AUDITORS MORE LIKELY TO RESIGN FROM INFLUENTIAL CLIENTS

When influential companies present auditors with risk, they have two options: give in to what the clients want, or resign from the engagement and lose their business.

In 2001, auditing firm Arthur Andersen neglected to flag fraudulent activity of one of its major clients, Enron, possibly due to fear of losing such a prominent client. The scandal prompted the Sarbanes-Oxley Act in 2002, which enhanced regulations preserving auditors' independence so they would not be pressured by firms into producing inaccurate reports.

Jayanthi Krishnan and Jagan Krishnan examine how, in the post Sarbanes-Oxley era, auditors treat influential clients that carry more risk but also generate more revenue. The researchers found that, on average, auditors are more likely to resign from clients who hold more influence.

Furthermore, they find that the auditors more likely to resign are those with smaller audit offices, or those lacking specific expertise. This indicates that smaller offices are less able to implement independence-risk mitigating controls in place, such as peer reviews.

Preventing scandals is a top priority for auditors. The findings suggest accounting firms–especially smaller ones–should strengthen their internal policies for dealing with independence risk. Furthermore, the findings can inform the U.S. Securities and Exchange Commission (SEC) as it considers changing auditor independence rules.

MAJOR TAKEAWAYS:

- Auditors are more likely to resign from clients who hold more influence.
- The auditors more likely to resign are those with smaller audit offices, or those lacking specific expertise.
- Smaller offices are less able to implement independence-risk mitigating controls in place, such as peer reviews.

WHO NEEDS TO KNOW:

- Accounting firms
- U.S. Securities and Exchange Commission
- Policymakers

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- Client influence and auditor independence revisited: Evidence from auditor resignations. https://doi.org/10.1016/j.jaccpubpol.2021.106846.