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Effects Of Rotation On Auditor Independence And Quality Of Audit Service In Malaysian Banking Industry

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Abstract

This study highlights the nature of auditor rotation in the Malaysian banking industry and its effects on auditor independence and quality of audit service in the industry. To generate primary data for analysis, interviews were conducted on officials of two banking institutions and one accounting/audit firm. The study finds that there have not been significant changes in the annual appointment of auditors in the Malaysian banking institutions over the last ten years, suggesting that there is a good working relationship between the auditors (especially the Big4) and the banks. This allows room for continuous debate on the need for mandatory rotation as a means for ensuring auditor independence and high audit quality in the Malaysian banking industry. In the absence of statutory/mandatory requirement for auditor rotation, it is recommended that the Malaysian banking institutions should be carefully evaluating the impact auditor rotation would have on the quality of audit work on their current and future financial statements, as they decide whether to rotate their auditors or not.

Keywords: *Auditor Rotation, Banking Institutions, External Auditors, Big4, Audit Quality*

Introduction

An auditor is an independent person who adds a lot of value and credibility to the financial statements of a client through high quality audit service. Even though external auditors are not insiders to reporting entities, they play key roles in developing their clients' internal control system and accounting system, thereby enhancing level of accountability, transparency, and prudent management of resources. Auditors are empowered by the law of different countries to comment on weaknesses in the accounting records, accounting system and internal control system that they review in the course of the audit. They also could provide a statistical analysis on the clarity and effectiveness of the accounting policies put in place by the client. Even procedures for documentation and production of financial reports that are efficient, ethical and fair could be improved upon with constructive suggestions from an independent auditor.

The processes of appointing and re-appointing an auditor may vary vary from country to country, due to variation in laws and applicable accounting and auditing standards. But following efforts at ensuring the merger of Financial Accounting Standard Board (FASB) with International Accounting Standards Board (IASB), and their local associates, there is hope that experts in accounting and auditing worldwide, would soon be working with same accounting and auditing standards without significant degree of discrepancies. Until then, auditors must be knowledgeable with a particular country's audit laws and procedures as well as the peculiarities of the business environment.

Auditor rotation is simply about change of accounting firm/auditor from one period to another, during the life of a going-concern reporting entity. It is about changing from one auditor to another, enjoying varieties of audit services from different auditors, while encouraging them to maintain their independence as they provide high quality audit services to a client. The rotation could be done on annual basis, two-year basis or three-year basis, depending on legal provision (if any) or the corporate strategy of a reporting entity.

In Malaysia, the issues of audit tenure and rotation of accounting firms or audit partners are not explicitly addressed in any of the relevant Malaysian official documents such as the Companies Act 1965, the Security Commission regulations, approved auditing standards, etc (Nasser, Wahid, Nazri and Hudaib, 2006). Lack of official pronouncements on these issues could be due to rejection of auditor rotation idea by the business community. Jaffar and Alias (2002) found that only 35 per cent of the papers in accounting firms and only 32.4 per cent of the chief financial officers surveyed favor the practice of auditor rotation after every three years of engagement.

However, in the light of Enron case, the Chairman of the Malaysian Accounting Standard Board announced the intention of the board to make it mandatory for reporting entities in the country to rotate their auditors at least once after every five years (The Edge, 2002). While some countries are either considering, or have already imposed, the five-year (or other ranges) restriction to rotate the audit firms, the dimension of auditor rotation and its possible effects on auditor independence and high quality audit service in the Malaysian banking industry and beyond are issues that are still unresolved.

The purpose of this study is to assess the effects of auditor rotation on auditor independence and quality of audit service for enhanced credibility of banking institutions in Malaysia. More specifically, the study aims to achieve the following specific objectives: (i) to find out how external auditors are being appointed by banks and the provisions of BAFIA thereon; (ii) to understand the relationship between mandatory rotation of external auditor, audit quality and auditor independence; (iii) to find out the trend of auditor rotation among Malaysian banking institutions; and (iv) to examine the effects of auditor rotation on the independence of auditors in Malaysia and the quality of the audit service they provide.

Literature Review

Auditor Rotation, Auditor Independence and Audit Quality

Mandatory rotation of accounting firms and mandatory rotation of firms' partners are two issues that deserve empirical studies in the developed and developing economies, in view of the need to safeguard auditors' independence and ensure high quality audit service (DeFond, Raghunandan and Subramanyam, 2002; and Carey and Simnett, 2006). Laws related to audit service in most countries of the world specify that appointment of an accounting firm/auditor is for a one year tenure, renewable to infinity, and this allows room for same auditors to enjoy continuous appointment from their clients over a long period of time.

Debates are on among academics, practitioners and even members of the general public on the need for a fixed number of years (say 3 or 5) that an auditor should serve and then dropped for another auditor to be appointed, or the need for a fixed number of years that an audit partner is to serve as an engagement partner to a client after which he/she is to be changed (Carey and Simnett, 2006). All the debates surrounding these issues are motivated by the need to ensure that mandatory rotation impacts positively on auditor independence and high quality audit service.

Chen, Lin and Lin. (2008) and Chi, Huang, Liao and Xie, (2009) suggest that the length of audit partner tenure is negatively associated with the audit quality. Both Chen et al. (2008) and Chi et al. (2009) used accrual-based proxy in their researches and this method was found to be noisy (Chi, et al., 2009). Prior study conducted by Carey and Simnett (2006) also depicts the fact that accrual-based results could be contradictory. Therefore, Chen et al. (2008) and Chi et al. (2009)'s studies might be biased.

In a good number of studies, the auditor's going-concern opinion is used as the proxy for audit quality (Hopwood, McKeown and Mutchler, 1994; DeFond, Raghunandan and Subramanyam, 2002; and Carey and Simnett, 2006). They all emphasized that the audit report is duty bound to inform the stakeholders about the going-concern problem of the audit client. Thus, an auditor must be free from impairment and withstand the client pressure to issue a clean opinion. In other words, there is a positive correlation between the auditor's propensity to the issue of going concern opinion, with the level of independence and the audit quality. Moreover, according to Sinason, Jones and Shelton (2001), auditor's tenure is longer with clients who receive unqualified opinions on continuous basis. All these suggest that the use of going-concern opinion as a proxy for testing audit quality is viable.

In the early period of an auditor's appointment, literature suggests that the auditor has a higher failure risk to detect material misstatements (Raghunandan, 2002; Chi & Huang, 2005). An auditor is bound to obtain the knowledge and skill to offer better high quality audit service after the familiarization period with a client (Pierre and Anderson, 1984; Chi, Huang, Liao and Xie 2005). Carey and Simnett (2006) viewed familiarization years as between three to seven years. The auditors are expected to maintain their independence within this period (Carey and Simnett, 2006). After this period (seven years), it is expected that audit quality will deteriorate (Carey and Simnett, 2006). Even though the length of the audit partner tenure period is not fixed, recent policy in Malaysia depicts a period of either five or seven years.

Determinants of Audit Client's Reputation

Factors that affect the client's reputation are client receiving qualified audit report, firms facing financial distress, auditor charging higher audit fee and the size of the client. Financial distress in a company is proxied by reduction of return on asset, high leverage and low liquidity of the firm, and auditors are expected to report all these when noticed. Meanwhile, the factor that contributes to the auditor effectiveness is longevity of audit engagement, which is based on the working relationship between management/directors and the auditor. It is believed in the auditing literature that the length of audit engagement is a factor, alongside the auditor's size, that contributes to client's decision on auditor rotation, in the absence of mandatory requirement to that effect.

Malaysia is a developing country, which relies on foreign direct investment to fund sustainable growth and development. The credibility of financial reports of companies in the country is essential to ensure that foreign investors are confident enough about the securities market in Malaysia (Teoh and Lim, 1996). This demonstrates the importance of audit quality in financial reports. In March 1999, Malaysian Institute of Accountants (MIA) announced its intention to propose a three or five years audit partner rotation for public listed companies (Shafie, Wan, Yusof and Hussain; 2009). Nonetheless, no formal policy has been put in place on audit rotation in the country thus far.

Following a series of scandals in the USA, the Malaysian Securities Commission (SC) and the Bursa Malaysia became more concerned about the issue of auditor rotation. With that, MIA and Malaysia Institute of Certified Public Accountants (MICPA) have established an MIA/MICPA Joint Taskforce on Auditor Independence in Malaysia to examine the auditor independence issues (Shafie, Wan, Yusof and Hussain; 2009). Once again, the proposal of mandatory audit partner rotation was recommended by MIA for a period of not more than five years. An audit partner should not resume the role of lead engagement partner in the audit of a client until two years have elapsed. In July 2006, MIA adopted ISQC 1, mandating the rotation of audit partner at least after every seven years.

Audit Service in Agency Relationship

Agency theory emanated from the separation of ownership and control of a business organization. As shareholders appoint directors to control their business, through managers appointed by the directors, agency relationship is established. A further agency relationship is where shareholders appoint auditors, as required by law, to audit the accounts prepared by directors and express professional opinion thereon for the use of the shareholders and other stakeholders. The auditors then are agents to shareholders, who are to be seen as the principals. Conflict of interest is bound to arise if care is not taken in any agency relationship, as examined by Jensen & Meckling (1976) and Fama & Jensen (1983). Directors should act in the best interest of the shareholders; management should act in the best interest of directors and shareholders; and auditors should act in the best interest of the law, even though appointed by the shareholders!

Agency theory suggests that a firm is made up of interlinking economic resources and obligations put together by different interest groups, especially owners/shareholders and creditors. The interests of these groups should be protected by any agent appointed under any agency contract. Shareholders are to consider directors/managers who are in charge of managing their resources and auditors who conduct professional financial examination for them as trustworthy agents (Jensen & Meckling, 1976; and Antle, 1982 & 1984). The directors are to appoint trustworthy managers, as agents, to take care of the day-to-day activities of the business they are appointed by the shareholders to direct and control.

Goldman and Barlev (1974) suggest that there could be conflict of interests in the auditing task, as the auditor works for the client but works closely with the managers, especially if the auditor comes up with a qualified report which is indicting on the directors/managers. The auditor has the ethical responsibility of satisfying his conscience, by remaining really independent in fact and in appearance, and by ensuring high quality audit. As a good agent of the shareholders, an auditor is expected to withstand pressures from directors/managers to certify financial statements that are not 'true and fair'.

Review of Empirical Studies

Factors of Influencing Auditor Rotation

Finding from previous researches show that companies decide to rotate their auditors due to factors such as management changes, disagreement between client and auditor, and dissatisfactions over audit fees (Burton and Roberts, 1967; Bedingfield and Loeb, 1974; and Woo and Koh, 2001), dissatisfaction with the service by auditors, disagreement over accounting issues, change of engagement partner, resignation, initial public offering, rapid growth and search for credible auditors (Johnson and Lys,1990; and Krishnan, 1994). Other significant reasons include leverage and income manipulation (Woo and Koh, 2001; and Lee, 2002).

A study by Takiah and Ghazali (1993) examines the association between qualified audit opinions and the effects on auditor rotation. Unfortunately, the study fails to ascertain significant association between qualified reports and auditor rotation. This might probably be due to the short period of the study (from 1986 to 1989), coupled with small sample size. The study also discovers that reporting losses or profits was not the primary reason of auditor rotation.

In a similar study on qualified audit report and auditor rotation, Hasnah, Ali and Goh (1997) found a different set of result. The result suggests that client firm receiving qualified opinion is more likely to rotate auditors than one who receives a clean report (unqualified report). Thus, the findings fail to support the previous finding by Takiah and Ghazali (1993), who found that client firms in Malaysia tend to rotate auditors following seriousness of audit qualification but there were no tendency of switching to Big-6 (now Big-4) audit firms or non Big-6 (now non- Big-4) auditors in order to get unqualified opinion. This suggests that opinion shopping is not popular in Malaysia.

Mandatory firm rotation

The following are arguments for mandatory audit firm rotation from some empirical studies:

1. **Close Relationship**

   A survey conducted by the Government Accountability Office of United State stated that the average length of the audit engagement was about 22 years for Fortune 1000 public companies (GAO, 2003). AICPA (1992) and Wooten (2003) stated that long-term audit engagement will create a close relationship between the auditors and their clients' management and therefore may result in a conflict of interest for the auditors which can adversely affect their action to appropriately deal with the financial reporting issues that materially affect their clients' financial statements. The auditors may begin to identify with management's problems and lose the necessary skepticism. Furthermore; they will begin to identify themselves with the interest of the client's management rather than the users of the financial statement. Arel, Brody and Pany (2005) reveal the close auditor-management relationship also as resulted in many auditors being hired by former clients. Company personnel may be the auditors from the past and current auditors may be auditioning for future employment. For example, many Enron employees had previously worked for Arthur Andersen**.**

2. **Audit Approach**

   The auditors become stale in their audit approach by a long-term relationship between auditors and their clients (Arel, Brody and Pany. 2005). This is due to lack of attention to detail, redundancy and repetition from the earlier engagement. The auditors would rely on the previous working papers in order to plan current audit process. There is also a possibility that the same audit staff will be engaged in the following financial year that may rely on their own working papers from the previous years. As a result, this practice will lead auditors to rely on the previous judgments in giving an opinion about the position of the financial statements of the current financial year. Therefore, there is a tendency to anticipate results rather than evaluating important changes in clients' circumstances (AICPA, 1992).

Even though close relationship is established between auditor and client over a long period of appointment, Arel, Brody and Pany (2005) argued that an auditor must interact with management on a daily basis during the audit and closeness to client management is bound to occur regardless of the length of the audit tenure. A client must feel comfortable with an auditor and be willing to share information and discuss problems when they exist. Auditors from a new firm are faced with the challenge of getting to know each other stage. The close relationship, using a positive-thinking philosophy, contributes to knowledge-sharing.

On quality, it is clear that lack of client-specific information during the initial year of engagement will reduce audit quality. This is due to the complexity of business operation, globalization and boundless world. Catanach and Walker (1999) mentioned that mandatory rotation, if adopted, would deny auditors the ability to assess the true financial situation of a company because their understanding of the client's business operations and systems would be limited to only a few years.

Methodology

Interviews were conducted with the branch managers of two banking institutions in Malaysia, namely: Affin Bank Berhad and Bank Rakyat Berhad. Information, through the interview sessions, was generated in early October, 2012. This was followed up with an interview conducted with the managing partner of Azmi Ismail & Co (Chartered Accountnats), an accounting firm serving as auditor to some organizations in Malaysia. The researchers choose to conduct interviews with those three persons for two reasons: firstly, to reap from the experiences gained by the managers and the external auditor in their client-auditor relationship; and, secondly, to allow fair hearing to the two main parties involved in the audit exercise (the banks as clients, and the accounting firm as the auditor).

The two bank managers have followed up the interview sessions via emails in order to give the researchers more information. Again, conducting the interview with a non-big4 auditor reveals vital information in terms of the role of auditor and the ethical issues related to audit of banks in Malaysia. However, with the auditor’s limited experience, there were cases where practical answers could not be obtained on auditor rotational practices in the Malaysian banking industry. Some of the answers given by the external auditor are theoretical in nature, since his firm has never been engaged for the audit of any Malaysian banking institution, but his responses are accepted as more independent than the responses to have been obtained from an auditor whose firm is involved in that type of audit.

The auditors’ reports in the financial statements of some Malaysian banking institutions from year 2002 to 2011 were reviewed to find out the level of rotation of auditors in the Malaysian banking industry. This is with a view to achieving the third objective of the study.

The Process of Appointing External Auditors by Banking Institutions

The rule guiding appointment of external auditor by banking institutions is applicable to all banking institutions (commercial banks and investment banks) licensed under the Banking and Financial Institution Act (BAFIA) 1989. This law sets out Bank Negara Malaysia’s expectations regarding the role and responsibility of each board of banking institution in relation to the appointment of auditors under section 40 of the BAFIA.

The preparation and integrity of financial statements are the responsibility of the board of directors (the board) and senior management of banking institutions. They are to give assurance of a properly conducted audit which provides an independent view on the financial report to ensure its reliability. Such assurance would depend significantly on the exercise of appropriate due diligence by banking institutions in the selection and engagement of auditors.

The law provides for the criteria for the appointment of auditors by banking institutions, the Bank's supervisory expectations regarding the term of audit engagement, application procedures and reporting obligations to be observed by the auditors and the banking institutions. All these are aimed at promoting the accuracy and reliability of financial statements issued by Malaysian banking institutions.

The *criteria* for auditor's appointment have been stated under section 40 of the BAFIA. Auditors appointed under section 40 of the BAFIA must: 1) not be disqualified under section 40(4)(a) - (i) and section 40(6) of BAFIA; 2) have adequate resources and the necessary skills, knowledge and appropriate experience to perform their duties with professional competence and due care in accordance with approved professional auditing standards and applicable regulatory and legal requirements; 3) not have relationships with, or interests in, the banking institution or any other entity that are likely to impair their objectivity or independence, and which cannot be reduced to an acceptable level through the application of appropriate safeguards; 4) not have any record of disciplinary actions taken against them for unprofessional conduct by the Malaysian Institute of Accountants (MIA) and the decision for such disciplinary actions has not been reversed by the Disciplinary Appeal Board of the MIA; and 5) not have served as an engagement partner for a continuous period of more than five years with a banking institution. An auditor who has been rotated off the audit of a banking institution may resume the role as engagement partner only after a lapse of five years from the last audit engagement with the institution.

The terms of audit engagement must also be carefully reviewed by the board of directors of the banking institutions prior to the conformation of engagement. All the agreed term must be documented in a clearly written audit engagement letter. Some of the expectations by bank towards the terms of audit engagements are to clearly address the objective of the audit, scope of the audit engagement, agreement on the audit plan, responsibilities of the engagement and concurring partners, reports to be prepared by the auditor, timing and fees, the use of experts in certain aspects of the audit and other significant arrangements in relation to the audit, including responsibilities of the auditor with regards to any change to members of the engagement team during the audit. For recurring audits, the existing terms of the audit engagement must be confirmed for each reporting period and appropriate modifications made as necessary to reflect any material changes in the banking institution or existing audit arrangements.

It has been stated in section 40(1) of BAFIA that banking institutions shall submit an application to the Bank for approval to appoint an external auditor for each financial year no later than two (2) months before the banking institution's annual general meeting of the preceding financial year. An application to the Bank Negara Malaysia shall be made using a specified form, together with the complete information required therein. The application should be addressed to Director of Financial Conglomerates Supervision Department or Director of Banking Supervision Department as applicable. An application shall not be submitted to the Bank unless the board is reasonably satisfied that the requirements and expectations of the Banking Act have been met.

If during the course of an audit, the auditor no longer fulfils or may not be able to fulfill any of the qualifying criteria or terms of the audit engagement as provided in the Banking Act, the banking institution shall immediately report that fact to the Bank Negara Malaysia.

Mandatory auditors' rotation, audit quality and auditor independence

Mandatory rotation of external auditors and audit quality:

The relationship between a long auditor-client relationship and audit quality is greatly determined by economic, political and social factors. Some empirical studies conclude that audit quality is greatly related to the risk that an auditor may fail to qualify opinion on financial statements that are materially misstated (Cameran et al, 2003; Li, 2007).

According to Cameran *et al*. (2003), the quality of audit work can be evaluated using factors such as: (i) performance determinants, which relate to the ability of auditors (based on both knowledge and experience), professional conduct, a general behaviors (including ethical constraints), and judgment; (ii) economic incentives; and (iii) audit market structure. The impact of mandatory rotation of auditors on performance determinants, economic incentives and audit market is an issue debated by scholars and regulators on merits and demerits of audit rotation.

Li (2007) defines audit quality as the market-assessed joint probability that an auditor will discover a breach or non-compliance in a client's accounting system. This probability depends upon the broad concept of an auditor's professional conduct which includes factors such as objectivity, due professional care and avoidance of conflict of interest.

All the interviewees (the two managers and the auditor) are proponents auditor rotation, as they consider rotation as a way to improve audit quality since, according to them, familiarity with the client has the effect of reducing the fresh point of view that auditors have in the first few years of audit. However, opponents of mandatory rotation, like Takiah and Ghazali (1993), have argued that the benefit of audit rotation is largely unproven and that the benefit cannot balance it costs and risks.

Mandatory rotation of external auditors and audit independence

The independence of an auditor is difficult to state. Independence implies independence in fact and in appearance. Independence in fact (IIF) implies that the expressed opinion has not been affected by factors that can compromise integrity, professional skepticism and objectivity of judgment. Independence in appearance (IIA) is what a reasonable and informed third party perceives to be independent after considering all the factors that can threaten the objectivity of the auditor.

The relationship between independence and rotation of external auditors can be interpreted differently. A long term auditor-client relationship is considered by the respondents/interviewees as the main element that could impair independence and objectivity. The generally agreed that long term tenure can reduce the incentive for the auditor to carry out his duties with professional independence. In this way, the auditor's and the client's point of view tend to converge, so the auditor's examination of the accounts might be biased.

Table 1. Year of Engagement between Audit Firm and Malaysian Leading Banking Institutions

Banking Institution	External Auditor	Period of Engagement	Comment
Maybank Berhad	Ernst & Young	2002-2011	
CIMB Berhad	Pricewaterhouse Coopers	2002-2011	
Bank Islam Malaysia Berhad	Hanafiah KPMG Desa Megat Co.	2002 2003-2011	
RHB Bank Berhad	Pricewaterhouse Coopers	2004-2011	Could not find information on the years **2002-2003**
Affin Bank Berhad	Pricewaterhouse Coopers	2005-2011	Could not find information on the years **2002-2004**

Source: ***Field survey, 2012***

Table 1 shows the results of the survey conducted by the researchers in order to find out the period of engagement among Malaysian leading banking institutions and their appointed auditors. The table shows that the five leading banking institutions in Malaysia engage only three of the Big- 4 accounting firms as their auditors with Pricewaterhouse Coopers enjoying the patronages of three of them (CIMB Berhad, RHB Bank Berhad and Affin Bank Berhad). It is clear from the table that Small and Medium-sized Accounting Firms (SMAF) are not considered for the audit of Malaysian leading banking institutions. This must be due to SMAFs' inability to meet the criteria specified in BAFIA, section 40 (40) (a) and section 40 (6) as discussed in 4.1 above.

Another important thing to note is that all the Big4 audit firms have been engaged for a period beyond five years, which is against one of provisions of Section 40(6) of BAFIA. They might have probably opted for payment of penalty for violation as a cheaper alternative to compliance!

Figure 2: Trends of Rotating of Auditors in Malaysian Banking Institutions

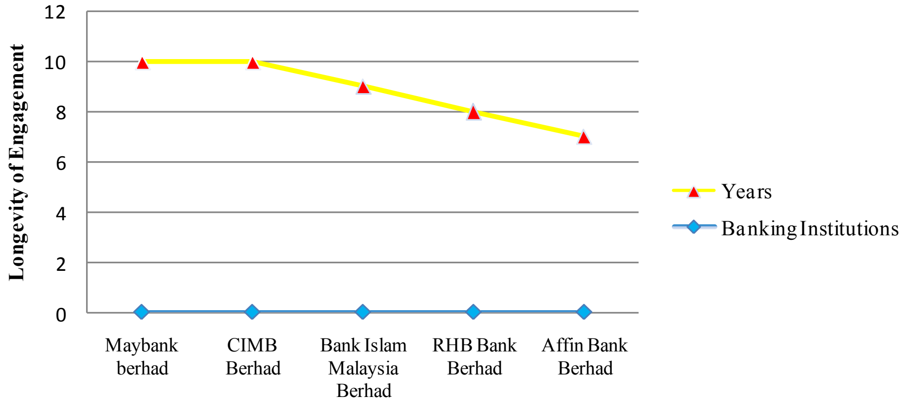

Figure 2 is developed using the results obtained from the financial statements of the sampled banking institutions so as to show the trend of rotation of auditors (or lack of it) by the banking institutions in Malaysia. It is clear, from the figure, that Malaysian banking institutions do not significantly change their auditors in line with the provision of section 40 (6) of BAFIA. None of the five leading banks has rotated its auditors in the last seven years, suggesting that there is a very good working relationship between the auditors and the clients. They prefer to pay penalty for non-compliance with the relevant provisions of the Banking Act that demand some degree of auditor rotation; even the rotation of engagement partners is not emphasized by the auditors (accounting firms) and the Banking institutions do not insist on that to be done as a condition for re -appointment.

The Effects of Auditor Rotation

Positive effects

As defined by Rajendra and Andrea (2012), the perceived advantages to mandatory rotation of audit or switching audit firms largely center on increased audit quality. The interviewees in this study posit that tenure limits (of the audit firms or even the engagement partners) would help to eliminate some of the 'chumminess' that may exist between audit firms and clients, thereby promoting increased independence, skepticism and objectivity. There are often situations where auditors may want to maintain the relationship and make it continuous as opposed to performing "excellent audit" work. Even when an accounting firm knows that its audit relationship is nearing its end (as the tenured appointment is limited to some years), its main concern would be to conduct the audit effectively and efficiently rather than impressing the client to get hired next year for the audit.

According to the interviewees, investors are also potential beneficiaries of this mandatory tenure limitation issue. Investors have been adversely affected by audit failures, some of which have arguably resulted from a lack of auditor skepticism/

criticism. The proposal of external auditors' rotation seeks to enhance auditor independence and audit quality, which could serve to increase investors' confidence in the audit process and the audit profession.

Fraud detection, while not the express purpose of an audit, may also be more likely with a change in audit firms in the sense that successor auditors may not be as easily dissuaded from questioning long-standing practices. For fraudsters, it is all about the opportunity to establish and maintain a trusted relationship with the auditors; fraudsters need the auditors to trust them in order to get the auditor's signature on the audit report.

Negative effects

The interviewees are in agreement that there are perceived disadvantages to mandatory rotation of audit firms. It is apparent that tenure limits could result in the loss of major clients and sources of revenue for accounting/audit firms. Also, the specialized nature of certain industries often necessitates that companies engage audit firms, which have staff with the appropriate level of industry expertise, but audit firm tenure limits may preclude companies from selecting audit firms; thus, the company's audit committee may have to relinquish its role in the vetting and selection of the accounting/audit firm, thereby diluting the committee's impact.

In order to perform quality audit, auditors have to understand their clients' businesses. This process requires time and resources on the part of both the audit firm and the client. Further, the time it takes to understand a new client may in fact increase the risk of audit failure in the first few years of an audit.

The increased need for, and costs associated with, communication between the successor and predecessor audit firms also has to be considered, given that the process of rotation would demand high level show of professional courtesy and due respect among the two accounting firms, with the client at the centre.

Meanwhile, rotation of auditors might also add to the risk of increasing audit costs, especially during a period of economic hardship and heightened global competition for the following reasons: (i) reporting entities would likely need to devote more time to helping the new auditor to learn about their business and accounting and internal control systems; (ii) as auditors are frequently rotated, there is the risk of increasing fraud since at the early years of appointment the auditors might not be able to detect fraud that might be perpetrated by the corrupt management, thereby necessitating fraud investigation that might cost a lot.

From the above, it is clear that mandatory audit firm rotation is likely to increase cost burden on the reporting entities without any demonstrable evidence that the rotation would amount to achieving the objective of enhancing audit quality. In fact, it is possible that audit rotation could cause audit quality to decline. The reason is that, with a change in audit firm, there is an inevitable loss of knowledge of the client and its operations. Similar negative effects on audit quality could also result from any structural change that would cause splitting of audit and non-audit service (Stringer, 2012).

Conclusion And Recommendation

Conclusion

Based on the review of related literature, analysis and interpretation of the results obtained and general observations, the following are the major conclusions of this study:

1. Appointment of external auditors by Malaysian banking institutions is done in accordance with the provisions of relevant sections of BAFIA 1989 as regards to qualification, duties, tenure and remuneration of auditors. The Malaysian banking institutions do not violate requirements for appointment and reappointment of auditors.
2. External auditors (accounting firms) observe strictly the rule for mandatory rotation of audit partners that serve as engagement partners among the senior partners in their firms; that there is no law/rule on rotation of accounting/audit firms by banking institutions in the country, and that the issues surrounding the enforcement of mandatory auditors' rotation are often focusing on the effects of such mandatory rotation and on violation of any law demanding it.
3. The study shows that Malaysian banking institutions do not frequently change auditors, which suggests that there is a very good working relationship between the auditors and the banks. It also suggests that banks are not basing their decision on auditor switching or lack of it on the size or resources of the appointed auditors, but on the good working relationship existing between the two parties (auditor and client).

Recommendations

Based on the conclusions/findings of the study, the following recommendations are hereby made:

1. Since the potential benefits of auditor rotation are achievable through mandatory engagement partners' rotation, there is no need for continuous agitation on it, especially as it is not covered in BAFIA or any other law of the land. The directors, managers and auditors of banking institutions in Malaysia should be committed to the ethics of their professions and engagements in doing the right things, as audit firms are appointed over and over again by their client banking institutions in the country.
2. The authors should justify the continuous reappointments they enjoy by ensuring high quality audit work at relatively lower cost to the client, ensuring that all elements of fraud and irregularities are dealt with, and ensuring that the client banking institution enjoys technical financial advice that would take it to the next level of financial and non-financial performance.

3. The agency relationships between the auditor and the client (shareholders) and the relationship that exists between the audit committee (the overseer of audit quality) and BODs (the protectors of shareholders' interest) should be strengthened in the Malaysian banking institutions to ensure that the independence of auditor is protected as high quality audit is performed, no matter the length of time the reappointment would take.

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