

Auditor Switching during the Term : Client Acceptance Decisions of the Big 3 in Japan

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Abstract

This paper presents a critical case study, which shows facts that differ from the commonly accepted theory. In Japan, big accounting firms are highly unlikely to accept new auditing engagements with companies that switch auditors during the term, which imply that the switch took place without approval at the annual shareholders' meeting and led to the appointment of a temporary auditor. Indeed, out of the 82 auditor switches occurred in Japan during 2008-2012, there is the only one case in which a switch was made from one Big 3 firm to another. This is the case of BICCAMERA INC. (BIC) in 2009. This study investigates the factors that the successor auditor considered when accepting BIC as a client from the perspective of audit fees and industrial specialization. By examining external data, this study suggests that big accounting firms' behavior in relation to accepting clients is not always risk averse.

Key words : auditing engagements ; client acceptance ; big accounting firm ; case study

I Introduction

This paper presents a critical case study that enables logical deductions to be made on the falsification of a theory (Flyvbjerg, 2001). Case study is the study method for producing systematic knowledge about a subject of research (Stake, 2000). Flyvbjerg (2001) identified four types of cases : extreme or deviant cases, maximum variation cases, critical cases, and paradigmatic cases. Extreme or deviant cases are chosen to learn from unusual (but often important) events or situations. Maximum variation cases are chosen to learn about one phenomenon while enabling variation of other, potentially moderating, variables. Critical cases

are selected to enable logical deductions about the falsification of a theory. Paradigmatic cases are selected to establish a new perspective or theoretical understanding (Sawabe, 2013). There is the strategic importance relating to the commonly accepted issues and/or theories in good critical case studies. Specifically, a theory may be disproved in all cases if only a certain case is disproving to a theory. However, it is absolutely essential to consider what is “critical” when raising provocative issues. When the judge is based on the theory, critical case study would have a goal of verification and improvement of the existing theory and/or building a new theory (King, Keohane, and Verba 1994¹; George and Bennett, 2005).

According to prior research, auditors tend to be sensitive to risk and avoid it in a number of ways; this tendency is particularly noticeable among big accounting firms. Therefore, a big accounting firm is highly unlikely to accept new auditing engagements with companies that switch auditors during the term, thus implying that such a switch occurs without approval at the annual shareholders’ meeting and leads to the appointment of a temporary auditor. Indeed, out of the 82 auditor switches that occurred in Japan during 2008-2012, only one case exists in which a switch was made from one Big 3² firm to another. This case involved BICCAMERA INC. (BIC), which switched auditors in 2009.

BIC switched auditors because of its adjustments to income made during the past fiscal years. This adjustment was caused by the use of improper accounting procedures for real estate securitization and led to the resignation of KPMG AZSA LLC (AZSA). Deloitte Touche Tohmatsu LLC (DTTL) assumed the role of BIC’s successor auditor on February 26, 2009.

The research design of this study is based on Yin, 1994 and its main purpose is to objectively infer from external data the factors that DTTL accepted to become BIC’s successor auditor. This study examines whether big accounting firms always exhibit risk aversion when deciding on whether to accept new clients. The findings also have implications related to the behavior of big accounting firms.

The remainder of the paper is organized as follows. Section II outlines the improper accounting procedures employed by BIC and presents background information on the auditor switching process. Through a review of the literature, Section III introduces the risk-averse

1 This type of case study indicates the limitations of existing theories and new logical issues (Cooper and Morgan, 2008).

2 Three large accounting firms, called the Big 3, operate in Japan: Deloitte Touche Tohmatsu LLC (DTTL), KPMG AZSA LLC (AZSA), and Ernst & Young ShinNihon LLC (EYSN). PricewaterhouseCoopers (PwC), one of global Big 4 accounting firms, provides affiliate assurance services with no large accounting firm. PwC had an affiliation with ChuoAoyama Audit Corporation until 2006; however, ChuoAoyama was subject to a suspension of the provision of auditing services for two months because of the accounting fraud related to Kanebo (a cosmetics company in Japan). In 2015, PwC’s affiliates in Japan are expected to include the mid-sized accounting firms of PricewaterhouseCoopers Arata and PricewaterhouseCoopers Kyoto.

behavior of large accounting firms in new auditing engagements. Sections IV and V provide a counterexample to such a theory. Section VI presents the conclusions, contributions, and limitations of this study.

II Background

II.1 Critical Case Study in Auditing

Pentland (1993) is often regarded as one of the pioneer of research cases that focus more on the way an audit, which might be an example of a paradigmatic case. He studied the activities of two audit teams in an effort to better understand how auditors become comfortable with the numbers in financial statements and the representations provided by management, by joining the audit team for 5 days each audit contract and collecting over 200 pages of documents. He concluded that the comfort created in the micro-interactions of audit team members leads to comfort in the audit opinion, comfort in securities documents, and comfort by capital market participants and society in the financial statements. After Pentland(1993), there are some studies as representative examples of critical case study in auditing : Covaleski, Dirsmith, Heian and Samuel (1998) ; Gendron (2001) ; Robson, Khalifa, and Jones (2007) ; Spence and Carter (2014) ; Westermann, Cohen, and Trompeter (2014).

³ Covaleski, Dirsmith, Heian and Samuel (1998) is an ethnographic field study³ in Big Six audit firms, where management by objectives and mentoring are used as techniques of control, examines how organizations transform professionals into disciplined and self-disciplining organizational members whose work goals, language, and lifestyle come to reflect the imperatives of the organization. They show that the scope and effect of these techniques shaped the identities of organizational participants but that the discourse of professional autonomy fueled resistance to these pressures toward conformity. Gendron (2001) examines how auditors actually make the client-acceptance decision in the midst of these forces, by a field study at three Big Six audit firms in Canada. The results show that in all firms the client-acceptance decision process in action is largely flexible, being characterized by a high degree of informal communication and the adaptation of the client-acceptance written policies and decision aids to circumstances. This result conflicts with the concerns that North American regulators have recently expressed about auditors' professionalism.

The primary purpose of Robson, Khalifa, and Jones (2007) is to critically scrutinize the

3 In this paper, the words "field study," "field work," and "field research" are included in a case study in general meaning.

claim that Business Risk Audit (BRA) methodologies have been promoted by a number of the large audit firms in response to the challenges of the information age and corporate clients' needs for assurance. They adopted a pre-dominantly qualitative approach: they built their research based on an analysis of discourses within a range of archival evidence, as well as examination of the major firms' publications, brochures, websites, and documentary material, then interviewed to partners and senior managers from various sized audit firms in Manchester and in London. They argue for a theory of audit change that recognizes (i) the centrality of legitimization processes and (ii) the co-construction of audit technology and the audit field. Spence and Carter (2014) interviewed to 31 accountants in the United Kingdom, Canada, and Ireland, to analyze the ways in which partners and other senior accountants embody institutional logics into their *habitus*. They respond to critics of Bourdieu's notion of *habitus*, highlighting how *habitus* does not merely denote the passive internalization of external structures, but is also capable of disembodying constraining institutional logics, thereby highlighting scope for professional self-determination.

Westermann, Cohen, and Trompeter (2014) examined responses from 77 auditors of varying experience to gain insight into individual, firm, and regulatory sources of accountability and their perceived effects on auditor skepticism. They also conduct six interviews with respondents to explore the issues in depth. Results indicate that professionals believe PS is a necessary but not sufficient condition for being an effective auditor. Their data suggests that sources of accountability that can be traced to an individual more strongly promote auditor skepticism. Conversely, time budget pressure and excessive documentation may attenuate an auditor's professional skepticism.

Turning to the prior research in Japan, the methodology of case study in financial accounting and auditing is not mainstream but is quite a minority.⁴ The main focuses on the case studies in auditing in Japan often be considering auditing practice and/or analyzing precedents.⁵

II.2 Outline of the Fraud

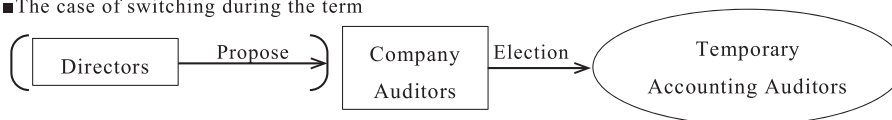
On February 20, 2009, BIC adjusted its income from the past fiscal years in relation to the August 2002 accounting process used for real estate securitization and for the addition of a consolidated subsidiary. Six days later, AZSA resigned as BIC's auditor during the term and

4 According to Ogawa (2013), only 73 papers are case study (3.10%) among 2,353 papers on Japanese Journal "Accounting" in 31 years.

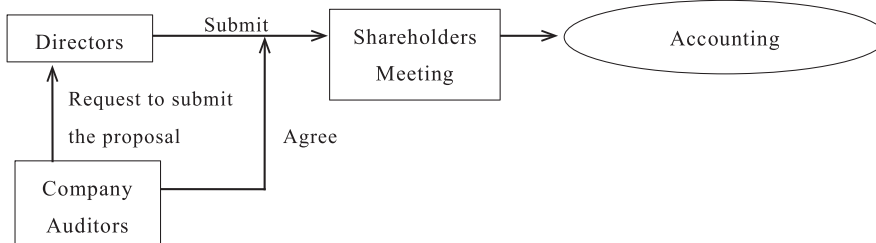
5 Harada, Y., I. Yoshioka, and M. Matsuwaki (2006); Yoshimi (2008), (2013); Nishiwaki (2009); Kato (2010); Kimura (2013).

Figure 1 The election process for accounting auditors and temporary accounting auditors (except for companies with committees)

■The case of switching during the term



■The case of switching at the end of the term



DTTL assumed the position of temporary auditor.

In Japan, the company auditor (or the board of company auditors) elects a person to temporarily perform the duties of an accounting auditor (Companies Act Article 346 (4), (6)) in the following scenarios: no accounting auditors are in an office, a vacancy exists that results in a shortfall in the number of accounting auditors prescribed in the articles of incorporation, or an accounting auditor is not elected without delay. Figure 1 indicates the election process for accounting auditors.

The phrase “an accounting auditor is not elected without delay” refers to the dismissal or resignation of auditors during the term. However, “an accounting auditor’s term of office shall continue until the conclusion of the annual shareholders meeting for the last business year which ends within one year from the time of their election” (Companies Act Article 338 (1)). Further, “unless otherwise resolved at the annual shareholders meeting under the preceding paragraph, accounting auditors shall be deemed to have been re-elected at such annual shareholders meeting (Companies Act Article 338 (2)).” Therefore, under ordinary circumstances, auditor switching during the term does not occur frequently.

The problems that caused the switch in auditors during the term began with the securitization of BIC’s real estate. First, BIC transferred its real estate securities into a bank trust and then acquired a stake in this bank. Then, BIC sold its stake to Miyama Management Limited Company for 29 billion yen. At that time, Miyama Management received 1,450 and 7,550 million yen from BIC and Toyoshima Kikaku Co., Ltd., respectively, to purchase its stake. Because neither BIC nor anyone closely affiliated with the company was initially thought to have any formal voting rights at Toyoshima Kikaku, the entity was not regarded as a subsidiary of BIC. Therefore, the accounting procedure for sales dealings was used when the

stake was transferred from BIC to Miyama Management. However, Toyoshima Kikaku should have been included in the range of consolidation because the investment in Toyoshima Kikaku was considered the same as that of the then-president of BIC taking over all of the company's outstanding stock. Consequently, BIC's payment ratio would have been approximately 31%, indicating that the transfer should not have been treated as sales dealings but rather as a financial transaction. The Tokyo Regional Taxation Bureau found that these facts indicated that income was being hidden and charged BIC with additional taxes on July 14, 2008.

BIC improved its accounting procedure after this imposition and published an announcement on December 25, 2008 on the adjustment of its income from past fiscal years. On January 16, 2009, BIC disclosed "The Quantitative Impact Associated with the Adjustment of Income from Past Fiscal Years" and was listed on the Kanri Post.⁶ On February 20, 2009, BIC corrected its financial reports from past years; however, despite these efforts, AZSA resigned as BIC's auditor and DTTL assumed the job of temporary auditor on February 26, 2009.

The hearings regarding BIC, which focused on the fact that "163,500 shares of stocks were sold for 12,337,710,000 yen through a Securities Registration Statement containing a false statement on important matters (based on the Fiscal 27 th Consolidated-Accounting Financial Report and the Fiscal 28 th Interim Consolidated-Accounting Semiannual Securities Report)" (Financial Services Agency, 2010 p.41), occurred four months later and BIC was ordered to pay a surcharge of 253,530,000 yen, which it paid on June 26, 2009.⁷

II.3 Client Context

Two types of auditor switches exist: dismissal and resignation. A client telling its auditor that it is switching auditors is a dismissal, whereas an auditor offering to leave is a resignation. In the case of BIC, auditor switching entailed the resignation of AZSA. The reason for the switch was explained as "the voluntary resignation of AZSA on February 26, 2009, due to the adjustment of income from past fiscal years" (BICCAMERA INC., 2009 a) in the extraordinary report and the timely disclosure document. Accordingly, this auditor switch was unlikely the case of so-called "opinion shopping."^{8, 9}

6 This special list of stocks is used to supervise trading in Japan. Most stocks on the Kanri Post undergo review for delisting.

7 For more information on the legal issues related to this case, see Yanaga, 2010.

8 Opinion shopping is defined as "shopping for an improved audit opinion from a new auditor" (Krishnan and Stephens, 1995 p. 179).

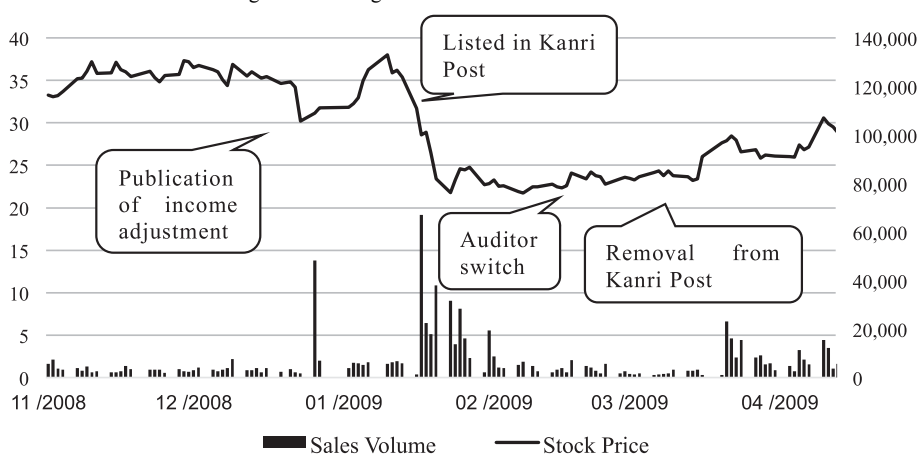
9 The problem related to opinion shopping is primarily caused by client-initiated auditor switching (Stefaniak *et al.*, 2009).

In addition, AZSA expressed an unqualified opinion in the adjusted financial report, and a “no additional opinion” in the paragraph “about the opinion of the accounting auditor that has left office” in the extraordinary report. Therefore, a disagreement between the client’s and the auditor’s opinions did not surface. If only these statements had been considered, AZSA would not have been required to resign. However, AZSA resigned “due to the adjustment of income from the past fiscal years” (BICCAMERA INC., 2009 a) and the concealment of some material facts related to securitization (Financial Services Agency, 2010), inferring that potential disagreements of opinion existed and significant damage to the trusting relationship occurred in these circumstances.

In contrast, BIC noted the company’s size and corporate governance as the reasons for its assignment of DTTL as its temporary auditor, declaring its intention to strengthen auditor cooperation (BICCAMERA INC., 2009 b). However, these reasons were not the major ones for why BIC specifically approached DTTL to be its temporary auditor because small accounting firms are also able to achieve the goals of strengthening cooperation or corporate governance. With regard to client size, second- or third-tier accounting firms are capable of conducting an audit. BIC’s sales were 604,804 million yen and its total assets were 235,924 million yen in the year before the switch (the term ending in August 2008); thus, both a Big 3 firm and a second-tier accounting firms could have audited a firm of this size. Indeed, the DTTL audit team included three partners, five Certified Public Accountants (CPAs), and twenty-six other staff members—not a particularly large audit team. However, the following point should be examined. February 2009, the month during which BIC switched its auditor, represents an introductory period for internal control auditing and many accounting firms are believed to be busy preparing for this auditing process. Therefore, BIC could have reached out only to big accounting firms because smaller firms did not have the capacity to take on new clients at that time.

Furthermore, a natural suggestion is that BIC engaged a Big 3 firm partially to send a signal to investors, except in cases in which the company did not provide any explanation. In fact, despite the tendency for stock prices to decrease on release of the information that auditors were switched during the term (Sakai, 2014), BIC’s stock price did not fall abruptly (shown in Figure 2).

Figure 2 Changes in Stock Price and Sales Volume



Note : The closing price divided by TOPIX (Tokyo Stock Price Index) is used as stock price.

Source : created by the author using Yahoo! Finance, 2014.

III Audit Engagement and Big Accounting Firm Behavior

Before considering the appointment of DTTL as BIC's successor auditor, prior research on the United States is reviewed. The manner in which risk in an audit engagement is managed by auditors is largely be divided into two approaches : (1) becoming selective when accepting new auditing engagements (Pratt and Stice, 1994) and (2) resigning from engagements in which significant business risk is perceived (Krishnan and Krishnan, 1997). With regard to the first type, Jones and Raghunandan, 1998 observed a significant reduction in the likelihood that Big 6 accounting firms audit higher-risk clients during a period of increasing litigation costs.¹⁰ Hsieh *et al.*, 2012 investigated clients audited by Big 4 accounting firms after SOX and found that the Big 4 are less likely to accept clients with higher risk, and that Deloitte (DT) is more conservative in client acceptance decisions than the other Big 4. In relation to the second approach, case studies such as Berton, 1995 and McDonald, 1997 suggested that big accounting firms drop risky clients to decrease their risk. In addition, empirical research suggested that auditor decisions to resign from engagements are consistent with auditor portfolio adjustments to lower risk (Krishnan and Krishnan, 1997).

The tendency for big accounting firms to be risk averse is also observed in Japan. The conclusion of an auditing contract is not only prescribed by Auditing Standards Committee

10 Several other studies exists that address client portfolio management by big accounting firms depending on litigation risk and reputation (Francis and Krishnan, 2002, Choi *et al.*, 2004, Read *et al.*, 2004, Hogan and Martin, 2009).

Statement (ASCS) 220, “Quality Control for an Audit of Financial Statements,” but also by the Standard to Address the Risks of Fraud in an Audit III.2, “Consideration of Risks of Fraud in the Acceptance and Continuation of Auditing Engagements,” which states the following : “The accounting firm shall establish policies and procedures for the acceptance and continuation of auditing engagements, which include the evaluation of risks relating to the acceptance and continuation of the auditing engagements considering the risk of fraud. The policies and procedures shall also require that the evaluation be reviewed by an appropriate department or person outside the engagement team. A review is required for the acceptance of all new engagements ; however, depending on the identified risks, a review is not necessarily required for the continuation of an engagement.” Therefore, accounting firms are wary of the risk of fraud in auditing engagements.

Moreover, big accounting firms have significant reputational risk and consider the cost of the defamation of their reputations from the disclosure of a scandal by one client as larger than that of terminating an audit engagement (DeAngelo, 1981, Sunder, 1997). Thus, Big 3 firms take risk-averse actions more frequently than other auditors.

According to prior research, auditors and big accounting firms in particular tend to be risk averse. Nevertheless, DTTL, one of the Big 3, was engaged as BIC’s successor auditor after its within-term switch even though the predecessor auditor resigned because of accounting fraud. The Fraud-Investigating Committee indicated that, “the former president was not differentiated from the corporation at BICCAMERA INC., and its group company. It could not be estimated that the appropriate corporate management based on commercial law (at that time) had been conducted in the corporate management of BICCAMERA INC. This securitization problem also proceeded only through meetings of high-level managers, advisors, and specialists, without an organizational response. It seems that both the understanding of the importance of accounting procedure and compliance consciousness were insufficient” (BICCAMERA INC., 2009 c pp.7-8). Therefore, BIC’s inherent risk and control risk were high and, given the existing theory that suggests that big accounting firms are risk averse, Big 3 firms are thought to be unwilling to accept auditing engagements in such a situation. Nevertheless, DTTL became BIC’s temporary auditor. The following sections examine the economic rationality for this event.

IV Discussion of Audit Fees

Auditors consider both audit fees and the client’s business risk and audit risk, and the

Table 1 Changes in Fees (millions of yen)

		2007	2008	2009	2010	2011
AZSA	Audit Fee	35	35	59		
	Non-Audit Fee	3	5	—		
DTTL	Audit Fee			70 (120)	75 (131)	70 (94)
	Non-Audit Fee			—	—	—

Note : AZSA was BIC's auditor until February 26, 2009, followed by DTTL in Fiscal 2009.

Note 2 : Total fee, including fee for consolidated subsidiaries, is shown in parentheses.

Source : created by the author using the financial reports of BICCAMERA INC.

auditor's business risk (Johnstone, 2000) when making client-acceptance decisions. The key point to consider in this case relates to the audit fees paid to the predecessor and successor auditors. Table 1 displays changes in auditing and non-audit fees.

In prior research, some studies discuss the issue of which auditor switching affects audit fees (Simon and Francis, 1988, Ettredge and Greenberg, 1990, Butterworth and Houghton, 1995, Deis and Giroux, 1996, Fearnley, 1998, Stefaniak *et al.*, 2009). Particularly in Japan, audit fees generally tend to fall after auditor switches (Machida, 2009). Nevertheless, BIC's audit fee increased abruptly and reached approximately 179 million yen in 2009, the year during which the within-term auditor switch occurred.

The factor that caused the audit fee to increase regardless of the switch is related to audit risk. Audit fees depend on audit time, which depends on client size, complexity, and the risk of a material misstatement. In this case, BIC's size and complexity did not change significantly before and after the auditor switch. Therefore, the incremental increase in the audit fee represents the exact imputation of risk to the fee. At a glance, this behavior of DTTL seemed to balance the risk of its client portfolio (Bell *et al.*, 2002, Johnstone and Bedard, 2003, 2004, Bedard *et al.*, 2008).

However, in 2009, 59 million yen out of a total 179 million yen as an audit fee was paid to the predecessor auditor AZSA, indicating that DTTL received 120 million yen as temporary auditor : 70 million yen for BIC and 50 million yen for the consolidated subsidiaries of BIC. AZSA's fee may have increased from 35 million yen to 59 million yen because of its audit of the adjustments to prior years' financial reports. Additionally, BIC's payment of 70 million yen to DTTL must include the same fee for its audit of the same adjustments to prior years' financial reports during its initial audit. In addition, 2009 marks the introductory period for internal control auditing, during which time audit fees generally increased by 1.5 times. Thus, BIC's fee was not much higher than the fee of other companies in the industry. Table 2 exhibits the audit fees of companies in the same industry as BIC before and after the start of internal control auditing.

Table 2 Comparison of Fees Before and After Internal Control Auditing Started (millions of yen)

		Before	After
BICCAMERA INC.	Audit Fee	35	70
	Non-Audit Fee	5	—
	Total	40	70
Joshin Denki Co., Ltd.	Audit Fee	25	42
	Non-Audit Fee	—	1
	Total	25	43
K's Holdings Corporation	Audit Fee	33	53
	Non-Audit Fee	1	—
	Total	34	53
YAMADA DENKI Co., LTD.	Audit Fee	39	63
	Non-Audit Fee	33	25
	Total	73	88

Note : The fees do not include fee for consolidated subsidiaries.

Note 2 : Auditor switching does not occur except for BIC.

Source : created by the author using the financial reports of BICCAMERA INC., Joshin Denki Co., Ltd., K's Holdings Corporation, and YAMADA DENKI Co., LTD.

This argument shows that BIC's audit fee for the first year is not assumed to be high enough to cover its risk. Therefore, the following scenario is drawn. In the case of BIC, for which the auditor switch occurred after the accounting fraud was revealed, DTTL accepted the new auditing engagement because the firm expected benefits that exceeded the risk, except for the audit fee.

V Discussion of Audit Market and Industrial Specialization

According to the previous discussion, judging that the audit fee did not cover all of the client risk is reasonable. Therefore, this section explores the rational reasons for DTTL to assume the temporary auditor position for BIC other than the audit fee. Tables 3 and 4 display the number of clients and shares classified by audit firms and industries (sub-classification and main classification) in 2009.

Tables 3 and 4 demonstrate that DTTL has a larger share of wholesale, retail trade, and services clients than other Big 3 firms, and has fewer clients in mining and real estate.

The absolute proof regarding whether auditors add a risk premium to audit fees for clients with industrial specialization cannot be found in prior research on both the United States and Japan (Claswell *et al.*, 1995 ; Carson, 2009 ; Fujiwara, 2013). This proof does not exist because, on the one hand, “auditors receive the reputation premium due to the influence of specialization upon reputation,” and, on the other hand, “the audit fee might be consequently reduced by performing of efficient audit” (Fujiwara, 2013 p.13). However, if the “auditor is

Table 3 Numbers of Clients of Accounting firms

Industry (sub-classification)	DTTL	AZSA	EYSN	Others	Joint Audit
Fishery, Agriculture & Forestry	2	2	4	2	0
Mining	1	2	4	1	0
Construction	37	46	64	56	2
Foods	42	23	40	36	1
Textiles & Apparel	14	19	16	19	1
Pulp & Paper	10	3	9	5	0
Chemicals	47	46	70	52	5
Pharmaceuticals	16	14	14	10	0
Oil & Coal Products	1	2	7	4	0
Rubber Products	2	4	8	6	0
Glass & Ceramics	21	18	13	12	4
Iron & Steel	9	16	16	15	0
Nonferrous Metals	11	6	18	5	0
Metal Products	29	17	17	35	2
Machinery	55	48	63	76	5
Electric Appliances	78	59	87	66	10
Transportation Equipment	21	25	30	29	1
Precision Instruments	16	12	10	11	2
Other Products	24	26	22	41	2
Electric Power & Gas	6	7	6	6	0
Land Transportation	11	20	26	8	0
Marine Transportation	2	2	11	3	0
Air Transportation	0	2	4	1	0
Warehousing & Harbor Transportation Services	7	14	15	10	1
Information & Communication	90	63	97	118	1
Wholesale Trade	104	75	87	105	2
Retail Trade	128	71	90	85	6
Banks	28	26	40	5	1
Securities & Commodity Futures	8	9	12	15	2
Insurance	3	3	2	5	0
Other Financial Business	15	10	10	12	1
Real Estate	20	27	41	42	1
Services	119	66	99	89	8
Total	977	783	1,052	985	58

Note 1 : DTTL : Deloitte Touche Tohmatsu LLC. ; AZSA : KPMG AZSA LLC. ; EYSN : Ernst & Young ShinNihon LLC

Note 2 : Areas shaded in gray represent the maximum values.

Table 4 Accounting firm Market Shares

Industry (main classification)	DTTL	AZSA	EYSN	Others	Joint Audit
Fishery, Agriculture & Forestry	20.0%	20.0%	40.0%	20.0%	0.0%
Mining	12.5%	25.0%	50.0%	12.5%	0.0%
Construction	18.0%	22.4%	31.2%	27.3%	1.0%
Manufacturing	24.3%	20.7%	27.0%	25.9%	2.0%
Electric Power & Gas	24.0%	28.0%	24.0%	24.0%	0.0%
Transportation, Information & Communication	21.7%	20.0%	30.2%	27.7%	0.4%
Trade	30.8%	19.4%	23.5%	25.2%	1.1%
Finance & Insurance	26.1%	23.2%	30.9%	17.9%	1.9%
Real Estate	15.3%	20.6%	31.3%	32.1%	0.8%
Services	31.2%	17.3%	26.0%	23.4%	2.1%
Total	25.3%	20.3%	27.3%	25.6%	1.5%

Note : Areas shaded in gray represent the maximum values.

able to select effective auditing procedures taking advantage of its knowledge and capability in such industries” (Fujiwara, 2013 p.13), for DTTL, being BIC’s temporary auditor was a good business opportunity to gain a large new client in an area in which it is strongest. Namely, DTTL took the position as temporary auditor despite the within-term switch caused by accounting fraud because the firm determined that the returns would surpass the risk.¹¹

However, another explanation is that Big 3 firms are risk averse given that BIC’s risk was not high enough to prevent accounting firms from engaging in an auditing contract despite the existence of accounting fraud, an alternative explanation to the hypothesis previously mentioned. Even if this explanation is true, little logical compatibility exists. Explaining not only the rationale for AZSA’s resignation but also the factors other than risk that caused the audit fee to increase abruptly is difficult. Consequently, this critical case study suggests that it enables logical deductions to be made regarding whether the related theory claiming that large auditing firms are risk averse may not always be applicable.

VI Summary and Conclusion

This study investigated the economic factors that DTTL considered in accepting BIC as a client from the perspectives of audit fees and industrial specialization, highlighting a rather unique case of a within-term auditor switch between Big 3 firms. By examining external data, the study suggests that DTTL’s behavior in relation to accepting clients is not always risk averse because the firm acquired new clients in industries in which it is strong despite the high risk of such clients and despite audit fees that failed to cover this risk. This result falsifies the existing theory that auditors, particularly big accounting firms, balance audit fees and risk when making a risk-averse decision on whether to accept clients.

This study contributes to developing the research in this area. First, although auditor switching has been discussed frequently in recent years, not enough case studies exist on auditor switching in Japan. In particular, most prior studies do not address auditor switching from the perspective of switches that occur during the term. However, this paper considered one of the most distinctive characteristics of auditor switching in Japan.¹² Second, a review of

11 In fact, BIC came back from being listed in the Kanri Post and was not subsequently delisted, although a discussion ensued over whether BIC was, or was not, delisted when DTTL assumed the temporary auditor role. Furthermore, DTTL was successful in obtaining new clients and became auditor for Kojima Co., Ltd., which subsequently became a consolidated subsidiary of BIC.

12 As shown in Section II, auditor switching is an action that requires a resolution at the annual shareholders’ meeting in Japan, whereas in the United States, a resolution at the meeting of the board of company auditors is required.

the implications for research on auditor behavior shows that this paper may assist in developing related research through this critical case study that presents facts that differ from the commonly accepted theory.

This paper is subject to a number of limitations. Although external data were used to gain objectivity, analyzing all of the details related to auditor switching using only external data is difficult. In addition, this study did not use an audit pricing model to verify audit fees and did not clarify the levels of audit fees considered reasonable and proper given the examined situation. Prior research has shown that audit pricing models are useful in the Japanese audit market (Yazawa, 2009). However, using a generalized valuation model is not suitable for auditor switching during the term caused by accounting fraud. Finally, this study does not investigate the ethical issues faced by auditors but rather investigates the economic rationality of the assumption that all auditors must ensure professional ethics. Future research should formulate and examine these issues.

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