The Controversy of Mandatory Audit Firm Rotation: Has Quantitative Accounting Research Misinformed us about the Relationship between Audit Tenure and Audit Quality?

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The Controversy of Mandatory Audit Firm Rotation

Has Quantitative Accounting Research Misinformed us about the Relationship between Audit Tenure and Audit Quality?

An honors thesis presented to the Department of Accounting, University at Albany, State University Of New York in partial fulfillment of the requirements for graduation with Honors in Accounting and graduation from The Honors College

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Research Advisor: Professor Caplan
May 2015
Abstract

There is controversy between regulators and audit firms over the policy of mandatory audit firm rotation. Many regulators favor mandatory audit firm rotation whereas audit firms are against such a policy. Regulators argue that mandatory firm rotation would improve audit quality while audit firms claim that audit quality increases with audit tenure.

Typically, regulators and audit firms refer to academic research that supports their position. One early paper on mandatory audit firm rotation that is commonly cited by academics and opponents of mandatory rotation is Carcello and Nagy (2004), which finds that longer audit tenure does not reduce audit quality. This Honors Thesis reevaluates the methodology and conclusions drawn by Carcello and Nagy. I find that the sample of audit failures used in that study is not well suited for drawing conclusions about the effect of audit tenure on audit quality. Also, I find that the paper’s lack of transparency regarding the sample firms included in the statistical analysis makes the paper’s research design difficult to evaluate or replicate.
Acknowledgments

I would like to thank Professor Caplan, my research advisor, for his guidance in helping me write my honors thesis. I am very grateful for the hard work that Professor Caplan did to assist with the paper. Professor Caplan’s dedication to his students should be recognized.

In addition, I would like to thank my parents for giving me the support I needed to pursue my career endeavors and goals, as well as their encouraging words to help me finish my paper.
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Introduction

Financial statements communicate financial information to parties outside an entity. Due to possible conflicts of interest between managers and shareholders, public companies are required to have their financial statements audited by a public accounting firm. The audit enhances the quality of the financial information reported by management and increases investor confidence in the reliability of the information. The purpose of an audit is to provide reasonable assurance that the financial statements of a company are not materially misstated due to fraud or error. The quality of an audit depends on the likelihood that the auditor will detect a material misstatement or omission and the auditor’s behavior subsequent to the detection of a material misstatement. Audit quality is improved when material misstatements are detected and corrected.

Audit tenure is the length of the client-auditor relationship (i.e., the number of years the auditor has audited the client). Audit tenure can affect audit quality. However, whether long tenure improves audit quality or compromises audit quality is unclear. For example, in 1987, the National Commission on Fraudulent Financial Reporting recommended that the peer review program of the AICPA’s SEC Practice Section pay more attention to the first-year audits of public clients due to the fact that the review of fraud-related cases by the Commission illustrated that a large majority of the fraud cases involved companies that had recently changed auditors (National Commission on Fraudulent Financial Reporting 1987, 54).

On the other hand, the International Federation of Accountants published a report in July 2003, called Rebuilding Public Confidence in Financial Reporting, which states that excessive familiarity would result in an auditor being more compliant and less hesitant to challenge management when appropriate regarding the accounting practices, procedures, and internal
controls (IFAC 2003). Also, Louwers (1998) finds that long tenure decreases the likelihood that
the auditor will issue a going-concern opinion for a distressed client.

Proponents and opponents of mandatory audit firm rotation sometimes refer to academic
research to support their positions. Carcello and Nagy (2004) has been an influential paper that is
often cited as evidence that longer audit tenure does not reduce audit quality. The paper conducts
a statistical analysis on a sample of companies that violated the antifraud provision of the
Securities Act of 1934 (Rule 10b-5), comparing the tenure of their auditors with a control sample
of non-fraud companies.

This Honors Thesis examines whether Carcello and Nagy (2004) drew appropriate
conclusions about the effect of audit firm tenure on audit quality. I attempt to replicate the
Carcello and Nagy sample. I find that a large majority of the short-tenure auditors were auditing
firms that had recently gone through initial public offerings. It is well known that companies
going public pose a greater risk of financial statement fraud than established public companies,
and also that the nature of private company audits differs significantly from public company
audits. I also find that the number of 10b-5 violations among medium and long-tenure auditors is
so small that statistical tests may not be powerful enough to detect whether long tenure
negatively affects auditor quality. Taken together, this evidence about the Carcello and Nagy
sample suggests that the conclusions drawn by the authors may not be warranted. Furthermore, I
identify a lack of transparency in the Carcello and Nagy paper that makes replication of their
study and evaluation of their research difficult. These potential weaknesses with their study are
particularly important insofar as their paper is cited by opponents of mandatory audit firm
rotation in the context of the public policy debate over rotation.
Background on Mandatory Auditor Rotation Regulation

The global aftermath of the Enron Scandal and the enactment of the Sarbanes-Oxley Act of 2002 led to stricter regulation for audits of public companies and their corporate governance. The new rules include an enhanced role for corporate audit committees, and independent inspections of accounting firms that audit public companies. The post-SOX environment has heightened awareness of factors that influence audit quality.

Concerns about audit quality have been raised for many years, and the accounting profession’s self-regulatory environment in the 1980s and 1990s created high levels of audit risk and auditor engagement risk. However, the Enron scandal in 2001 commenced a global shift to more regulation that was led by the Sarbanes-Oxley Act of 2002, which imposed major changes for U.S. auditing standards, financial reporting standards, and corporate governance. Some changes included oversight of public company audits and their auditors by a new independent agency, the Public Company Accounting Oversight Board, restriction of consulting services to public company audit clients, and a requirement for greater engagement with the auditors by the company’s audit committee. In other countries, similar changes were enacted into legislation. In the United Kingdom, for instance, the Financial Reporting Council’s Audit Inspection Unit was established.

The Sarbanes-Oxley Act of 2002 required the U.S. Comptroller General to study and evaluate the effects of mandatory audit firm rotation, and the General Accounting Office (GAO) released its study in 2003. The GAO study stated “mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence” (GAO 2003). However, the GAO also stated that if the Sarbanes-Oxley Act does not lead to better audit quality, then mandatory audit
firm rotation may be necessary.

**The Potential for Archival Research to Influence Public Policy: Carcello Citings**

The potential for archival research to influence public policy is reflected in several comment letters submitted to the PCAOB in connection with its Concept Release on Auditor Independence and Audit Firm Rotation (2011) as well as recent academic accounting publications.

The Auditing Standards Board, which is a part of the AICPA, submitted a comment letter to the PCAOB opposing audit firm rotation. In its comment letter, the Auditing Standards Board cites the Carcello and Nagy study in the Audit Quality section, which asserts that audit failures are more likely to occur on newly acquired clients in the earlier years of the auditor-client relationship.

Michael Meyer, Associate Professor in the Department of Accountancy at the University of Notre Dame, submitted a comment letter that questioned whether “truncating the auditor-client relationship will lead to better judgments on the part of the auditor” (Meyer 2012). The only support that Meyer provides for his position was a published research paper he had coauthored, which he included with his comment letter. The research paper cites Carcello and Nagy as providing evidence of a higher incidence of financial statement fraud in the earlier years of the auditor-client relationship (Meyer, Rigsby and Boone 2007, 54).

More recently, the Carcello and Nagy study was cited in a survey article of academic research on auditor independence. The article identifies Carcello and Nagy as one of several archival studies that do not link longer audit tenure with reduced financial reporting quality (Church et al. 2015).
Summary of Carcello and Nagy

The motivation for Carcello and Nagy (2004) was to use rigorous research methodology instead of anecdotal evidence to prove or disprove whether mandatory audit firm rotation would improve audit quality. Carcello and Nagy (2004) comments that public policy, which would impact over 17,000 SEC registrants in regards to the cost of quality of auditing services, should not be shaped by solely opinions, but contextual facts.

Carcello and Nagy (2004) tests two hypotheses. Hypothesis 1 states: “Fraudulent financial reporting is more likely given short auditor tenure (three years of less) as compared with medium auditor tenure (four to eight years).” This hypothesis is based on the primary argument against mandatory audit firm rotation, which is that audit quality is worse in the early years of the auditor-client relationship. This may occur because the auditor is unfamiliar with the client’s business, operations, systems, controls, and accounting policies. Hypothesis II states “Fraudulent financial reporting is more likely given long auditor tenure (nine years or more) as compared with medium auditor tenure (four to eight years).” This hypothesis is based on the primary argument for mandatory audit firm rotation that long auditor tenure leads to a reduction in audit quality because auditors become complacent, fail to maintain professional skepticism, or develop relationships with their clients such that the auditors are willing to accommodate their clients’ aggressive financial reporting practices.

The study tests the relation between audit firm tenure and fraudulent financial reporting using the following logistic regression model:

\[
\text{FRAUD} = \beta_0 + \beta_1 \text{SHORT} + \beta_2 \text{LONG} + \beta_3 \text{SIZE} + \beta_4 \text{ZFC} + \beta_5 \text{YRSPUB} + \beta_6 \text{MKTBK} + \beta_7 \text{CPA} + \beta_8 \text{BDOU}T + \beta_9 \text{BDSIZE} + \beta_10 \text{BOSS} + \varepsilon
\]
Audit firm tenure was measured as the number of consecutive years that the audit firm has audited the client (found by counting backwards from the year the fraud began). A SHORT audit tenure was three years or less and a LONG audit tenure was nine years or more.\(^1\) The resources utilized to compute audit firm tenure were the Standard & Poor’s Research Insight (version 7.6), proxy statements, EDGAR and the Q-Data SEC files microfiche collection, and annual editions of Who Audits America.

SIZE is the natural log (in millions) of total assets. ZFC is Zmijewski’s 1984 financial condition score, which is a bankruptcy indicator (Zmijewski 1984). YRSPUB is the number of years the company has been listed on a national stock exchange. MKTBK is the ratio of the company’s market value to its book value. CPA is an indicator variable indicating whether the auditor is a Big 6 firm. BDOuT is the percentage of the company’s board of directors who are independent directors. BDSIZE is the number of directors on the board. BOSS is an indicator variable for whether the CEO or President is also the Chairman of the board of directors.

The regression was run using two alternative populations of control firms. The first population was a matched sample, where each fraud firm was matched to a non-fraud firm for year, industry, and size. The second population of control firms (called the “full-population”) was all other public companies available on the Research Insight database between 1988 and 2000.

To create the sample, all the Accounting and Auditing Enforcement Releases (AAERs) issued by the SEC between 1990 and 2001 were read, where the first year of the fraudulent

\(^1\) Although not included in the regression, medium tenure obviously includes firms with an audit tenure from four to eight years.
reporting was after 1987. There were 267 companies subject to AAER’s that violated Rule 10b-5 during the 12 year period of the study. Companies were eliminated from the sample if the financial statements or audit report were unavailable, the proxy statement was unavailable, the companies were banks or insurance firms, the company’s first reporting year is a fraud year (no clean year), the researchers were unable to find a matched firm, the researchers were unable to determine the first fraud year, or the researchers were unable to determine auditor tenure. The final sample size of fraud firms for the matched-pairs analysis was 104 and the final sample of fraud firms for the full population analysis was 147. See Table 1, which is reprinted from Carcello and Nagy (2004).

Table 1

<table>
<thead>
<tr>
<th>Sample Description</th>
<th>Matched-Pair Analysis</th>
<th>Full-Population Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Sample</td>
<td>267</td>
<td>267</td>
</tr>
<tr>
<td>Financial Statements or audit report unavailable</td>
<td>(59)</td>
<td>(59)</td>
</tr>
<tr>
<td>Proxy statement information unavailable</td>
<td>(28)</td>
<td>NA</td>
</tr>
<tr>
<td>AAERs affecting banks or insurance firms</td>
<td>(27)</td>
<td>(27)</td>
</tr>
<tr>
<td>First reporting year is a fraud year (no clean year)</td>
<td>(25)</td>
<td>(25)</td>
</tr>
<tr>
<td>Unable to match</td>
<td>(15)</td>
<td>NA</td>
</tr>
<tr>
<td>Unable to determine first fraud year per AAER</td>
<td>(6)</td>
<td>(6)</td>
</tr>
<tr>
<td>Unable to determine auditor tenure</td>
<td>(3)</td>
<td>(3)</td>
</tr>
<tr>
<td>Final Sample</td>
<td>104</td>
<td>147</td>
</tr>
</tbody>
</table>

Both logistic regressions find a statistically significant relationship between short auditor tenure and fraud (significant at the 1 percent level). Also, both regressions fail to find a
significant relationship between long auditor tenure and fraud. Control variables that were found
to be negatively associated with fraud and significant at the 1 percent level in both regressions
were the number of years the company had been public and whether the auditor was a Big 6
firm. Also, in the matched pairs analysis, the following control variables were significant at the 1
percent level: the market-to-book ratio, the percentage of outside directors, and whether the
CEO/President is also the Board Chairman. The authors conclude that the results of their study
support the argument that long audit tenure does not have an adverse effect on audit quality.

**Replication of Carcello and Nagy**

As discussed in the introduction, this study is driven by the desire to determine whether
the conclusions drawn by Carcello and Nagy (2004) are supported by the study’s data and
methodology. Two concerns about the Carcello and Nagy sample are (1) there may be two few
medium and long audit tenure frauds to provide a sufficiently powerful test on the variable
LONG, and (2) the variable YRSPUB may not adequately control for the relationship between
audit quality and companies that have recently gone public. It is difficult to alleviate these
concerns with the information provided about the fraud companies in Carcello and Nagy (2004).
From the paper’s table of descriptive statistics (Table 2), one can infer that the number of long-
tenure fraud firms in the matched-sample analysis was approximately 21 (out of a total fraud
sample of 104), and in the full-population analysis was approximately 25 (out of a total fraud
sample of 147). There were approximately 36 medium-tenure fraud firms in the matched-sample
analysis and approximately 45 medium-tenure fraud firms in the full-population analysis. Also,
we know that the mean for the years-public control variable was approximately 8 years for the
matched-pairs analysis fraud sample (with a standard deviation of 5.5) and the mean was
approximately 6 years for the full-population analysis fraud sample (with a standard deviation of 4). This data would seem to indicate that a large number of fraud firms had recently gone public. The goal of this Honors Thesis was to conduct a small sample study of the fraud firms with more detailed information about audit tenure, auditor transition, and the years since the company went public. For this purpose, the first step was to replicate the Carcello and Nagy sample.²

Sample Selection

Using the SEC website, I identified all companies other than financial institutions and insurance companies, from 1994 to 2001, that violated Rule 10b-5. 1994 was chosen as the start of my sample period because this was the first year that the SEC made filings available to the public on its website. 2001 was selected as the last year to coincide with the end of the time period examined in Carcello and Nagy (2004). This selection process identified 88 companies. To follow Carcello and Nagy, firms were eliminated based on the following factors:

(a) The financial statements or the audit report was unavailable;

(b) The first reporting year is a fraud year;

(c) I was unable to determine the first year of fraud;

(d) I was unable to determine audit tenure;

(e) I was unable to determine if the company went public within nine years of the fraud.

² I contacted Professor Carcello to ask if I could receive a list of the firms used in Carcello and Nagy (2004). Professor Carcello told me that he no longer had the data.
The final number of companies in my sample was 22. See Table 2 below.

### Table 2

<table>
<thead>
<tr>
<th>Sample</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial Sample</td>
<td>88</td>
</tr>
<tr>
<td>Financial Statements or audit report unavailable</td>
<td>0</td>
</tr>
<tr>
<td>Proxy statement information unavailable</td>
<td>0</td>
</tr>
<tr>
<td>First reporting year is a fraud year (no clean year)</td>
<td>(32)</td>
</tr>
<tr>
<td>Unable to determine first fraud year per AAER</td>
<td>(5)</td>
</tr>
<tr>
<td>Unable to determine if IPO was in the last 9 years</td>
<td>(17)</td>
</tr>
<tr>
<td>Unable to determine auditor tenure</td>
<td>(12)</td>
</tr>
<tr>
<td>Final Sample</td>
<td>22</td>
</tr>
</tbody>
</table>

My sample of 22 firms should be a subset of the Carcello and Nagy sample of 147 firms. I was only able to identify approximately 15% of the original sample. The reasons for this include the fact that my sample excludes the first four years of the original sample, and I did not have access to the Research Insight database. To obtain the information required for my sample, in addition to the SEC website, I used *Who Audits America* and web-based news and information sources.

Table 3 identifies each company in my sample, the first year of the fraud, and the number of years from the time the audit firm first audited the company (as a public company) until the first year of the fraud, up to a maximize of nine years (the cutoff in Carcello and Nagy for identifying the auditor as a long-tenure auditor). Hence, the first year in my calculation of auditor tenure is either the year the company went public, or the year the company hired the audit firm that was still conducting the audit in the first year of fraud, or the ninth year prior to the first year of fraud. A key feature explicit in my analysis, and implicit in Carcello and Nagy, is that audits of public companies are generally considered riskier than audits of private companies, and
consequently, auditors may conduct more thorough, in-depth audits and/or make more conservative audit reporting decisions on public company audits.

Table 3

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>1st Year of Fraud</th>
<th># Yrs. Counting Backwards</th>
<th>First year of auditor tenure determined by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>DCI Telecommunications</td>
<td>1995</td>
<td>1</td>
<td>IPO</td>
</tr>
<tr>
<td>Laser Technology</td>
<td>1993</td>
<td>1</td>
<td>IPO</td>
</tr>
<tr>
<td>Amazon Natural Treasures</td>
<td>1997</td>
<td>1</td>
<td>IPO</td>
</tr>
<tr>
<td>Secure Sign</td>
<td>1999</td>
<td>1</td>
<td>IPO</td>
</tr>
<tr>
<td>Millennium Software Solutions</td>
<td>1997</td>
<td>1</td>
<td>IPO</td>
</tr>
<tr>
<td>Engineering Animation</td>
<td>1999</td>
<td>2</td>
<td>IPO</td>
</tr>
<tr>
<td>Vari-L</td>
<td>1996</td>
<td>2</td>
<td>IPO</td>
</tr>
<tr>
<td>MAX Internet Communication</td>
<td>1999</td>
<td>2</td>
<td>IPO</td>
</tr>
<tr>
<td>Sensoromatic Electronics</td>
<td>1993</td>
<td>2</td>
<td>IPO</td>
</tr>
<tr>
<td>Trinity Gas</td>
<td>1996</td>
<td>2</td>
<td>IPO</td>
</tr>
<tr>
<td>Phoenix Metals USA</td>
<td>1989</td>
<td>2</td>
<td>IPO</td>
</tr>
<tr>
<td>Presstek</td>
<td>1997</td>
<td>3</td>
<td>auditor switch</td>
</tr>
<tr>
<td>Atratech</td>
<td>1997</td>
<td>6</td>
<td>auditor switch</td>
</tr>
<tr>
<td>Informix Corp.</td>
<td>1995</td>
<td>6</td>
<td>auditor switch</td>
</tr>
<tr>
<td>System Software Associates Inc.</td>
<td>1994</td>
<td>8</td>
<td>IPO date</td>
</tr>
<tr>
<td>Ferrofluidics Corp.</td>
<td>1991</td>
<td>9</td>
<td>N/A</td>
</tr>
<tr>
<td>Fabric-Centers of America</td>
<td>1992</td>
<td>9</td>
<td>N/A</td>
</tr>
<tr>
<td>Guildford Mills</td>
<td>1997</td>
<td>9</td>
<td>N/A</td>
</tr>
<tr>
<td>New Jersey Resources</td>
<td>1992</td>
<td>9</td>
<td>N/A</td>
</tr>
<tr>
<td>Venator Group</td>
<td>1993</td>
<td>9</td>
<td>N/A</td>
</tr>
<tr>
<td>Kellogg &amp; Andelson</td>
<td>1993</td>
<td>9</td>
<td>N/A</td>
</tr>
<tr>
<td>Waste Management</td>
<td>1999</td>
<td>9</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Exhibit A shows audit tenure counting backwards from the first year of the fraud to either the IPO or the most recent auditor switch. Companies with audit tenures of nine or more years were public for at least nine years prior to the fraud, and used the same auditor during that time. The exhibit illustrates two important points. First, less than 15% of the sample are neither short audit tenure, nor long audit tenure firms. Second, for half of the sample, the same auditor had audited
the company—as a public company—for only one or two years. It should also be noted that while approximately one-third of our fraud sample are long audit tenure firms, which is about equal to the 37% for long tenure non-fraud firms in Carcello and Nagy’s full population analysis, Carcello and Nagy’s sample of long tenure fraud firms is only 17% of its full population analysis. Hence, unlike the descriptive statistics in Carcello and Nagy (Table 2 in that paper), the characteristics of my sample provides no evidence that long audit tenure reduces the likelihood of fraud.

**Exhibit A**

![Bar chart showing audit tenure distribution](image_url)

**Discussion, Analysis, and Conclusion**

In my sample, 55% of the fraud cases were short audit tenures, compared to 52% in the fraud sample for the full population analysis in Carcello and Nagy, although only 25% of the non-fraud firms were short audit tenures in Carcello and Nagy’s full population analysis. In that
respect, my fraud sample is consistent with their fraud sample. Importantly, however, half of the companies with fraudulent financial reporting in my sample occurred within the first two years of the company’s initial public offering, and this could be true in Carcello and Nagy’s sample as well, since the number of years the company was public had a mean of 6 for the full population analysis and the standard deviation was 4. Although Carcello and Nagy include the number of years as a public company as a control variable, if in fact nearly half of their sample consists of companies that had been public for only one or two years before the fraud, one might question whether this control variable fully accounts for the three-way interaction among fraud, auditor tenure, and years as a public company. Since audit risk associated with companies that have recently gone public may be higher than companies that have been public for many years but have recently switched auditors, it would seem that a better research design would examine only companies that had been public for a minimum number of years. This would ensure that short audit tenure firms are limited to firms that actually switched auditors while they were public companies. As it stands, Carcello and Nagy’s conclusions may not be particularly informative about audit risk associated with short auditor tenures.

The conclusions of my paper are consistent with Church et al. (2015). That article’s main point was to analyze selected academic studies in relation to auditor independence and evaluate the differential findings between experimental and archival studies. Church et al. found that experimental research sometimes supports regulators’ concerns that long tenure compromises independence, while archival research frequently fails to find such an association. Church et al. (2015) attribute the differences in results between the two methodologies to how researchers study independence breaches. It is my conclusion that the research design in Carcello and Nagy (2004) may not have been well-suited to addressing the benefits of mandatory firm rotation.
Another weakness in Carcello and Nagy’s research design is the following. If long audit tenures compromise objectivity of the auditor client relationship, then without a law in place requiring mandatory audit firm rotation, it is very difficult to measure the benefits of such a law. Without mandatory rotation, auditors have incentives to compromise auditor independence to satisfy clients, in order to retain the audit engagement and maintain the revenue stream from the client. If the auditor knows that the auditor-client relationship will end, then this incentive will be eliminated. Carcello and Nagy (2004) might pick up the benefits of the greater knowledge that long tenure provides the auditor, but their study cannot incorporate the benefits that might accrue when the auditor knows that the auditor/client relationship will terminate in the foreseeable future.

Carcello and Nagy (2004) also fail to adequately consider another point. They encourage the use of statistical methods to analyze the benefits of mandatory firm rotation: “Therefore, it is critical that public policy regarding mandatory firm rotation is shaped by research and not anecdote” (p. 56). This statement fails to appreciate the role that anecdotes play in influencing investor confidence and financial markets. Audit failures are extremely low probability events (about 1/5 of 1% as computed using the data in Carcello and Nagy) and difficult to predict using statistical models. However, most of the high-profile audit failures (or alleged failures) have occurred in companies with long audit tenures. These audit failures include Waste Management in 1999, HealthSouth in 1999, Enron in 2001, Lehman in 2008, and Olympus Corporation (which the public learned about in 2011). All of these companies used Big 4 (Big 5) audit firms. In each of these cases, forensic investigation of the frauds strongly suggest that the auditors may have compromised their independence. Even if, on average, long tenure does not reduce audit
quality, regulators and lawmakers are understandably motivated to take reasonable steps to minimize the probability of similar audit failures in the future.

Finally, it should be noted that the existence of a well-functioning independent board or independent audit committee, which is required by section 301 of the Sarbanes-Oxley Act, may indicate that the arguments for mandatory audit firm rotation are less relevant today than prior to Sarbanes-Oxley. The purpose of the independent board or audit committee is to uphold the interests of shareholders and to ensure the objectivity of the audit process. In 2003, the International Federation of Accountants wrote that the audit committee needs to directly interact with management and the auditors in certain areas that have typically been handled by people outside the audit committee. Usually, the function of the audit committee and the effectiveness of mandatory audit firm rotation have been thought of as independent matters, however the quality of financial statement audits may actually be directly influenced by the function of the audit committee. The audit committee has the responsibility to oversee the financial reporting process and the external audit. Therefore, the role of the committee should be included when debating mandatory audit firm rotation (Chi, 2010).
References


