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Rotation of independent auditors and analysis of their reports before and after rotation in Brazil

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The aim of mandatory rotation of audit firms by public companies is to preserve the independence of the external auditor and reduce errors and fraud associated with the auditing of financial statements. Nevertheless requiring this rotation periodically is a controversial subject, since it involves the commercial and professional relationship of auditors with their clients and the market for auditing. This study focuses on the effect of rotation on the reports issued by audit firms, comparing them before and after the mandatory rotation established by the Brazilian Securities Commission (CVM), effective as of 2004. For this purpose, the auditor's report was analyzed on the financial statements of 151 listed companies for the period of 2003 to 2006 that changed audit firms as required by the CVM's rules. According to the results, the rotation of independent auditors did not assure the preservation of independence, nor is there any evidence of an increase in the quality of auditing. However, it was noted that the requirement for periodic rotation led to reduced concentration in the auditing market, with increased participation of small audit firms.

Key words: Auditing; auditor rotation; audit opinion; mandatory rotation.

INTRODUCTION

There is a growing demand for transparency and trustworthiness from companies, regardless of the size or sector. Stakeholders (government, financial institutions, employees, suppliers and customers) increasingly want reliable information about companies, to provide greater security in their decisions (Cunha et al., 2009). Among other obligations, publicly traded corporations in Brazil, the subject of this study, are required to submit their financial statements to the Brazilian Securities Commission.

According to Boynton, Johnson and Keel (2002),

although the audited company is the audit firm's client, the "responsibility of the auditors to the users of their opinion is significant." The many accounting and financial scandals and failures that have occurred in the past two decades (Enron/Arthur Andersen, World Com., Parmalat, among others) have prompted growing questions in the capital market about the independence, ethics and quality of auditing services (Reis, 2009).

In response to this rising concern the Brazilian Central Bank issued BACEN Resolution 2,267, which required financial institutions in the Brazilian market to rotate their

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auditors every four years (Oliveira and Santos, 2007). Following an imposition by the Central Bank, the CVM issued Instruction 308, requiring all listed Brazilian firms to rotate independent auditors every five years, starting with the 2004 fiscal year (Batista et al., 2009).

The imposition of these limits on independent auditor tenure by the Central Bank and the CVM was prompted by the belief that the provision of external auditing by a single firm for a long period of time can jeopardize the quality of the service, due to an overly cozy relationship. Other countries have also imposed mandatory auditor rotation, such as Italy, Greece and Austria (Oliveira and Santos, 2007). The advocates of mandatory auditor rotation argue that the new auditors will be more skeptical and will carry out their work with greater independence (Nagy, 2005). In contrast, opponents of mandatory rotation claim that quality does not only come from independence, but also involves factors such as specific knowledge of the client and its business sector, which is enhanced by long-term relationships (Ghosh and Moon, 2005).

With the enactment of Law 11,638 in 2007, which introduced important changes in the basic Law of Corporations (Law 6,404/1976), the CVM issued Deliberation 549/08, relaxing the requirement of Instruction 308/99 and allowing listed companies not to substitute their independent auditors until the issuance of their opinions for the year ended December 31, 2011 (Reis, 2009). Nevertheless, many firms had already changed auditors due to application of the previous deadline. According to Assunção and Carrasco (2008), in a study carried out at the behest of the CVM, a change in the audit firm caused by mandatory rotation increases the chances expression of reservations in the report issued auditors on the financial statements. This article further investigates this issue – of whether or not the new audit firm tends to be more rigorous in interpreting accounting rules in Brazil after the requirements for rotation, by carrying out a quantitative analysis profile of the reports issued before and after the compulsory rotation of independent auditors.

THEORETICAL FRAMEWORK

Review of the literature

Various studies have been published on the effects of rotating auditors, in Brazil and other countries. In the international context, Johnson et al. (2002) found evidence that short relationships between auditors and clients (two to three years) are more associated with lower quality of financial reports than medium-term relationships (four to eight years). In contrast, Myers et al. (2003) reported evidence of higher earnings quality with longer auditor tenure and interpreted their results as indicating that longer auditor tenure on average results in

auditors placing greater constraints on extreme management decisions in the reporting of financial performance, that is, greater independence.

In turn, Nagy (2005) found evidence in line with the findings of Johnson et al. (2002), reporting that longer relationships are not related to reduced quality of auditing, but rather tend to improve it. Barbadillo et al. (2009) studied Spanish financial institutions, which were required to rotate auditors every nine years from 1988 to 1995, seeking evidence that this requirement was associated with an increase in the issuance of going-concern opinions of distressed banks. Their results provided empirical support for the arguments of opponents of mandatory rotation.

Finally, in a study focused on Taiwan, Chi et al. (2009) found that the policy established in that country requiring rotation had a mixed effect in terms of constraining managers' extreme use of accruals to increase or decrease earnings, but that in the perception of investors it enhanced auditor independence. In Brazil, Formigoni et al. (2007) analyzed the contribution of auditor rotation to the Independence and quality of the services provided and concluded that this rotation does not have a relevant effect on either the quality or independence. Likewise, Braunbeck (2008) studied the influence of auditor rotation on the quality of auditing from the perspective of investors. The findings indicated that the self-regulatory governance mechanisms combined with the quality control policies and procedures of large international audit firms in general neutralize the negative effects of the development of an overly cozy relationship between auditor and client, thus arguing against mandatory rotation.

Martinez and Reis (2010) studied the effects of auditor rotation on the propensity to manage earnings and found there were no significant differences in the proxy for earnings management and the rotation of independent auditors. They further found that the quality of auditing not only results from auditors' independence; it also depends on the knowledge of the client built up over the years of a relationship and the specific knowledge of the client's business sector. Likewise, Oliveira and Santos (2007) performed a survey among 127 financial market analysts about the effects of rotation and concluded that in the opinion of the respondents, this rotation does not assure greater independence or reduce the risk of accounting errors and fraud.

In contrast to the above findings, the work of Assunção and Carrasco (2008), carried out at the request of the CVM, concluded that auditor rotation is favorable to the market because after a change, the new auditors tend to be more conservative, increasing the probability of issuing an opinion with reservations.

Finally, Costa and Azevedo (2008) found inconclusive evidence regarding the effects of rotation. While they found statistically significant evidence that a change in

audit firm decreases the likelihood of earnings management, they found no significant differences in this respect between when this change was voluntary and mandatory, thus rejecting the hypothesis that compulsory rotation decreases the level of earnings management. Almeida and Almeida (2007) investigated if Brazilian firms audited by one of the Big Four international firms (Deloitte Touche Tohmatsu, Ernst and Young, KPMG and Price water house Coopers) are more or less likely to engage in earnings management. They found that companies audited by one of the Big Four are less likely to manage earnings. Mendes, Niyama and Ito (2007) investigated the quality of Brazilian auditing by comparing Brazilian auditing rules against international standards, concluding that in general Brazilian rules adhere to international ones. Cupertino and Martinez (2007) performed a study of the level of accruals and if this level could be an indicator for the need to investigate by oversight authorities, finding that the level of accruals can act as a good yardstick in this respect.

Independence of auditing

Independence is an essential feature of effective auditing, being directly associated with the quality of the service and thus the reliability and usefulness of the information contained in financial statements. In the Brazilian literature, Azevedo (2007), Nagy (2005) and Oliveira (2005) all state that the relationship of auditing firms with their clients for extended periods can reduce the independence that should by definition prevail in the work of independent auditors.

In the international setting, Boynton, Johnson and Kell (2002) claim that independence is the philosophical foundation of the auditing profession. The American Association of Certified Public Accountants (AICPA) defines independence as the “ability to act with integrity and exercise objectivity and professional skepticism” (AICPA, 2010). In Brazil, auditing standards are established by the Federal Accounting Council. In 2010 it issued NBC PA 290 – Independência – Trabalhos de Auditoria e Revisão, which covers the requirements for independence of audit work and for limited or special revision of the financial statements. The main purpose was to bring Brazilian practices in line with the international standards issued by the International Federation of Accountants (IFAC).

With globalization of the capital markets, firms are increasingly issuing securities for trading on exchanges outside their home markets, requiring preparation of financial statements and their submission to independent auditing according to the rules in multiple jurisdictions (Santos et al., 2009). In the United States, auditing procedures and standards have traditionally been established by the Auditing Standards Board (ASB), through the issuance of Statements on Auditing Standards (SAS).

According to AICPA (2009). The ASB was established in 1978 as the highest authority to establish auditing standards in the USA. In recent years, there has been increasing convergence of these standards with those in the international arena (IFAC, 1997). But the accounting rules in the USA are also subject to the dictates of the Sarbanes-Oxley Act of 2002, which altered the hierarchy of auditing procedures and set up the Public Company Accounting Oversight Board (PCAOB), with which audit firms and certified public accountants must be registered to be able to perform services to listed companies.

According to PCAOB (2009) and as prescribed by SAS #1, the main objective of independent auditing of financial statements is to express an opinion on their adequacy, in all material respects, in conformity with USGAAP. In the international realm, the IFAC has been trying to harmonize the auditing standards and practices adopted in the 120 member countries of the Federation. Brazil participates, through the CFC and IBRACON (Brazilian Institute of Independent Auditors). In 1999 a supranational body was created called the International Forum for Accounting Development (IFAD), with the aim of institutionally coordinating and supporting the harmonization and implementation of international accounting and auditing standards in the member countries of the IFAC. Under the coordination of the IFAC and IASB (International Accounting Standards Board), these accounting and auditing standards were to be revised and harmonized by 2005 (Nasi, 2002).

In 2005, the International Auditing and Assurance Standards Board (IAASB), another body of the IFAC, coordinated the ISA Clarity Project, for the purpose of revising and updating International Standards on Auditing (ISA) and issuing new ones, set to take effect at the end of 2009. Then, in January 2006 the IAASB issued a revised version of its Handbook of International Auditing, Assurance and Ethics Pronouncements, containing updated ISAs and quality control standards (International Standards on Quality Control – ISQC). ISQC #1 establishes the standards and guidelines regarding the responsibilities for the quality control system of firms that perform financial audits.

Audit report

The final product of the financial statement audit is the independent auditor’s report. According to Almeida (2006, p. 41), the audit is “materialized through the auditor’s report, by which the professional who conducted the auditing work issues an opinion regarding the adequacy of the object of study.” CFC Resolution 953/03 (item 11.3.1.1), defines the “Independent Auditor’s Report” as “the document by which the auditor expresses an objective opinion on the financial statements indicated therein.” CFC Resolution 820/97 establishes four

categories of audit reports: a) report without reservation; b) report with reservation; c) report with adverse opinion and d) report with abstention from opinion. Various authors have examined the effects of this classification framework, among them Almeida (1996), Attie (1998) and Franco and Marra (2001).

CFC Resolution 953/03 revised the basic structure of the standardized report, dividing it into three paragraphs: introduction, extension and opinion. Due to the convergence of Brazilian accounting standards to international ones, CFC Resolution 1,231/09 changed this basic structure to: introduction, responsibility of management, responsibility of the auditors and opinion.

Report without reservation or clean report

According to CFC Resolution 953/03 (item 11.3.2.1), a report without reservation is defined as that in which “the auditor is convinced that the accounting statements were prepared in harmony with the provisions contained in item 11.1.1.1 [GAAP] in all material aspects.”

Report with reservation

The same Resolution, in item 11.3.4.1, establishes that a report with reservation is one “issued when the auditor concludes that the effect of any discordance or restriction on the extent of the work is not so great as to require an adverse opinion or abstention from expressing an opinion.” Attie (1998, p. 73) defines it as follows: A report with reservation is issued when one or more numbers in the financial statements do not adequately reflect the correct position, according to the fundamental principles of accounting, or when the auditor cannot obtain sufficient evidence to verify such numbers.

Report with adverse opinion

Item 11.3.5.1 of CFC Resolution 953/03 defines a report with adverse opinion as one issued when the auditor believes “the financial statements are not adequately represented, as of the dates and for the periods indicated, according to the provisions contained in item 11.1.1.1 [GAAP].” When issuing an adverse opinion, the independent auditor must describe the reasons and nature of the divergences observed that corroborate the adverse opinion, as well as the consequences on the equity and financial position and profit/loss for the year.

Report with abstention from opinion

According to item 11.3.7.1 of the Resolution, the auditor

must abstain from issuing an opinion. When there is uncertainty regarding a material fact, whose outcome can significantly affect the equity and financial position of the entity, as well as the result of its operations and the auditor must add a paragraph of emphasis in the report, referring to an explanatory note from management, which describe more comprehensively the nature and when possible, the effect of the uncertainty. When issuing a report with abstention from opinion, the independent auditor does not avoid responsibility to mention any significant deviation that would be included as a reservation and that can influence the decision of users of financial information.

METHODOLOGY

This is an exploratory and empirical study, based on research of the international and Brazilian literature and the standards and rules issued by international and national professional bodies and on content analysis of the reports of the independent auditors of a sample of listed Brazilian firms. Raupp and Beuren (2004) point out that in accounting, qualitative research is very common, since accounting deals exclusively with numbers, it can more accurately be described as a social science as opposed to an exact one.

The reports consulted of the independent auditors of 167 listed Brazilian companies, obtained from the CVM website, for the period of 2003 to 2006, during which these firms either had to rotate auditors due to CVM Resolution 308/99 or did so voluntarily. Of these 167 firms, 16 did not have complete data available, so the final sample consisted of 151 listed firms. The audit reports was compared of these 151 companies in the year before the change in audit firm and that after the rotation, irrespective of which year the shift occurred. In the financial statements of these 151 companies were identified the independent audit firms in the years before and after the rotation.

Then the firms were segregated into the “Big Four” (Price water house Coopers, Deloitte Touche Tohmatsu, KPMG and Ernst and Young) and other firms, to check for any changes in the relative participation of the big international firms versus smaller audit firms.

The audit reports was also classified according to the four categories defined above: without reservation, with reservation, with adverse opinion and with abstention from opinion and counted the number of paragraphs contained in the reports and how many of these paragraphs contained an emphasis of matter. The resulting data was analyzed utilizing frequency distributions and statistical coefficients, displayed in tables. As mentioned, according to Assunção and Carrasco (2008) in a study performed at the behest of the CVM, mandatory auditor rotation increases the chance that auditors will express reservations on the financial statements. To test this claim in the Brazilian setting, It was formulated the following two hypotheses:

Hypothesis 1: After the auditor rotation, there was increase in reports with reservations.

Hypothesis 2: After the auditor rotation, there was an increase in emphasis of matter paragraphs.

The aim is to contribute to the national and international debate about the legal and/or regulatory requirements for rotation of independent auditors.

Table 1. Firms engaged to audit the financial statements – before rotation Auditor

Auditor	Absolute frequency	Relative frequency (%)
Pricewaterhouse Coopers Auditores Independentes	38	25.19
Trevisan Auditores Independentes	19	12.58
BKR - Lopes, Machado Auditores S/C	17	11.26
Ernst and Young Auditores Independentes S.S.	11	7.28
Deloitte Touche Tohmatsu Auditores Independentes	10	6.62
KPMG Auditores Independentes	10	6.62
Boucinhas and Campos + Soteci	4	2.65
Martinelli Auditores Independentes S.C.	4	2.65
Rokembach and Cia. Auditores S/C	3	1.99
Alonso, Barretto and Cia. Auditores Independentes	2	1.33
Bendoraytes, Aizenman and Cia	2	1.33
Gama and Cia Auditores Independentes S/C	2	1.33
HLB Audilink and CIA. Auditores	2	1.33
Veeck and Cia – Auditores	2	1.33
Actus Auditores Independentes S/S	1	0.66
Adelino Dias Pinho	1	0.66
AKW Auditores Independentes S/S Ltda	1	0.66
Auditór Auditores Independentes S/C	1	0.66
BDO Trevisan Auditores Independentes	1	0.66
Claudio Bianchessi and Assoc.Aud. S/C	1	0.66
Directivos S/C Auditores Independentes	1	0.66
Ecopal SC Auditores Independentes	1	0.66
Elmiro José Hallmann	1	0.66
ETAE Auditores Independentes S/C	1	0.66
Exacto Auditoria S/S	1	0.66
Francisco Assis de Sousa Auditor Independente	1	0.66
Imatéo Auditoria e Consultoria S/C	1	0.66
Instituto Nacional de Auditores	1	0.66
Justus Auditores Independentes	1	0.66
Maion and Cia. S/C Auditores Independentes	1	0.66
Narazzaqui and Cia. – Auditores	1	0.66
Nardon, Nasi - Auditores Independentes	1	0.66
Performance Auditoria e Consultoria Empresarial S/C	1	0.66
Santa and Souza Auditores Independentes	1	0.66
Teixeira and Associados Auditores Independentes	1	0.66
Terco Auditores Independentes S/C	1	0.66
Tufani, Reis and Soares Auditores Independentes	1	0.66
Units Auditores Independentes	1	0.66
Walter Hever Auditores Independentes	1	0.66
TOTAL OF 40 AUDIT FIRMS	151	100.00

ANALYSIS OF THE RESULTS

Firms engaged to audit the financial statements before rotation

The audit firms was first identified, retained to audit the financial statements of the sample companies before the

rotation. The statistics are shown in Table 1.

In the period before the change in the independent auditor, 40 audit firms worked for the 151 companies in the sample. The audit firm with the most clients was Pricewaterhouse Coopers Auditores Independentes, with 38 clients, or 25.19% of the companies. The percentages of all the other audit firms were less than half this rate,

with the most significant being Trevisan Auditores Independentes, which audited 12.58% of the companies, BKR - Lopes, Machado Auditores S/C, at 11.26%, Ernst and Young Auditores Independentes S.S., with 7.28% and Deloitte Touche Tohmatsu Auditores Independentes and KPMG Auditores Independentes, both with 6.62%. Boucinhas and Campos, Soteci Auditores Independentes and Martinelli Auditores Independentes S.C both worked for four companies, or 2.65% of the sample, while Rokembach and Cia. Auditores S/C was retained by 1.99% companies. Alonso, Barreto and Cia – Auditores Independentes, Bendoraytes, Aizenman and Cia, Gama and Cia Auditores Independentes S/C, HLB Audilink and Cia. Auditores and Veeck and Cia – Auditores all had two clients, or 1.33% of the sample, while the rest each audited the books of one company apiece, or 0.66% of the total.

Firms engaged to audit the financial statements after rotation

It was then identified the breakdown of the audit firm engagements after the rotation. The results are shown in Table 2.

In the second period all the companies in the sample had changed auditors, either because of the new rule or spontaneously. The number of audit firms retained by the 151 sample companies increased to 54 from the 40 in the previous period. In this case, the most popular independent auditor was Deloitte Touche Tohmatsu Auditores Independentes, with a frequency of 16.56%, followed by Performance Auditoria e Consultoria Empresarial S/C with 9.27%, KPMG Auditores Independentes with 7.95%, Ernst and Young Auditores Independentes S.S. with 7.28%, Price water house Coopers Auditores Independentes and Trevisan Auditores Independentes, each with 5.30% and BDO Trevisan Auditores Independentes, with 3.31%, Audimar Auditores Independentes S/C and Directa Auditores, each with 2.65%, and Imer Puerari and Cia. Auditores, Mazars and Guérard Auditores Independentes S/C and PS Contax and Associados. Aud. Independentes. S/S, all with 1.99%. All the rest of the audit firms had one client only, for a frequency of 0.66%

Representation of the big four audit firms before and after rotation

As could be expected, in Table 3 among the 151 companies analyzed, the Big Four audit firms together represented a substantial share of the audit market, both before and after the rotation. This concentration in the Brazilian market is likely due to the reputation of the leading four international audit firms, with their clients' choices being influenced by a desire to convey greater

security to investors. However, the combined percentage of the Big Four fell from 45.71% of the sample companies before the rotation to 37.09% afterward, indicating that the rotation requirement increased the opportunity for smaller independent auditors.

Classification of the audit report before and after the rotation

It can be seen from Table 4 that before the rotation, 78.81% of the companies analyzed received a "clean" opinion, that is, an audit report without reservations, meaning there was no relevant fact of concern. The remaining 21.19% of the companies received an opinion with reservation, while none received an adverse opinion or a report with abstention from opinion. These statistics changed little after the rotation. In this case, 79.47% of the companies analyzed received a report without reservations, while 19.87% received one with reservation, meaning there was at least one fact that raised the concern of the independent auditor. There was also one case where the auditor identified transactions of the client company with subsidiaries whose books had not been audited, preventing the issuance of an opinion on the financial statements of the parent company.

Number of paragraphs contained in the audit reports– before rotation

Table 5 shows that 151 audit reports received by the companies in the sample before the rotation contained a total of 688 paragraph, with the greatest frequency being reports containing three paragraphs (33.11%, or 50 companies), followed by reports containing four paragraphs (29.14%, or 44 companies), reports containing five paragraphs (14.45%, or 22 companies) and reports with six paragraphs (10.60%, or 16 companies). The rest of the sampled companies received audit reports containing seven or more paragraphs, with one report being 13 paragraphs long. The average number of paragraphs before the rotation was 4.55.

Number of paragraphs contained in the audit reports– after rotation

Table 6 shows that after the rotation, the audit reports of the 151 companies in the sample contained a total of 786 paragraphs. The largest percentage of these contained five paragraphs (60 companies, 39.74%), followed by 47 reports containing four paragraphs (31.13%) and 21 reports with six paragraphs (13.90%). Companies receiving reports with seven and eight paragraphs each represented 5.30% of the sample (8 companies), while

Table 2. Firms engaged to audit the financial statements – after rotation

Auditor	Absolute frequency	Relative frequency (%)
Deloitte Touche Tohmatsu Auditores Independentes	25	16.56
Performance Auditoria e Consultoria Empresarial S/C	14	9.27
KPMG Auditores Independentes	12	7.95
Ernst & Young Auditores Independentes S.S.	11	7.28
Pricewaterhouse Coopers Auditores Independentes	8	5.30
Trevisan Auditores Independentes	8	5.30
BDO Trevisan Auditores Independentes	5	3.31
Audimar Auditores Independentes S/C	4	2.65
Directa Auditores	4	2.65
Imer Puerari & Cia. Auditores	3	1.99
Mazars & Guérard Auditores Independentes S/C	3	1.99
OS Contax & Assoc. Auditores Independentes S/S	3	1.99
Audiva - Auditores Independentes S/C.	2	1.33
BKR - Lopes, Machado Auditores S/C	2	1.33
Boucinhas & Campos + Soteconti Auditores Independentes S/C	2	1.33
Martinelli Auditores Independentes S.C	2	1.33
RBA Global - Auditores Independentes S/S	2	1.33
Rodyo's Auditores Independentes S.S	2	1.33
Sigmac Auditores	2	1.33
Soltz, Matoso & Mendes Auditores Independentes	2	1.33
Terco Grant Thornton Auditores Independentes	2	1.33
Veeck & Cia – Auditores	2	1.33
Actus Auditores Independentes S/S	1	0.66
AFM Auditores Independentes	1	0.66
Alonso, Barreto & Cia - Auditores Independentes	1	0.66
Audicont – Auditores e Consultores Ltda	1	0.66
Audiplan Auditores Independentes	1	0.66
Bendoraytes, Aizenman & Cia. Auditores Independentes	1	0.66
Binah SP Auditores Independentes	1	0.66
BKS Auditores	1	0.66
Bordasch Auditores Associados	1	0.66
Cerutti & Machado Auditores Associados	1	0.66
Cokinós & Associados - Auditores Independentes S/C	1	0.66
Directivos Auditores Independentes	1	0.66
DRS Auditores	1	0.66
Fernando Motta & Associados Auditores Independentes	1	0.66
Gama & Cia Auditores Independentes SC	1	0.66
Guimarães e Associados Auditores e Consultores S/C	1	0.66
HLB Audilink & Cia. Auditores	1	0.66
Horwath Tufani, Reis & Soares Auditores Independentes	1	0.66
IGAF LM Auditores Independentes	1	0.66
João Valério e Moura Filho Auditor Independente	1	0.66
Loudon Blomquist Auditores independents	1	0.66
Macro Auditores Independentes	1	0.66
Maion & Cia. S/C Auditores Independentes	1	0.66
Moore Stephens Lima Lucchesi Auditores Independentes	1	0.66
Moreira & Associados Auditores	1	0.66
Padrão Auditoria S/S	1	0.66
Quorum Auditores Independentes	1	0.66

Table 2. cont'd

R & R Auditoria e Consultoria	1	0.66
Sacho Auditores Independentes	1	0.66
SGS Auditores Independentes S/C	1	0.66
Sicom Auditores Independentes	1	0.66
TOTAL OF 54 AUDIT FIRMS	151	100.00

Table 3. Big Four audit firms

Auditor	Before rotation	After rotation
Pricewaterhouse Coopers Auditores Independentes	25.19%	5.30%
KPMG Auditores Independentes	6.62%	7.95%
Deloitte Touche Tohmatsu Auditores Independentes	6.62%	16.56%
Ernst and Young Auditores Independentes S.S.	7.28%	7.28%
TOTAL	45.61%	37.09%

Table 4. Classification of the independent auditor's report

Classification of the audit report	Absolute frequency – Before	Relative frequency (%)	Absolute frequency – After	Relative frequency (%)
Without reservation	119	78.81	120	79.47
With reservation	32	21.19	30	19.87
With adverse opinion	0	0.00	0	0.00
With abstention from opinion	0	0.00	01	0.66
TOTAL	151	100.00	151	100.00

Table 5. Number of paragraphs

Number of paragraphs	Absolute frequency	Relative frequency (%)
03	50	33.11
04	44	29.14
05	22	14.56
06	16	10.60
07	10	6.62
08	03	1.99
09	03	1.99
11	02	1.33
13	01	0.66
TOTAL	151	100.00

four companies received reports containing nine or more paragraphs and the reports of three companies had only three paragraphs. The average for the sample after the rotation was 5.205 paragraphs.

Companies receiving audit reports containing an emphasis of matter paragraph

Also it was investigated the presence of paragraphs in

Table 6. Number of paragraphs

Number of paragraphs	Absolute frequency	Relative frequency (%)
05	60	39.74
04	47	31.13
06	21	13.90
08	08	5.30
07	08	5.30
03	03	1.99
09	02	1.32
14	01	0.66
11	01	0.66
TOTAL	151	100.00

Table 7. Existence of an emphasis of matter paragraph before rotation

Emphasis paragraph	Absolute frequency	Relative frequency (%)
Yes	78	51.66
No	73	48.34
Total	151	100.00

Table 8. Existence of an emphasis of matter paragraph after rotation

Emphasis paragraph	Absolute frequency	Relative frequency (%)
Yes	78	51.66
No	73	48.34
Total	151	100.00

the audit reports containing an emphasis of matter comment. The results before the rotation are shown in Table 7. It can be seen that the audit reports of 51.66% of the companies analyzed contained an emphasis paragraph.

Table 8 shows the number of reports with emphasis paragraphs after the rotation.

The statistics on emphasis paragraphs were exactly the same after the rotation, indicating that the change in audit firms did not cause any change in the matters held by the auditors to deserve emphasis.

CONCLUSION

The mandatory rotation of audit firms has received increasing attention from regulators in recent years, as a way to strengthen auditor independence and improve professional skepticism. Proponents suggest that it would prevent the development of excessively close relationships between the auditor and the audited

company administration and limiting the economic dependence of auditors of the companies they audit. Opponents have a number of considerations about the mandatory rotation of audit firms, including that it would be detrimental to audit quality, weaken the role of the board of directors and audit committees, would increase the total costs for preparers of financial statements and would be very difficult to implement in a complex global environment.

The objective of this work was to analyze empirically the impact of auditor rotation on the audit reports issued on the financial statements, using a sample of 151 listed Brazilian firms, obtained from the website of the Brazilian Securities Commission (CVM), during the period of 2003 to 2006, when a requirement for periodic auditor rotation came into effect.

Comparison of the independent auditors engaged by these companies in the year before and the year after the rotation showed an increase in the number of audit firms from 40 to 54, indicating the rotation requirement provided a chance for more audit firms to work among

this sample of companies. Nevertheless, the Big Four continued to predominate after the rotation, although their combined percentage in the sample declined from 45.61% to 37.09%. With respect to the classification of the report issued, the rotation policy did not have a significant effect on the rigor of the opinions, as reflected in the percentage issued with reservations, indicating there was no increase in the level of independence. The same result was found regarding the number of paragraphs containing emphasis of matters, again indicating the rotation policy did not enhance the independence of audit firms.

Due to the learning curve that audit firms must face in each new audit, audits may be less efficient in early labor. Audit firms can obviously and effectively manage transitions effectively, but this is not without cost or risk, both the auditor and the company incur costs at the beginning of the work with an external auditor. The cost of mandatory audit firm rotation may be aggravated because of the particular circumstances of a company. For example, changing an auditor in the middle of a great deal of capital or loan is complicated and expensive. The imposition of a specific date for the completion of the rotation of the audit firm could further worsen the situation under volatile market conditions. From this paper, there is no evidence that mandatory audit firm rotation increases audit quality. In fact, our studies have shown that it may affect it negatively. One of the advantages of hiring an audit firm for the long term is that the auditor obtains knowledge and so meaningful understanding of the company over time, as well as its risks, which can improve audit quality. Hiring for a longer period may allow the audit firm to develop expertise and credibility to the organization, demonstrating, over time, your accounting technical expertise, the quality of their audit work and his knowledge of the company's business. Hiring for a longer period may also result in a greater respect for the judgment of the auditor when the auditor makes inquiries about the conclusions of the management of the audited company. The results presented here are informative in character. A more comprehensive analysis is necessary to reach more solid conclusions on the effect of requiring auditor rotation on the quality of auditing and the profile of reports in the Brazilian market.

The restricted number of observations is also a limitation, as it was chosen only to study companies that changed auditors against a backdrop of the new rule requiring rotation (although not all the companies that changed did so because the maximum tenure of their incumbent auditor had expired).

One avenue for further study would be identification of the reasons for emphasis paragraphs and their absolute frequency.

Another would be to analyze the audit reports of Brazilian companies with dual listing (on the BM and FBovespa and NYSE) that either by regulatory requirement or spontaneously changed audit firms.

Conflict of Interests

The author(s) have not declared any conflict of interests.

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