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Auditor Independence

Auditor's Move to Client Company Can Erode Independence: Study



By Amanda Iacone

The one-year cooling-off period for auditors who go to work for their former clients isn't long enough to ensure independent audits, new research suggests.

A Simon Fraser University study found that auditors were more likely to side with a client's position if a colleague from their firm was now the client's chief financial officer even after two years had passed—twice what is required by the Sarbanes-

Oxley Act, the 2002 law passed in the wake of the Enron Corp. and Waste Management Inc. accounting scandals.

Study co-author Michael Favere-Marchesi told Bloomberg Tax that an auditor's tendency to trust the work of a former colleague who has become a client is "alarming" and puts the integrity of the audit profession at risk.

"When you work together on an audit team, you start building some strong social bonds," said Favere-Marchesi, an associate professor of accounting and auditing at the Beedie School of Business. "You don't break social bonds just because you leave the firm."

"If an auditor cannot produce, cannot render judgment objectively, it has no value. If it is biased, the audit has no value to the users of the financial statement because it's compromised," he said.

Researchers asked 140 managers from the Big Four accounting firms to take part in an online experiment to test whether the background of a client's CFO would change their decisions in a certain audit scenario.

According to the study's findings, 76 percent of managers agreed with the position suggested by the client if they knew that their client's CFO had previously worked at their audit firm.

Another group was told that the client's CFO had worked at another Big Four audit firm—nearly half of those managers agreed with the client's position.

A third group of managers was told nothing about the CFO's background—that group was least likely to agree with the client's position and were more skeptical, the study found.

Changing the Game

"Auditor independence, which is supported by strict regulatory prohibitions and robust firm policies, is a core value of public company auditing," said Cindy Fornelli, executive director of the Center for Audit Quality, an autonomous affiliate of the American Institute of CPAs.

Fornelli questioned the study's methodology and said it's impossible to measure whether auditors' judgment could be influenced by those relationships.

Cathy Allen, a consultant on auditor ethics, said there are steps firms can take to protect the integrity of the process and to counteract any relationship biases.

"You need to change the game up," Allen said.

For example, firms can revise their audit program so the former staff member doesn't know exactly how it's now conducted.

Firms can also reinforce the audit team ensuring that it has the stature and experience to match the skills and knowledge of the former colleague, said Allen, who previously worked for PricewaterhouseCoopers LLP and the AICPA.

Door Still Spins

"I think it highlights that the rule wasn't where it needs to be," Lynn Turner, a former Securities and Exchange Commission chief accountant, said of the study's findings.

Snapshot

- Auditors more likely to trust client if CFO worked for their firm
- Might fail to apply sufficient professional skepticism

"It's just not long enough," Turner said of the one-year cooling-off period.

The revolving door between audit firms and the companies they serve continues to spin despite the one-year prohibition. Extending the cooling-off period to three years would help ensure auditor independence, but so would an outright ban, Turner said.

"I do think they tend to give someone they knew and worked with the benefit of the doubt—it's just human behavior," said Turner, who now works as a senior adviser for the forensic accounting firm Hemming Morse LLC. "You don't want your auditor giving you the benefit of the doubt."

The study appeared in the March issue of Accounting Horizons, a peer-reviewed journal published quarterly by the American Accounting Association.

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