W. Robert Knechel Awarded $10,000 PwC Grant

Fisher School of Accounting Eminent Scholar Robert Knechel was recently awarded a $10,000 PwC INQuires Grant. The grant is funded by the PwC Charitable Foundation, Inc., and it is designed to provide funding for applied research.

Professor Knechel will use the grant to gather empirical evidence to explore mandatory audit firm rotation. The case for mandatory firm rotation is based on the intuitively appealing argument that over time an auditor may lose objectivity because the auditor becomes too close and familiar with the client, but in spite of this appealing logic, and the swell of regulatory initiatives, there is very little evidence available to suggest that extended audit firm tenure leads to a deterioration in audit quality.

The relationship between a client and an auditor is very complex, involving many stakeholders including management, the Board and audit committee, analysts and institutional lenders and investors. Given the legal environment and these extended relationships, it is less clear why extended tenure should reduce audit quality. In fact, it is highly likely that client personnel as well as audit personnel change over a lengthy tenure, reducing the chance that personal bonds can influence an audit team’s judgment.

The study will use the incidence of accounting restatements as a measure of audit quality. The expectation is that the previously observed deterioration in audit quality observed for short tenure audits will be less pronounced in our analysis, while the increase in audit quality for long tenure audits will be more pronounced than has previously shown by researchers.

The study also seeks to identify companies where short tenure is likely to cause deterioration in audit quality. If these expectations are upheld by the analysis, the debate on the issue of mandatory rotation might eventually be refocused from “why companies should be forced to periodically get a new auditor” to a different perspective, namely, “why companies should only change their auditor for due cause”.