



Highlights of [GAO-04-216](#), a report to Senate Committee on Banking, Housing, and Urban Affairs and House Committee on Financial Services

Why GAO Did This Study

Following major failures in corporate financial reporting, the Sarbanes-Oxley Act of 2002 was enacted to protect investors through requirements intended to improve the accuracy and reliability of corporate disclosures and to restore investor confidence. The act included reforms intended to strengthen auditor independence and to improve audit quality. Mandatory audit firm rotation (setting a limit on the period of years a public accounting firm may audit a particular company's financial statements) was considered as a reform to enhance auditor independence and audit quality during the congressional hearings that preceded the act, but it was not included in the act. The Congress decided that mandatory audit firm rotation needed further study and required GAO to study the potential effects of requiring rotation of the public accounting firms that audit public companies registered with the Securities and Exchange Commission.

www.gao.gov/cgi-bin/getrpt?GAO-04-216.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Jeanette M. Franzel at (202) 512-9471 or franzelj@gao.gov.

PUBLIC ACCOUNTING FIRMS

Required Study on the Potential Effects of Mandatory Audit Firm Rotation

What GAO Found

The arguments for and against mandatory audit firm rotation concern whether the independence of a public accounting firm auditing a company's financial statements is adversely affected by a firm's long-term relationship with the client and the desire to retain the client. Concerns about the potential effects of mandatory audit firm rotation include whether its intended benefits would outweigh the costs and the loss of company-specific knowledge gained by an audit firm through years of experience auditing the client. In addition, questions exist about whether the Sarbanes-Oxley Act requirements for reform will accomplish the intended benefits of mandatory audit firm rotation.

In surveys conducted as part of our study, GAO found that almost all of the largest public accounting firms and Fortune 1000 publicly traded companies believe that the costs of mandatory audit firm rotation are likely to exceed the benefits. Most believe that the current requirements for audit partner rotation, auditor independence, and other reforms, when fully implemented, will sufficiently achieve the intended benefits of mandatory audit firm rotation. Moreover, in interviews with other stakeholders, including institutional investors, stock market regulators, bankers, accountants, and consumer advocacy groups, GAO found the views of these stakeholders to be consistent with the overall views of those who responded to its surveys.

GAO believes that mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence and improve audit quality considering the additional financial costs and the loss of institutional knowledge of the public company's previous auditor of record, as well as the current reforms being implemented. The potential benefits of mandatory audit firm rotation are harder to predict and quantify, though GAO is fairly certain that there will be additional costs.

Several years' experience with implementation of the Sarbanes-Oxley Act's reforms is needed, GAO believes, before the full effect of the act's requirements can be assessed. GAO therefore believes that the most prudent course of action at this time is for the Securities and Exchange Commission and the Public Company Accounting Oversight Board to monitor and evaluate the effectiveness of existing requirements for enhancing auditor independence and audit quality.

GAO believes audit committees, with their increased responsibilities under the act, can also play an important role in ensuring auditor independence. To fulfill this role, audit committees must maintain independence and have adequate resources. Finally, for any system to function effectively, there must be incentives for parties to do the right thing, adequate transparency over what is being done, and appropriate accountability if the right things are not done.