Lenders' Reactions to Audit Rotation for Nonpublic Companies

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In this study, I surveyed lenders to examine their perceptions of audit rotation (partner or firm) for nonpublic companies. This study provides insight into lenders' perceptions of audit rotation for nonpublic companies. Nonpublic companies should use this information to weigh the pros and cons of voluntarily implementing an audit rotation policy. This research adds to the audit rotation and nonpublic company literature. Future research should examine other variables (partner signature, corporate governance, professional skepticism, etc.) as means to enhance auditor independence and audit quality for nonpublic companies.

INTRODUCTION

This study examines lenders' perceptions of audit rotation (partner or firm) for nonpublic companies. First, I investigate the perceptions of mandating or voluntarily implementing audit rotation. Second, I investigate the perceptions of the cost-benefit and rotation cycle of audit rotation. Third, I examined the perceptions of audit rotation relating to auditor independence and financial statement reliability. Fourth, I gained lenders' perceptions of auditor independence for nonpublic companies. Lastly, I gain additional insight into participants' perceptions of audit rotation and its impact on auditor independence and financial statement reliability.

I developed a twenty item survey. The first sixteen items consist of audit rotation statements, cost-benefit and rotation cycle statements, independence and reliability statements, and general auditor independence statements for nonpublic companies which are rated on a five-point Likert scale of "Strongly Disagree" (1) to "Strongly Agree" (5). The last four items consist of supplemental questions relating to audit rotation and its impact on auditor independence and financial statement reliability.

The survey results suggest that a majority of participants disagree with a requirement of partner or firm rotations for nonpublic companies. However, there is no consensus on whether nonpublic companies should voluntary implement audit partner or audit firm rotations. The results show that most of the lenders agree that the cost may exceed the benefit of implementing partner or firm rotations. Furthermore, most participants disagree with the rotation cycle of every five years for both partner and firm rotations. There is no consensus on whether partner or firm rotation affects auditor independence or financial statement reliability. Furthermore, they do not believe that auditor independence standards should be the same for public and nonpublic companies. Nonetheless, most lenders believe that auditor independence (in fact and appearance) is important for nonpublic companies regardless of size. For the supplemental questions, the results suggest that most lenders are concerned that partner or firm rotations may negatively affect audit quality, industry knowledge, and increase audit cost.

This study provides insight into lenders' perceptions of audit rotation for nonpublic companies. Nonpublic companies should use this information to weigh the pros and cons of voluntarily implementing an audit rotation policy. This research adds to the audit rotation and nonpublic company literature. Future research should examine other variables (partner signature, corporate governance, professional skepticism, etc.) as means to enhance auditor independence and audit quality for nonpublic companies.

AUDIT ROTATION RESEARCH ON NONPUBLIC COMPANIES

There has been little research on how audit rotation (partner or firm) impact auditor independence and audit quality for nonpublic companies. The audit partner or audit firm is not required to rotate for nonpublic companies. However, if audit rotation increases auditor independence and audit quality then nonpublic companies should consider audit rotation as a means.

Knechel and Vanstraelen (2007) was one of the first studies to examine the impact of audit firm rotation on audit quality for a nonpublic using a Belgian sample and find that firm rotation did not have an affect on audit quality. However, Mayse, Booker and Hill (2015) find that when a private company has implemented firm rotation the auditor is more independent than if there is an audit partner or no audit rotation policies. In a between-subjects experimental study by Mayse (2018a), loan officers are more confident the audited financial statements are free from intentional misstatements when there is audit rotation (partner or firm) compared to no audit rotation, and are more likely to approve a loan when there is partner rotation compared to firm rotation or no rotation. In a within-subjects experimental study by Mayse (2018b), lenders are more confident that the auditor is independent when there is partner rotation compared to no rotation or firm rotation, are more confident that the audited financial statements are free from unintentional and intentional misstatements when there is partner rotation compared to no rotation. Zanzig and Flesher (2004) find that CPAs are in support of periodic rotation of personnel in charge of an audit engagement.

When examining nonprofit organizations, Mayse and Daniels (2015) find that CEOs and CFOs believe the auditor is more independent when there is partner or firm rotation compared to no rotation and financial statements are more reliable when there is partner rotation than no rotation. Furthermore, Mayse, Daniels, and Ellis (2016) find that CEOs and CFOs believe that audit independence is important for nonprofit organizations, however there was no consensus on partner or firm rotations impact on auditor independence.

Elder, Lowensohn, and Reck (2015) find that audit firm rotation may be beneficial in enhancing the quality of audits in a governmental setting. Similarly, Simmons, Costigan, Lovata (2009) find that audit firm rotation may be beneficial by providing a fresh look for the government client to address new issues.

METHODOLOGY

The objective of this exploratory study is to examine lenders' reactions of implementing audit rotation for nonpublic companies. Furthermore, this study will investigate lenders' perceptions about the impact of partner and firm rotation on auditor independence and financial statement reliability. To investigate the lenders' perception, the following research questions are addressed:

RQ1: What are lenders' general perceptions regarding auditor independence for nonpublic companies?

RQ2: What are lenders' general perceptions towards the implementation of partner or firm rotation for nonpublic companies?

RQ3: What are lenders' general perceptions of audit rotation enhancing a) auditor independence and b) financial statement accuracy and reliability for nonpublic companies?

To obtain independence perceptions in a nonpublic setting, the study focuses on lenders as the participants because they have a vested interest in issues that may affect auditor independence and financial statement reliability. The name and address of participants are received from Hugo Dunhill mailing list. Nine hundred lenders are randomly selected from the Hugo Dunhill mailing list. The entire population is mailed the survey which consists of the following: 1) Questionnaire, 2) Supplemental Questions, and 3) Demographic Questions. Responses for forty-five (45) participants were received (early participants). Approximately six weeks later, lenders who did not respond to the first mailing were sent a second request and responses for twenty-nine (29) participants are received (late participants). A total of seventy-four (74) responses were received. The nonresponse bias test shows that there is no difference ($p > .05$) between the early and late participants. After adjusting for the eighteen (18) undeliverable (returned) responses, the adjusted response rate is 6.30%. Table 1 provides a summary of the response rate for participants completing the survey instrument.

TABLE 1
RESPONSE RATE SUMMARY

	Participants	Percentage
Total Mailed	900	100.0%
Responses Received	74	8.2%
Undeliverable (Returned) Responses	18	2.0%
Total Complete and Usable Responses	56	*6.3%

*Response rate is calculated as follows: [56/ (900-18)].

To empirically analyze how lenders view partner and firm rotations for nonpublic companies, a survey instrument is developed. The exploratory questions are analyzed through the survey. Each participant received a cover letter, a survey instrument consisting of a questionnaire, supplemental questions, and demographic questions. The cover letter explains the purpose of the study and its importance to the field of accounting. Additionally, the cover letter reassures the participants that the responses are held confidentially. Finally, the cover letter gives instructions to the participants to return the information in the self-addressed pre-stamped envelope that is enclosed. Each instrument is coded with a number to identify the returned instruments.

The participants answer sixteen (16) questions relating to audit partner rotation, audit firm rotation, and auditor independence for nonpublic companies. Next, the participants answer four (4) questions about the implementation of partner or firm rotation and their impact on independence and financial statement reliability for nonpublic companies. The participants are asked to provide demographic information as well. Table 2 summarizes the demographic information for the participants. A majority of the participants were over the age of 46 (90.91%). Over ninety-eight percent (98.15%) of the participants have over seven years of loan experience. A majority of the participants (90.91%) were male. Less than thirty-three percent of the participants (32.5%) reported some type of professional certification. Over sixty-one percent (61.11%) of the participants devoted more than fifty percent of their job to approve loans. In addition, over eighty-nine percent (89.09%) of participants reported a 5 or higher on the 11-point Likert scale anchored at 0 for “Not Knowledgeable at All” to 10 for “Very Knowledgeable” relating to their level of knowledge of auditing. A majority of the participants report their current title as vice president or president of the bank (81.82%). Over ninety-two percent (92.59%) of the participants hold a bachelor degree or higher, with 31.48% holding a master degree and 1.85% holding a doctorate degree. Over seventy-four percent (74.55%) of the participants represent banks with asset of more than 100 million.

TABLE 2
DEMOGRAPHIC INFORMATION

Demographics	Total Count	Percentages
Age		
Under 26	0	0.00%
26-35	1	1.82%
36-45	4	7.27%
46-55	10	18.18%
56-65	32	58.18%
Over 65	8	14.55%
TOTAL	55	100.00%
Loan Experience		
Less than 1 year	0	0.00%
1-3 years	1	1.85%
4-6 years	0	0.00%
7-9 years	2	3.70%
10-15 years	3	5.56%
Over 15 years	48	88.89%
TOTAL	54	100.00%
Gender		
Male	50	90.91%
Female	5	9.09%
TOTAL	55	100.00%
Certification		
Yes	13	32.50%
No	27	67.50%
TOTAL	40	100.00%

RESULTS

The questionnaire portion of the survey instrument consists of sixteen questions relating to audit rotation and/or auditor independence for nonpublic companies. Each question is answered on a 5-point Likert scale as follows: 1 = Strongly Disagree, 2 = Disagree, 3 = Neutral, 4 = Agree and 5 = Strongly Agree. The questionnaire is analyzed by grouping related statements into the following categories: 1) Audit Rotation Statements, 2) Cost and Rotation Cycle Statements, 3) Independence and Reliability Statements, and 4) Independence General Statements.

Audit Rotation Statements

Table 3 provides the summary of percentages, means, and standard deviation for the audit rotation statements.

TABLE 3
AUDIT ROTATION STATEMENTS
SUMMARY OF PERCENTAGES, MEANS, AND STANDARD DEVIATIONS

	Rotation Type	Mean (S.D.)	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	Panel A: Mandatory Rotation Required						
Statement 1[+]	Mandatory partner rotation should not be required for nonpublic companies.						
	Partner	2.214 (1.246)	3.6%	19.6%	8.9%	30.4%	37.5%
Statement 3[+]	Audit firm rotation should not be required for nonpublic companies.						
	Firm	1.875 (1.096)	3.6%	4.1%	10.7%	30.4%	48.2%
	Panel B: Voluntarily Implement Rotation						
Statement 10	Nonpublic companies should voluntarily implement a policy of audit partner rotation.						
	Partner	2.786 (1.124)	16.1%	21.4%	35.7%	21.4%	5.4%
Statement 8	Nonpublic companies should voluntarily implement a policy of audit firm rotation.						
	Firm	2.518 (1.236)	25%	26.8%	28.6%	10.7%	8.9%

Note: All participants responded to each item using a five-point scale where:
1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, and 5=Strongly Agree

Panel A of Table 3 examines the audit rotation statements related to mandated audit rotation. Statement One states that audit partner rotation should not be required for nonpublic companies. The results show that 67.9 percent of the lenders agree that partner rotation should not be required for nonpublic companies. However, 23.2 percent of the lenders disagree with the statement that partner rotation should not be required. Statement Three states that audit firm rotation should not be required for nonpublic companies. The results show that 78.6 percent of the participants agree that firm rotation should not be required for nonpublic companies, while 7.7 percent disagree. The results of these statements suggest that lenders are more in favor of partner rotation being required than firm rotation. However, the results suggest that most lenders are opposed to mandatory partner or firm rotation.

Panel B of Table 3 examines the audit rotation statements related to voluntarily implementing audit rotation. Statement Ten states that nonpublic companies should voluntarily implement a policy of audit partner rotation. The results show that 26.8 percent of the lenders agree that nonpublic companies should voluntarily implement a policy of audit partner rotation, whereas 37.5 percent disagree and 35.7 percent are neutral. Statement Eight states that nonpublic companies should voluntarily implement a policy of audit firm rotation. The results show that 19.6 percent of the lenders agree that nonpublic companies should voluntarily implement a policy of audit firm rotation, while 51.8 percent disagree and 28.6 percent are neutral. The results of these statements suggest that lenders are more in favor of partner rotation being voluntarily implemented than firm rotation. In addition, the results suggest that more lenders oppose than support partner rotation. However, there is not a consensus about whether partner rotation should be voluntarily implemented. The results suggest that over half of lenders are opposed to voluntarily implementing firm rotation. However, over twenty-eight percent of the lenders are undecided about whether partner or firm rotation should be voluntarily implemented.

Cost and Rotation Cycle Statements

Table 4 provides the summary of percentages, means, and standard deviation for cost and rotation cycle related statements.

TABLE 4
COST AND ROTATION CYCLE RELATED STATEMENTS
SUMMARY OF PERCENTAGES, MEANS, AND STANDARD DEVIATIONS

	Rotation Type	Mean (S.D.)	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	Panel A: Cost vs. Benefit						
Statement 2	The cost of audit partner rotation would likely exceed the benefit for nonpublic companies.						
	Partner	3.732 (1.213)	3.6%	16.1%	19.6%	25.0%	35.7%
Statement 4	The cost of audit firm rotation would likely exceed the benefit for nonpublic companies.						
	Firm	4.036 (1.071)	1.8%	9.1%	16.4%	29.1%	43.6%
	Panel B: Rotation Cycle						
Statement 16	Nonpublic companies should rotate audit partners every 5 years.						
	Partner	2.214 (1.124)	32.1%	30.4%	26.8%	5.4%	5.4%
Statement 11	Nonpublic companies should rotate audit firms every 5 years.						
	Firm	2.179 (1.114)	35.7%	25.0%	28.6%	7.1%	3.6%

Note: All participants responded to each item using a five-point scale where:
1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, and 5=Strongly Agree

Panel A of Table 4 examines the audit rotation statements related to cost versus benefits. Statement Two states that the cost of audit partner rotation would likely exceed the benefit for nonpublic companies. The results show that 60.7 percent of the lenders agree that the cost of partner rotation would likely exceed the benefit for nonpublic companies. However, 19.7 percent disagree that the cost of partner rotation would likely exceed the benefit. Statement Four states that the cost of audit firm rotation would likely exceed the benefit for nonpublic companies. The results show that 72.7 percent of the lenders agree that the cost of firm rotation would likely exceed the benefit for nonpublic companies, while 10.9 percent disagree. The results of these statements suggest that a majority of lenders believe that the cost of firm rotation will more likely exceed the benefit than the cost of partner rotation. However, the results suggest that a majority of lenders believe partner and firm rotation would cost more than the benefit.

Panel B of Table 4 examines the audit rotation statements related to the rotation cycle. Statement Sixteen states that nonpublic companies should rotate audit partners every five years. The results show that 10.8 percent of the lenders agree that nonpublic companies should rotate audit partners every five years. Over sixty-two percent (62.5%) of lenders disagree that nonpublic companies should rotate audit partners every five years. Statement Eleven states that nonpublic companies should rotate audit firms every five years. The results show that 10.7 percent of the lenders agree that nonpublic companies should rotate audit firm every five years, while 60.7 percent disagree. The results of these statements suggest that a majority of lenders are not in favor of nonpublic companies rotating audit partners or firms every five years.

Independence and Reliability Statements

Table 5 provides the summary of percentages, means, and standard deviation for the auditor independence and financial statement accuracy and reliability related statements. Panel A of Table 5 examines the audit rotation statements related to auditor independence. Statement Twelve states that audit partner rotation provides confidence that the auditor is independent for nonpublic companies. The results show that 23.2 percent of the lenders agree that audit partner rotation provides confidence that the auditor is independent for nonpublic companies, while 44.6 percent disagree and 32.1 percent are neutral. Statement Thirteen states that audit firm rotation provides confidence that the auditor is independent for nonpublic companies. The results show that 29.1 percent of the lenders agree that audit firm rotation provides confidence that the auditor is independent for nonpublic companies, while 47.2 percent disagree and 23.6 percent are neutral. The results of these statements suggest that most lenders do not believe that partner or firm rotations would provide confidence that the auditor is independent. However, over twenty percent of lenders are undecided about whether partner or firm rotations provide confidence that the auditor is independent. Perhaps, these findings are due to lenders being more concern about auditor reliability than auditor independence as noted by Taylor et al. (2003).

TABLE 5
INDEPENCE AND RELIABILITY RELATED STATEMENTS
SUMMARY OF PERCENTAGES, MEANS, AND STANDARD DEVIATION

	Rotation Type	Mean (S.D.)	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	Panel A: Auditor Independence						
Statement 12	Partner rotation provides confidence that the auditor is independent for nonpublic companies.						
	Partner	2.600 (1.211)	19.6%	25.0%	32.1%	19.6%	3.6%
Statement 13	Firm rotation provides confidence that the auditor is independent for nonpublic companies.						
	Firm	2.655 (1.265)	23.6%	23.6%	23.6%	21.8%	7.3%
	Panel B: Financial Statement Accuracy & Reliability						
Statement 14	Partner rotation provides confidence that the nonpublic company's audited financial statements are reliable and accurate.						
	Partner	2.636 (1.176)	21.8%	20.0%	38.2%	12.7%	7.3%
Statement 15	Firm rotation provides confidence that the nonpublic company's audited financial statements are reliable and accurate.						
	Firm	2.636 (1.184)	21.4%	23.2%	33.9%	14.3%	7.1%

Note: All participants responded to each item using a five-point scale where:
1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, and 5=Strongly Agree

Panel B of Table 5 examines the audit rotation statements related to financial statement accuracy and reliability. Statement Fourteen states that audit partner rotation provides confidence that the nonpublic company's audited financial statements are reliable and accurate. The results show that 20 percent of the lenders agree that audit partner rotation provides confidence that the nonpublic company's audited financial statements are reliable and accurate, whereas 41.8 percent disagree and 38.2 percent are neutral. Statement Fifteen states that audit firm rotation provides confidence that the nonpublic company's audited financial statements are reliable and accurate. The results show that 21.4 percent of the lenders agree that audit firm rotation provides confidence that the nonpublic company's audited financial statements are reliable and accurate, while 44.6 percent disagree and 33.9 percent are neutral. The results of these statements suggest that most lenders do not believe that partner or firm rotations would provide confidence that the audited financial statements are reliable and accurate. However, over one third of lenders are undecided about whether partner or firm rotations provide confidence that the audited financial statements are reliable and accurate. Lenders did not come to a consensus about whether partner or firm rotation provides confidence that the audited financial statements are reliable and accurate.

Independence General Statements

Table 6 provides the summary of percentages, means, and standard deviation for independence general statements. Statement Five states that independence is the foundation of the independent audit for nonpublic companies. The results show that 75 percent of the lenders agree that independence is the foundation of the independent audit for nonpublic companies, while only 1.8 percent disagrees. Statement Six states that independent auditors should be independent in "fact and appearance" for nonpublic companies. The results show that 80.3 percent of the lenders agree that independent auditors should be independent in "fact and appearance" for nonpublic companies, while only 1.8 percent disagree. Statement Seven states that rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a nonpublic company that is large versus a medium or small entity.

TABLE 6
AUDITOR INDEPENDENCE GENERAL STATEMENTS
SUMMARY OF PERCENTAGES, MEANS, AND STANDARD DEVIATIONS

	Rotation Type	Mean (S.D.)	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
Statement 5	Independence is the foundation of the independent audit for nonpublic companies.						
		4.101 (.824)	0.0%	1.8%	23.2%	37.5%	37.5%
Statement 6	Independent auditors should be independent in "fact and appearance" for nonpublic companies.						
		4.232 (.809)	0.0%	1.8%	17.9%	35.7%	44.6%
Statement 7	Rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a nonpublic company that is large versus a medium or small entity.						
		2.750 (1.392)	21.4%	28.6%	21.4%	10.7%	17.9%
Statement 9	Rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a SEC registrant versus a non-SEC registrant.						
		3.304 (1.159)	5.4%	21.4%	28.6%	26.8%	17.9%

Note: All participants responded to each item using a five-point scale where:
1=Strongly Disagree, 2=Disagree, 3=Neutral, 4=Agree, and 5=Strongly Agree
$^{+}$indicates the negatively-worded item mean score was reverse coded for consistency.

The results show that 28.6 percent of lenders agree that rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a nonpublic company that is large versus a medium or small entity. However, fifty percent (50%) of lenders disagree that rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a nonpublic company that is large versus a medium or small entity. Statement Nine states that rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a SEC registrant versus a non-SEC registrant. The results show that 44.7 percent of lenders agree that rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a SEC registrant versus a non-SEC registrant, whereas 23.8 percent disagree.

The results of these statements suggest that a majority of lenders do believe that independence is the foundation of the independent audit for nonpublic companies. Furthermore, a majority of lenders believe the independent auditors should be independent in "fact and appearance" for nonpublic companies. Equally important, half of lenders believe that auditor independence rules and regulations should be the same for every size of nonpublic companies. Conversely, most lenders believe that auditor independence rules and regulations should be different for SEC and non-SEC registrants. However, more than twenty-eight percent of lenders were undecided about whether auditor independence rules and regulations should be different for SEC and non-SEC registrants.

Supplemental Questions Results

The next part of the survey instrument consists of four supplemental questions to gain further insight in the participants' perceptions of auditor independence and financial statement accuracy and reliability when there is an audit partner or firm rotation condition. Each of the questions requires a "yes" or "no" response as well as an explanation. Table 7 provides the summary of percentages, means, and standard deviation for the supplemental questions relating to audit rotation. Question One asks would implementing an audit partner rotation policy enhance auditor independence for nonpublic companies. The results show that 64.2 percent of the lenders responded "no" and 35.8 percent responded "yes". The results suggest that most lenders believe that implementing an audit partner rotation policy may not enhance auditor independence for nonpublic companies. Question Two asks would implementing an audit firm rotation policy enhance auditor independence for nonpublic companies. The results show that 62.7 percent of the lenders responded "no" and 37.3 percent responded "yes". The results suggest that most lenders believe that implementing an audit firm rotation policy may not enhance auditor independence for nonpublic companies.

TABLE 7
SUPPLEMENTAL QUESTION ANALYSIS (n=51)
SUMMARY OF PERCENTAGE, MEANS, AND STANDARD DEVIATIONS

	Rotation Type	Mean (S.D.)	Yes	No
Question 1	Would implementing an audit partner rotation policy enhance auditor independence for nonpublic companies?			
		1.647 (.483)	35.8%	64.2%
Question 2	Would implementing an audit firm rotation policy enhance auditor independence for nonpublic companies?			
		1.628 (.488)	37.3%	62.7%
Question 3	Would implementing an audit partner rotation policy enhance the reliability of financial statements for nonpublic companies?			
		1.686 (.469)	32.7%	67.3%
Question 4	Would implementing an audit firm rotation policy enhance the reliability of financial statements for nonpublic companies?			
		1.726 (.451)	27.5%	72.5%

Question Three asks would implementing an audit partner rotation policy enhance the reliability of financial statements for nonpublic companies. The results show that 67.3 percent of the lenders responded "no" and 32.7 percent responded "yes". The results suggest that most lenders believe that implementing an audit partner rotation policy may not enhance the reliability of financial statements for nonpublic companies. Question Four asks would implementing an audit firm rotation policy enhance the reliability of financial statements for nonpublic companies. The results show that 72.5 percent of the lenders responded "no" and 27.5 percent responded "yes". The results suggest that most lenders believe that implementing an audit firm rotation policy may not enhance the reliability of financial statements for nonpublic companies.

To further analyze the responses, participants are asked to provide an explanation. Responses are reviewed, categorized and listed in the order of frequent occurrence. Majority of the participants who responded "no" to the supplemental questions provided the following reasons: 1) cost more to implement a rotation policy, 2) lack of industry knowledge, 3) lower audit quality, 4) reputation and integrity is more important than audit rotation, 5) increase audit failures, 6) peer review board are in place to assure independence and 7) banks are suspicious when companies change audit firms.

Some of the participants who responded "yes" to the supplemental questions provided the following reasons; 1) familiarity may produce a negative acceptance factor, 2) different set of eyes are needed, 3) stop collusion, 4) higher audit quality, 5) lessen the likelihood of intentional fraud, and 6) rotation is a good practice. Some participants state that it depends on the size of the company. Smaller companies would benefit by have the same audit partner or firm but larger companies may benefit by rotating audit partner or firm.

SUMMARY OF SURVEY

A survey is conducted with 56 lenders which a majority have over seven years of loan experience, devote more than fifty-percent of their job to approve loans, and are vice-president or president of a bank. After mailing 900 survey instruments, the response rate for the survey is 6.3 percent. The lenders received a survey which consisted of a questionnaire and supplemental questions.

For the questionnaire, lenders were asked to agree or disagree with 16 questions relating to audit rotation. Most of the lenders believe that mandatory partner rotation should not be required. Furthermore, a majority of lenders believe that audit firm rotation should not be required for nonpublic companies. There was no consensus among lenders about whether partner rotation should be voluntarily implemented. However, one half of the lenders believe that audit firm rotation should not be voluntarily implemented. More than half of the lenders believe that the cost of partner and firm rotations would likely exceed the benefit. In addition, more than half of the lenders believe that nonpublic companies should not rotate audit partners or audit firms every five years. Lenders did not come to a consensus about whether partner or firm rotation provides confidence that the auditor is independent. Additionally, lenders did not come to a consensus about whether partner or firm rotation provides confidence that the audited financial statements are reliable and accurate. A majority of lenders do believe that independence is the foundation of the independent audit for nonpublic companies. Furthermore, a majority of lenders believe the independent auditors should be independent in "fact and appearance". Equally important, most lenders believe that auditor independence rules and regulations should be the same for every size of nonpublic companies. Conversely, most lenders believe that auditor independence rules and regulations should be different for SEC and non-SEC registrants.

For the supplemental questions, lenders are asked four "yes" or "no" questions with a request to explain responses. The results suggest that most lenders believe that implementing an audit partner or firm rotation policy may not enhance auditor independence for nonpublic companies. Furthermore, most lenders believe that implementing an audit partner or firm rotation policy may not enhance the reliability of the financial statements for nonpublic companies. Regarding explanations provided by the participants, the results suggest that most lenders are concerned that partner or firm rotations may negatively affect audit quality, industry knowledge, and increase audit cost.

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APPENDIX

Questionnaire

The Sarbanes-Oxley (SOX) Act includes a provision which requires the lead or coordinating partner and the audit review partner to rotate off an audit engagement every five years on all public company audits. However, there are no requirements for partner rotation or firm rotation for nonpublic company audits. **Please respond to the following questions about audit partner and firm rotation for nonpublic companies.**

Please answer each statement below by circling your response, using the following scale:
1=Strongly Disagree (SD), 2=Disagree (D), 3=Neutral (N), 4=Agree (A), 5=Strongly Agree (SA)

General Statements	**SD**				**SA**
1. Mandatory **partner** rotation should not be required for nonpublic companies.	1	2	3	4	5
2. The cost of **audit partner rotation** would likely exceed the benefits for nonpublic companies.	1	2	3	4	5
3. **Audit firm** rotation should not be required for nonpublic companies.	1	2	3	4	5
4. The cost of **audit firm rotation** would likely exceed the benefits for nonpublic companies.	1	2	3	4	5
5. Independence is the foundation of the independent audit for nonpublic companies.	1	2	3	4	5
6. Independent auditors should be independent in "fact and appearance" for nonpublic companies.	1	2	3	4	5
7. Rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a nonpublic company that is large versus a medium or small entity.	1	2	3	4	5
8. Nonpublic companies should voluntarily implement a policy of **audit firm** rotation.	1	2	3	4	5
9. Rules and regulations governing whether an auditor is independent should differ based on whether the CPA firm is auditing a SEC registrant versus a non-SEC registrant.	1	2	3	4	5
10. Nonpublic companies should voluntarily implement a policy of **audit partner** rotation.	1	2	3	4	5
11. Nonpublic companies should rotate **audit firms** every 5 years.	1	2	3	4	5
12. **Partner rotation** provides confidence that the auditor is independent for Nonpublic companies.	1	2	3	4	5
13. F**irm rotation** provides confidence that the auditor is independent for nonpublic companies.	1	2	3	4	5
14. P**artner rotation** provides confidence that the nonpublic company's audited financial statements are reliable and accurate.	1	2	3	4	5
15. **Firm rotation** provides confidence that the nonpublic company's audited financial statements are reliable and accurate.	1	2	3	4	5
16. Nonpublic companies should rotate **audit partners** every 5 years.	1	2	3	4	5

Supplemental Questions
Please circle YES or NO to the following questions and EXPLAIN your response.

1. Would implementing an **audit partner** rotation policy enhance auditor independence for nonpublic companies? **YES** **NO**

2. Would implementing an **audit firm** rotation policy enhance auditor independence for nonpublic companies? **YES** **NO**

3. Would implementing an **audit partner** rotation policy enhance the reliability of financial statements for nonpublic companies? **YES** **NO**

4. Would implementing an **audit firm** rotation policy enhance the reliability of financial statements for nonpublic companies? **YES** **NO**

5. Please provide additional comments and experiences relating to audit partner rotation or audit firm rotation.

Demographics
For each question, please **circle** the appropriate response:

Age: Under 26 26-35 36-45 46-55 56-65 Over 65

Loan Experience in Years: Less than 1 year 1-3 4-6 7-9 10-15 Over 15

Percentage of Job Devoted to Loans: Below 50% 50-69% 70-79% 80-89% Over 90%

Bank's Asset Size:
Less than 100 million 100million-1billion Over 1 billion-10 billion Over 10 billion

Knowledge of Auditing:
Not Knowledgeable At All 0 1 2 3 4 5 6 7 8 9 10 **Very Knowledgeable**

Title: Credit Analyst Loan Officer Vice President President/CEO Other: ______

Highest Degreed Earned: High School Associates Bachelors Masters Doctorate

Professional Designation/Certification: Yes (specify) ________________ No

Gender: Male Female
Please place survey in the enclosed pre-addressed stamped envelope and mail today.
Thank you for your participation!