Mandatory Audit Firm Rotation—Are We Going 'Round in Circles?

by Fayez Choudhury, Chief Executive Officer, IFAC | October 18, 2016 | 5

Last week, the South African Independent Regulatory Board for Auditors (IRBA) announced a timeline for new mandatory audit firm rotation requirements—a policy requiring companies to switch auditors periodically. In the same week, the Monetary Authority of Singapore (MAS) announced its intention to discontinue the very same policy. IFAC recently convened roundtables of international business leaders and regulatory agencies on smart regulation, and this contrast is a prime example of two principles the participants urged policymakers and regulators to observe: start with clear objectives, and assemble a clear evidence base.

IRBA has proposed the measures to "strengthen auditor independence and enhance investor protection," also suggesting "we will only see true empowerment when opportunities are provided equally among everyone." MAS found "research studies conducted thus far internationally did not provide conclusive evidence linking mandatory firm rotation with an improvement in audit quality," and "from MAS's observations and feedback received from stakeholders, MAS recognizes that there are also negative consequences associated with frequent rotation of external auditors."

Business leaders and regulators at IFAC's recent roundtables suggested that getting regulation right is not just about the answer, but it is all about starting with the right question. Being clear from the outset on what the regulation is trying to achieve is essential. In the case of mandatory audit firm rotation, is it trying to address audit quality and investor protection? Is it about competition and an effective market for audit services? Or is it about economic empowerment? These are all important priorities, and they all demand their own focus to find the approach most likely to yield the desired result.

Many other countries are at various phases of implementing or discontinuing mandatory audit firm rotation, with similarly diverse objectives. South Korea, Argentina, and Brazil have implemented and discontinued the policy for certain sectors; the EU is now implementing with numerous variations across Member States—some of which, such as Spain and Italy, had previously implemented and discontinued the policy; and the US House of Representatives in 2013 voted 321-62 to prohibit the Public Company Accounting Oversight Board from requiring mandatory audit firm rotation.

The list goes on. In the meantime, for global businesses trying to coordinate their audits worldwide, the complexity, costs, and risks of trying to navigate this patchwork regulatory environment detracts from their focus on obtaining the highest quality audit—possibly even going so far as necessitating multiple auditors in different jurisdictions to meet different rotation requirements.

IFAC roundtable participants in Hong Kong and London also stressed that research and a clear evidence basis are vital to identify solutions most likely to be effective. This is all the more critical in light of the costs of regulation to businesses trying to operate in a global environment, and possible unforeseen consequences. However, all too often, it seems to be the solutions looking for the problems, rather than the other way around.

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