Study supports shareholder vote on auditors

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[1]New research lends weight to calls for shareholders to have more say in a company's choice of an auditor.

Companies that give shareholders a choice have fewer serious restatements that hurt stock prices, though their audit fees are also higher, the new study found.

Auditor selection has become a hot-button issue [2]. Regulators are considering ways to make auditors more independent of companies and skeptical when checking their financial statements.

Independence has been a thorny issue because of an inherent conflict in the auditors' business model: they are supposed to be looking out for investors' interests by vouching for the accuracy of companies' books, but they are paid by the companies whose numbers they check.

Giving shareholders a vote on the auditor may be one way of making the auditor more accountable to investors, according to the researchers, Kannan Raghunandan and Dasartha Rama at Florida International University and Mai Dao of the University of Toledo:

> When there is shareholder involvement in auditor selection, the investors become monitors of the auditor's work. Such an arrangement makes the auditor more a direct agent of the shareholder than of the board of directors and/or management.

Shareholder votes on auditors became a contentious issue in recent months as labor unions pushed for a say on whether companies should "rotate," or switch auditors after a certain number of years.

Unions have been trying to get auditor rotation put to a shareholder vote at Alcoa, Deere & Co, Walt Disney and other companies, though the Securities and Exchange Commission has ruled that auditor selection is "ordinary business" that does not have to be put to a shareholder vote.

Though it is not required, most companies have opted to let shareholders ratify their auditor each year. Those that have shareholder ratification tend to be larger companies with a Big Four audit firm, and auditors usually get overwhelming shareholder approval.

But coming up short — even getting 90 percent approval versus the expected 98 or 99 percent — can lead board audit committees to start asking questions and put auditors on the spot, the researchers said.

Shareholder votes add another "pressure to perform" on auditors, likely encouraging them to spend extra effort on the audit, according to the study, appearing in the January/February issue of the American Accounting Association's Accounting Review.

The findings came from a study of audits for the year 2006 of 1,382 U.S. companies and their financial restatements over the next three years. About 3.5 percent of companies that had shareholder votes on their auditors had serious restatements affecting their share price, versus 6.1 percent for companies without shareholder votes on auditors, the researchers found.

The additional effort, however, showed up in audit fees, which were about 9 percent higher at firms that had shareholder votes on auditors, they found.
