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Audit Firm Independence and Safeguards for the Revolving Door Practice

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## ABSTRACT

Maintaining an independent relationship with an audit client is required of audit firms. This study investigates how audit firm safeguards may protect a firm's independence in appearance and audit quality when a nonpublic client audit engagement experiences a revolving door practice situation. The revolving door practice occurs when an auditor leaves an audit firm to join one of the audit firm's clients. Whether audit firm safeguards reduce or eliminate independence risk is measured through bank loan officers' perceptions. Loan officers analyze three potential safeguards consisting of: (1) the current AICPA guidance, (2) the current AICPA guidance plus a mandatory peer review, and (3) the current AICPA guidance plus a mandatory internal cooling-off period for their effectiveness.

The study results are derived from a national survey of bank loan officers. There are 46 respondents providing information to the study's between-subject design case experiment. The research results do not indicate a statistically significant difference between safeguards. Each individual safeguard attains an above moderate confidence level rating for independence and audit quality. The safeguard forms provide sufficient independence to allow an audit firm to continue to provide the audit for a nonpublic company client in revolving door practice situations.

This is the first experimental case study on the revolving door practice to specifically compare potential safeguard forms for effectiveness. The study provides information useful to accounting authorities responsible for establishing policy on independence and audit quality for audit engagements involving nonpublic companies. The study may assist audit firms in designing policies and procedures to manage their independence reputation.