have any other suggestions on how an auditor's independence can be improved?

Appendix 2
Draft Interview Questions

This list of questions were not rigidly followed, meaning that the interviewer could adapt his technique to suit each individual interview depending on the interviewee's circumstances and their initial responses.

1. If mandatory rotation of accounting firms were required, what should be the limit on the incumbent firm's audit tenure period?

2. If mandatory rotation of accounting firms were required, after what period of time should the incumbent firm be permitted to once again compete for audit services?

3. If mandatory rotation of accounting firms were required, should it be implemented over a period of years (staggered) on a reasonable basis to avoid a significant number of companies changing auditors simultaneously?

4. If mandatory rotation of accounting firms were required, do you believe such a requirement should be applied uniformly for audits of all companies regardless of the nature or size of the company?

5. Overall, what do you think the benefits are of introducing mandatory audit firm rotation in Ireland? Drawbacks?

6. If mandatory audit firm rotation was introduced, do you think that the "fresh look" that new audit firms are said to provide would benefit the client more rather than the associated costs?

7. If mandatory audit firm rotation came in, how do you think the new accounting firm's initial level of knowledge of the client's specific operations and financial reporting practices compare to the previous auditor of record's level of knowledge of the client's operations and financial reporting processes?

8. Do you think that there is pressure on an accounting firm to retain clients as a factor in whether or not they appropriately deal with financial reporting issues that may materially affect a company's financial statements, especially in today's economic climate?

9. In your opinion, how would establishing a limit on an accounting firm's tenure as a company's auditor affect the perception of the auditor's independence by capital markets, institutional investors and individual investors?

10. It has been said that there is a higher risk of being able to uncover any issues in the earlier years of an auditors tenure as the new firm may not have fully developed and applied an in depth understanding and financial reporting practices. Do you agree with this?
    Do you think this would lead to under auditing in certain areas due to the fact that the auditor may place more reliance on management representations?

11. In contrast, do you think the client that an audit firm may become complacent as the audit tenure period increases due to the "comfort level" that may exist after a long-term relationship with their client's management?
    And could there be a fear that management may become too familiar with the auditor's approach and procedures giving them scope to mislead the auditor?

12. At the moment, it is between 5 and 10 top accounting firms that do the audits for the PLC's! If mandatory audit firm rotation was introduced would this increase this number? Would more of the mid-tier firms get some of the bigger audits?
    (Expand Big 4 into Top 20)

13. Do you have any other suggestions on how an auditor's independence can be improved?

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