

**The Client Acceptance and Retention Process: How Policies and Procedures Are Developed
and Implemented Within Audit Firms**

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ABSTRACT

When developing client acceptance and retention policies and procedures, an audit firm's policy-makers are required to adhere to quality control and auditing standards established by the Public Company Accounting Oversight Board (PCAOB) and American Institute of Certified Public Accountants (AICPA) that are not well defined. As a result, the policies and procedures across firms may differ significantly. These differences arise from the development as well as the implementation of client acceptance and retention policies when evaluating prospective and continuing clients. My research study examines these differences in client acceptance and retention policies and procedures and also investigates the potential differences in policies and procedures across firms of different sizes (international, national, and regional). Using a qualitative setting, I interview risk management and local office partners across multiple firms to gather firm-specific and partner-specific information about client acceptance and retention policies and procedures. My results contribute to the existing literature on the processes and procedures developed by audit firms to assess and evaluate risks that may arise from prospective and/or continuing clients.

GENERAL AUDIENCE ABSTRACT

Auditing standards provide requirements and recommendations for audit firms to follow when performing financial statement audits. These auditing standards also include both required and recommended procedures related to an audit firm's decision to accept new clients and retain existing clients. Using a qualitative research methodology, I interview audit partners from five audit firms who are responsible for helping establish the firm-specific policies and procedures around client acceptance and client retention processes. I also interview partners from the same five audit firms who are responsible for performing those procedures when deciding whether to accept a prospective client or keep an existing client. I find that there are differences between the two partner groups as to the importance of certain client acceptance and client retention procedures. I also find that there are differences among the firms as well as the individual partners within each firm as to which procedures are key considerations in the client acceptance and retention processes.

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CHAPTER ONE

INTRODUCTION

1.1 Introduction

Managing audit risk is a primary concern for auditors, but audit risk is a complex issue with multiple facets embedded within it. Audit risk changes based on different factors such as industry, economic conditions, and regulatory requirements. However, audit risk also varies by individual audit client. Factors that are higher risk for one audit client may result in a lower risk assessment for a different client, and because of the judgment involved, two auditors may come to different risk assessment conclusions about the same client. The complexity of the risk assessment process requires audit firms to create their policies and procedures to be responsive to audit risk across different considerations, such as industry-specific and client-specific issues that can vary among each of the firm's individual clients. Firms adapt these policies and procedures based on the requirements and recommendations from the auditing standards issued by the Public Company Accounting Oversight Board (PCAOB) and American Institute of Certified Public Accountants (AICPA), as well as the firm's past experience with the risk assessment process (e.g., results of inspections by regulators or peer reviewers) and consideration of firm-specific and client-specific factors. However, extant research generally focuses on the final decisions made by auditors (e.g., Hsieh and Lin 2016; Asare et al. 2005; Chang and Hwang 2003), rather than the processes and procedures used to make those decisions. Audit literature needs to address how firms assess audit risk, not just the results of those risk assessments, especially related to considerations that can vary among individual clients.

Information specific to individual clients is at the center of the audit risk assessment process. Managing audit risk is not only contingent on an auditor's actions (AICPA 2016a;

PCAOB 2010a), but it is also affected by attributes of the audit client, including management's integrity (AICPA 2016b; PCAOB 2003a). Thus, the evaluation of whether or not to accept or retain a client is an important determinant of audit risk. As the first line of defense for an audit firm's assessment of client risk (Bedard et al. 2008; Asare et al. 2005; Beaulieu 2001; Johnstone and Bedard 2001; Johnstone 2000), the client acceptance and retention¹ decision-making processes impact the auditor's overall audit risk assessment. Considering the significance of these processes, it is important to address the following research question: How do audit firms develop and implement the policies and procedures related to client acceptance and retention?

These policies and procedures are important because of the uncertainties auditors face when making client acceptance and retention assessments². Auditors are limited in the amount of information they can obtain about a company, its management, and its Board, primarily due to time constraints and/or management's willingness to share extensive and/or detailed information about the company. This limitation is especially apparent in the client acceptance process (Johnstone and Bedard 2004). In most cases, an auditor must gather enough information to make the acceptance decision relatively quickly, sometimes with limited interaction with a prospective client. Moreover, while there is additional information available based on prior work experience with a client, the retention decision in subsequent years does not always include a comprehensive

¹ Audit firms use different terminology to refer to the process of whether or not to continue the existing client-auditor relationship for a subsequent audit cycle, including continuance, reacceptance, and retention. For purposes of clarity and simplicity, I use only the term "retention" to refer to this process.

² Throughout this paper, client acceptance and retention are generally discussed together as a single process. Through informal discussions with partners at various firms, firms view client acceptance and retention as separate processes but have many similarities. In general, both processes are designed to assess overall risk related to accepting or continuing an audit engagement with the client. The primary differences between the processes include certain acceptance-specific procedures, such as background searches of the company and key personnel, and retention-specific procedures, such as evaluation of information obtained during the prior year audit. Prior research has considered the processes both separately (e.g., Hsieh and Lin 2016; Hatfield et al. 2008; Ayers and Kaplan 2003; Johnstone 2000) and combined (e.g., Johnstone and Bedard 2004; Bell et al. 2002; Winograd et al. 2000). The discussion throughout this paper focuses on the general processes that are similar between the two processes. However, the interview protocols are designed to discuss the client acceptance and retention procedures and policies separately, in the event that differences exist between a firm's client acceptance and retention processes.

picture of the client, as the auditor generally focuses on matters that are material to the client's financial statements, rather than all aspects of that client. Therefore, auditors must find ways to gather additional reliable and relevant information to assess potential risks before deciding whether to accept or retain a client. In order to understand how auditors perform this risk assessment evaluation, it is necessary to understand the specific procedures involved in the client acceptance and retention processes.

The issuance of standards by the AICPA and the PCAOB specific to client acceptance and retention indicates the significance of this aspect of a firm's policies and procedures. "A firm's client acceptance and continuance policies represent a key element in mitigating litigation and business risk" (AICPA 2015, paragraph 1.11). The auditor's decision to accept or not to accept a new client or retain an existing one is based on risk factors and criteria established by the firm, with limited guidance from the PCAOB and AICPA. The AICPA and PCAOB quality control standards establish minimum requirements for firms performing audits over privately held and publicly traded clients, respectively. In general, these quality control standards require firms to establish policies and procedures in various areas including acceptance and retention of clients (AICPA 2016b; PCAOB 2003a).

The PCAOB has noted quality control deficiencies arising from "client acceptance and continuance policies resulting in the acceptance or retention of audit clients that present unreasonable risks or for whose audit the firm is not sufficiently qualified" (Hanson 2015). Specifically, the PCAOB issued a sanction order against Deloitte & Touche LLP in 2007 citing concerns about the lead engagement partner's professional competencies and the high level of engagement risk (PCAOB 2007a). The PCAOB separately notes that deficiencies found in inspection results for smaller firms (those auditing 100 or fewer public issuers) arise from factors

including “ineffective client acceptance and continuance practices that fail to consider technical knowledge called for in particular audits” (PCAOB 2013, iii). Despite the existence of established quality control standards surrounding the client acceptance and retention process, these findings indicate that firms still struggle with making the appropriate acceptance and retention decisions. Part of this struggle is because firms often are unaware of deficiencies in audit decisions until a much later point in time when company failures occur or fraud is uncovered (Power 1997) or when PCAOB inspection reports are issued (Glover, Prawitt, and Taylor 2009). Additionally, existing research has been limited in its ability to identify the core issues and/or causes behind the PCAOB’s findings.

Therefore, research that examines how firms develop and implement policies and procedures related to client acceptance and retention is necessary. If client acceptance truly is a first line of defense for audit firms, it is important that policies and procedures address factors that create potential risks whenever the auditor has limited knowledge about the client. As auditors are able to learn more about the client through additional experience, it is important to understand how firms perform the client retention assessment in a fair and relatively unbiased way, considering the dismissal of a client results in lost revenue. Lastly, it is important to understand how local offices within international, national, and regional firms interpret and apply firm-wide policies and procedures when performing client acceptance and retention procedures to understand whether differences in these policies and procedures may be a function of firm size, client base, or other factors that are not related to differences in firm size.

These open research questions require an in-depth examination of firm-specific policies and procedures. This type of analysis is intended “to generate rich descriptions of processes,” necessitating the use of a qualitative research approach (Power and Gendron 2015, 151). I

conduct interviews of Risk Management partners and local office partners³ at international, national, and regional firms to examine my research questions. My analysis examines the firm-level development of required client acceptance and retention policies and procedures and the implementation of these policies and procedures by local practice office client service partners, including differences between these two groups within a firm. As part of this analysis, I also study differences between client acceptance and client retention practices within each firm. This aspect of my dissertation responds to Gendron's (2001) call to examine the relationship between a firm's established processes and the decision outcomes of client acceptance, as well as his subsequent call to examine client retention decisions, as "these decisions are often more difficult to make than client-acceptance decisions" (Gendron 2002, 682). I also investigate potential differences in client acceptance and retention policies and procedures across firms of different sizes (international, national, and regional). This investigation is important as it considers whether policy differences across firms are associated with firm size and/or client base or if these differences are firm-specific. This study also answers a call for additional research that examines how audit firms make portfolio management decisions, specifically related to prospective client screening procedures and client retention decisions (Johnstone and Bedard 2004).

³ The term "local office partner" represents a partner in a firm's practice office who is responsible for client service activities. This partner role also includes individuals who are responsible for recruiting new clients to the firm. For the purposes of this study, local office partners are partners who recommend prospective companies as new clients, although these partners may not be the engagement partner for the client upon acceptance, as well as partners who serve existing clients and are required to consider client retention on a regular basis (at least annually).

CHAPTER TWO

BACKGROUND AND LITERATURE REVIEW

2.1 Theory and Background

An auditor's decision whether or not to accept a new client or retain an existing one is based on risk factors and criteria set by the audit firm. As the firm's initial evaluation of client risk (Bedard et al. 2008; Asare et al. 2005; Beaulieu 2001; Johnstone and Bedard 2001; Johnstone 2000), the client acceptance and retention considerations are arguably two of the most important aspects of the overall audit risk assessment for a firm. Submitting a proposal to perform audit services does not solidify the auditor-client relationship, just as completing an audit in the prior year does not ensure the auditor-client relationship will continue into the future.

Both the auditor and client have the right to maintain or withdraw from the relationship, subject to certain contractual requirements (i.e., the audit engagement letter). Under certain situations, even with a signed engagement letter in place, auditing standards may require the auditor to consider withdrawing from an engagement due to issues such as significant scope limitations (AICPA 2016c; PCAOB 2007b) and the client's refusal to furnish a management representation letter (AICPA 2016d; PCAOB 2003b). Similarly, if the auditor identifies concerns about the client either during the initial acceptance process or prior to retention of the client, the auditor has the option to address these concerns by terminating (or never beginning) the auditor-client relationship. While this option provides a way to reduce audit risk (or eliminate it if the client is never accepted), it requires that the auditor remains vigilant during the client acceptance and retention processes.

2.2 Prior Research in Audit Client Acceptance and Retention

Archival audit research has focused on various aspects of client acceptance and retention. Partners with industry expertise are less likely to accept higher risk audit clients than firm-level industry specialists, most likely due to reputational concerns (Hsieh and Lin 2016). Audit partners with higher risk propensity (measured by past criminal convictions) are associated with riskier client portfolios than audit partners without past convictions (Amir et al. 2014). Client risk also influences client acceptance subsequent to an auditor's resignation. Non-Big 4 firms are more likely than Big 4 firms to accept clients who have been dismissed, with most of the non-Big 4 additions coming from Big 4 resignations (Catanach et al. 2011). For all of the dismissed clients, financial performance deteriorates over time subsequent to the predecessor auditor's resignation and this deterioration is greater for clients when non-Big 4 firms are the successor auditors (Catanach et al. 2011).

Experimental audit research also examines factors that can affect client acceptance. Johnstone (2000) utilizes an experimental setting with audit partners to build a risk assessment model related to client acceptance, finding that client acceptance decisions generally include both a risk evaluation phase and a risk adaptation phase. Johnstone (2000) also notes partners strive to avoid risk by focusing on both the prospective client's risk characteristics and the possible risk of loss to the firm in the risk adaptation phase. Partner risk review experience can impact these risk assessments, as partners with the responsibility for risk reviews within audit firms were more conservative in their acceptance judgments for a moderately risky prospective client than engagement partners without risk review experience (Ayers and Kaplan 1998). Risk review partners also do not seem to be affected by the initial engagement partner's assessment of the prospective client, as experimental research finds that the overall risk assessment of a

moderately risky prospective client is not impacted when the engagement partner provides an overly favorable assessment as opposed to an accurate assessment of the prospect (Ayers and Kaplan 2003).

Client acceptance decisions are also influenced by management integrity, as audit partners view prospective clients as introducing greater business risks to the firm when management integrity is low. Interestingly, the acceptance of these riskier clients was no more likely when there was a potential for the auditor to provide additional non-audit services (Asare et al. 2005). Additionally, when management integrity of newly acquired clients is deemed to be low, auditors respond with higher risk assessments which then lead to increases in planned evidence collection during the audit and higher audit fees (Beaulieu 2001). Similarly, when management's control environment and/or the corporate governance structure is strong for a prospective client, auditors were more likely to recommend acceptance (Cohen and Hanno 2000).

Field study research also examines certain aspects of client acceptance within firms. Bell et al. (2002) discuss the process used by KPMG to develop the firm's client acceptance and retention decision aid system, including the risk factors utilized within the automated system. Winograd et al. (2000) discuss the development of PwC's audit software, which includes a risk assessment tool for client acceptance and retention that uses complex algorithms to assess responses to risk-based questions in order to diminish biases that may exist in the decision-making process. Other qualitative research examines the outcomes of client acceptance decisions within firms. A field study of the prospective client bids (both successful and unsuccessful) for a single audit firm by Johnstone and Bedard (2001) finds that the firm is generally able to charge a premium for clients with fraud and/or risk factors identified in the client acceptance bid process,

but is not able to extract a similar premium for prospective clients with additional non-audit services. Johnstone and Bedard (2003) observe that client acceptance within the single firm under study is less likely when prospective clients have fraud risks, error risks, risk of going concern, and when the prospect is publicly traded. They also find that auditors manage client acceptance risk through the use of audit specialists to mitigate risks (i.e., fraud and/or error risks) and increased audit fees to mitigate client business risks (i.e., financial issues and public issuers) (Johnstone and Bedard 2003).

Gendron (2001) interviewed partners at three of the Big 6 firms in Canada and found that all three firms used a flexible process, rather than non-discretionary standards, when making difficult client acceptance decisions. Despite each firm's requirements, partners at all three firms relied on information gathered during the acceptance process and consultation with other partners rather than relying on just the firm's decision aid, and partners at one firm were more likely to ensure the prospective client would be accepted before entering information into the firm's acceptance decision aid (Gendron 2001). A second field study of three Canadian Big 6 firms finds that the organizational structure of the firm (i.e., professional or commercial) influences the reasoning of actions and, hence, influences the decision-making processes of the individual partners, including within the context of client acceptance (Gendron 2002).

Despite the expansive areas considered in the client acceptance literature, existing research typically focuses only on the final acceptance decision results (e.g., Hsieh and Lin 2016; Asare et al. 2005). While there is limited research that examines certain aspects of the processes used in client acceptance decision-making (Gendron 2002; Gendron 2001; Johnstone 2000), the existing literature generally does not address the specific requirements firms use to make acceptance decisions. Gendron's (2002, 2001) works provide insight into the actual approaches

used by audit firms based on the organizational structure of the firm, but only from the perspective of making difficult client acceptance decisions and is limited to partner decisions in three Canadian firms. The research question set forth in this study helps bridge the gap in the literature by examining individual aspects of client acceptance that both policy setters and prospective engagement partners view as most significant when making client acceptance decisions. The qualitative design employed is also an important aspect of this study, as qualitative studies are most beneficial when the research question focuses on phenomena that have multiple elements and/or when the research question addresses the specific features of a particular process (Cooper and Morgan 2008).

The need for a qualitative study on firm policies and procedures also extends into client retention. Archival literature has considered various aspects of client retention results, including research that considers the client's continuing relationship with an auditor subsequent to restatements. The literature reports that as the number of non-fraud restatements within an auditor's client portfolio increases, the likelihood of that auditor being dismissed by clients without restatements also increases, and this effect is greater when the restatement is more severe (Irani et al. 2015). These effects are more pronounced for non-Big 4 firms than for Big 4 firms (Hennes et al. 2014). From the audit firm decision-making perspective, an empirical analysis of engagement-related data obtained from a Big 6 firm reveals auditors are less likely to retain clients over a five-year period when initial realization rates are less than budgeted rates, indicating that fee pressure plays a role in client retention decisions (Hackenbrack and Hogan 2005).

Client retention is also a focus of experimental research, as behavioral researchers are generally able to examine specific aspects of the retention process that cannot be readily

examined by archival researchers due to data limitations. For example, Chang and Hwang (2003) manipulate client business risks and retention incentives and find that while auditors generally disallow aggressive reporting when a client's business risks are high, auditors allow aggressive reporting for moderate-risk clients when there are substantial incentives from the firm to retain the client. Retention risk also can influence the negotiation strategies used by auditors. Hatfield et al. (2008) find that when clients are going out to bid for the next year's audit, auditors are more likely to utilize reciprocity-based strategies when negotiating income-decreasing adjustments with clients, especially when the client's negotiation style is competitive. Consistent with these results, auditors believe that using concession-based approaches to client negotiations will help improve client satisfaction and the likelihood of retaining the client (Sanchez et al. 2007). Sanchez et al. (2007) also find that the CFO and controller participants in an experimental study are more likely to remain clients under a collaborative relationship with the auditor.

Audit research in client retention also includes field studies. As noted above, the studies by Bell et al. (2002) and Winograd et al. (2000) discuss the development of client retention decision-aid software. In a study of a single firm, Bedard and Johnstone (2004) find that auditors increase both planned audit hours and expected billing rates when continuing public clients are believed to have higher earnings manipulation risk. These increases are higher still when increased earnings manipulation risk is coupled with greater corporate governance risk (Bedard and Johnstone 2004). Similarly, Johnstone and Bedard (2004) examine a single firm's portfolio related to client acceptance, retention, and rejection decisions over a fiscal year period and find that audit risk declines between the beginning of the year and the end of the year for this firm's clients, as a result of the firm terminating higher risk clients and accepting new lower risk clients.

However, differences in billing rates do not appear to be a factor in client acceptance or retention decisions (Johnstone and Bedard 2004).

Similar to the gap in client acceptance literature, existing client retention research typically focuses only on the final retention decision (e.g., Hackenbrack and Hogan 2005; Chang and Hwang 2003) and generally does not address the specific requirements firms use to make retention decisions. For example, Johnstone and Bedard (2004) analyze the decline in audit risk over a one-year period related to a firm's acceptance and retention decisions, without examining the factors that contributed to those decisions. Additionally, the analysis is limited to only a single firm and has limited generalizability (Bedard et al. 2008). This same generalizability limitation exists for the other Johnstone and Bedard single-firm studies (Bedard and Johnstone 2004; Johnstone and Bedard 2004, 2003, 2001). My research study attempts to address the gap in audit literature by specifically focusing on the development and implementation of client retention policies and procedures. Qualitative research allows the researcher to "convert private knowledge... into publicly available knowledge" (Cooper and Morgan 2008, 160). Thus, the examination of specific policies and procedures related to client retention (and acceptance) will provide information about how firms approach these two particular processes and why specific aspects of the processes are important, which archival (i.e., answering "how much" questions) and experimental (i.e., answering "what" questions) are unable to address (Cooper and Morgan 2008).

In addition to the need for qualitative research that examines factors used in client acceptance and retention decisions, the age of many of the existing client acceptance and retention studies indicates a reexamination of these processes is necessary. Significant changes have occurred in the audit environment in the period subsequent to the prior archival,

experimental, and field studies. The collapse of Arthur Andersen, as a result of the fall of Enron, brought about reforms whereby audit partners have to consider new and different issues, such as limitations on non-audit services and considering areas where it may be possible for client management to exert significant influence over key audit decisions (e.g., possible independence issues or fee pressures) (U.S. House of Representatives 2002). Specifically, the Sarbanes-Oxley Act of 2002 (SOX) established the PCAOB to increase oversight of the audit profession. This oversight involves inspections of a firm's quality control systems, which include client acceptance and retention processes. SOX also included rules designed to limit the auditor-client relationship, as it disallowed auditors to provide certain non-audit services to audit clients. Although research on the impact of non-audit services on audit quality has been mixed, an experiment performed just prior to the passage of SOX finds that prospective clients with low integrity are less likely to be accepted as clients by audit partners, and this likelihood is not impacted by the potential for non-audit service revenues (Asare et al. 2005). The more stringent rules for non-audit service restrictions under SOX indicate these findings should continue in the post-SOX era. Alternatively, it could be argued that the increased SOX-based reporting requirements for a company's management and audit committee give the auditor more room to accept and/or retain clients that might previously be classified as higher risk, regardless of additional service revenue opportunities, because of the required management certification and audit requirements related to internal control over financial reporting (ICFR). Thus, these corporate governance and auditing regulation reforms result in a significantly different environment for audit decision-making than the environment found in the pre-SOX studies on client acceptance and retention.

Together with the effects of SOX and the PCAOB, changes in auditing standards subsequent to these studies have likely led to changes in practice. In 2006, the AICPA issued its Risk Assessment Standards, consisting of AICPA Statement on Auditing Standards (SAS) Nos. 104-111, which are now incorporated into various areas of the Clarified Statements on Auditing Standards. In 2010, the PCAOB issued its own Risk Assessment Standards (PCAOB 2010b), which have been reorganized within the codified General Auditing Standards. Both sets of Risk Assessment Standards include considerations that impact many areas of the audit, including client acceptance and retention. Both sets of risk standards require auditors to focus on risk assessments and possible audit responses throughout the audit. Thus, the partner opinions and perspectives in Gendron's (2002, 2001) interviews likely differ now, considering that firms must focus more heavily on risk rather than profitability when making client acceptance decisions or may rely more on the requirements found in forms and checklists to gather information relevant to the acceptance decision. Specifically, the PCAOB's new standards require auditors to consider any risks identified in the client acceptance and/or retention processes when performing risk assessment procedures (PCAOB 2010b), implying that the initial client acceptance/retention process itself is a key risk assessment procedure. Johnstone's (2000) client acceptance model includes stages for risk assessment and risk adaptation procedures; however, the requirements of the Risk Assessment Standards could change this model, including those procedures related to the initial risk assessment process and the strategies auditors use to address identified risks. As part of their field study on client acceptance, Johnstone and Bedard (2003) specifically analyzed auditor expertise and audit fees as ways audit firms increased the likelihood for accepting riskier clients. However, the new Risk Assessment Standards provide firms with additional considerations and assessments that could be performed related to identified risks, potentially

necessitating new procedures for risk assessments of prospective clients or allowing firms to accept riskier clients as long as the auditor can appropriately address the risks. It is important to consider of the impact of these Risk Assessment Standards on client acceptance and retention practices because audit partners have historically used a combination of audit risk, client business risk, and auditor business risk when making client acceptance decisions (Johnstone 2000). Newer guidance for how risks must be assessed and addressed within the audit process could have a significant impact on how firms analyze potential and continuing clients.

Lastly, although the work by Gendron (2002, 2001) provided significant insight into the client acceptance process for three major firms, it focused only on “difficult” client acceptance decisions. The client acceptance process is important for all new client decisions, and certainly situations exist where the acceptance decision was not deemed difficult, but subsequent interaction with the newly accepted client indicates some risk that was unforeseen at the time the initial acceptance decision was made. It is also important to consider the ongoing decision-making process around client retention decisions, which could be considered as a continuation of the original client acceptance decision based on new information learned during the prior year audit. Johnstone and Bedard (2003) examine both client acceptance and retention decisions, but their work is isolated to a single firm, thereby limiting the generalizability of the study. The research questions posed in this study are presented to address the current gap in audit research related to client acceptance and retention by using a field study to examine the acceptance and retention decision-making processes across several firms.

2.3 Current Client Acceptance and Retention Requirements in U.S. Auditing Standards

Despite the importance of client acceptance and retention decisions, U.S. auditing standards include only limited guidance. Client acceptance and retention falls under the quality

control standards for firms, although there is reference to these quality control standards in the auditing standards for both the AICPA (AU-C 220) and PCAOB (AS 1110) (AICPA 2016e; PCAOB 2003c). Both AU-C 220.03 and AS 1110.02 establish a similar requirement: that an audit firm must implement a quality control system with the appropriate procedures necessary to conduct an effective audit (AICPA 2016e; PCAOB 2003c).

Auditors of publicly traded companies must follow the quality control requirements found in the PCAOB's QC Section 20 while auditors of privately held companies must follow the quality control requirements from the AICPA's QC Section 10. Both of these quality control standards establish broad requirements for audit firms. For example, both the PCAOB and AICPA require CPA firms to establish a system of quality control to enable firms to comply with professional standards, although the policies and procedures established can vary based on factors such as firm size and services performed (AICPA 2016b; PCAOB 2003a). Specifically, the PCAOB's QC Section 20.04 states, "The nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of authority allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations" (PCAOB 2003a, paragraph 20.04). The AICPA has a similar consideration, found in QC Section 10.05: "The nature and extent of the policies and procedures developed by an individual firm to comply with this section will depend on various factors, such as the size and operating characteristics of the firm and whether it is part of a network" (AICPA 2016b, paragraph 10.05). Thus, the quality control standards themselves allow latitude in how quality control systems are developed and implemented across firms. However, the requirements under both the PCAOB's QC Section 20 and the AICPA's QC

Section 10 are very general and do not provide specific requirements that firms must follow as part of the client acceptance and retention processes. For example, the PCAOB's guidance requires only that a firm establish policies and procedures to determine whether a client should be accepted or retained, specifically considering management's integrity, the risks related to client acceptance and retention, and the firm's ability to perform the work in a competent manner (PCAOB 2003a).

The AICPA guidance is more extensive than that of the PCAOB. Similar to the PCAOB requirements, the AICPA requires a firm to consider the potential or existing client's integrity, as well as the ability of the firm to perform the required procedures (AICPA 2016b). However, the AICPA's QC Section 10 also requires the firm to consider some specific factors as part of the client acceptance and retention processes. These requirements include consideration of potential conflicts of interest; specific items surrounding firm personnel knowledge, experience, and competence; specific matters such as business operations, the reputation and attitudes of key members of management, and results of background searches and inquiries of third parties such as attorneys and bankers; and significant issues arising in previous audits and the implication of those issues on the existing client relationship (i.e., whether to continue the relationship) (AICPA 2016b).

Although these specific matters are included in the AICPA's standards, they are only considerations; the firm is not required to implement any of these recommendations if it deems them unnecessary. With minimal specific requirements and significant firm-specific considerations, it is highly likely that two very similar firms could have significantly different client acceptance and retention policies while still complying with the requirements prescribed by both the AICPA and the PCAOB. Therefore, it is important to address factors outside of the

regulatory requirements that a firm may consider when developing client acceptance and retention policies in order to understand why diversity in policies exist across various firms, regardless of size.

In summary, the minimal requirements and vague recommendations found within auditing standards afford firms a great deal of latitude when developing client acceptance and retention policies. In essence, firms are only required to establish policies for evaluating (prospective) clients for acceptance and retention. The individual policies are generally at the individual firm's discretion, meaning that the procedures could vary significantly among firms. The firm's ability to consider without implementing the AICPA's recommendations, along with the vague requirements under the PCAOB rules, further indicates the need for additional research in the area of client acceptance and retention policy-making practices.

2.4 Models of Client Acceptance and Client Retention Processes

To develop an understanding of the factors used in client acceptance and retention decisions across firms, I propose a basic model for the processes of client acceptance (see Figure 1) and retention (see Figure 2) based on the guidance found within current auditing standards. Both proposed models provide a general approach that auditors follow, although each of the stages within the model have several potential considerations that a firm may follow to achieve the recommendations of each stage. Because many of the client acceptance and retention procedures found within auditing standards are not required (i.e., they are preceded by either "should" or "may," rather than "must" (AICPA 2016b, 2016f; PCAOB 2016)), the proposed models include the recommendations that auditors are encouraged to consider at each stage in the client acceptance and retention processes. Given the flexibility inherent in the auditing standards, significant variation in the procedures performed within any of these stages could occur, thereby

making all stages within these models fertile ground for analyses of between-firm and within-firm comparisons. Both models include three stages: (1) understanding the engagement, (2) evaluating client-specific and firm-specific matters, and (3) reaching the final (acceptance or retention) decision. Within these stages, I include procedures required by auditing standards (“Requirements”) and those that are recommended (“Other Considerations”). For both types of procedures, I also reference the relevant auditing standards from the PCAOB and the AICPA.

2.5 Stage 1 – Understanding the Engagement

For the first stage of the models, the auditor⁴ must obtain information about the prospective or existing client. In the client acceptance model, this stage includes the requirements that the auditor understand the purpose of the engagement (PCAOB 2003d; AICPA 2016g), the terms of the engagement (PCAOB 2003d; AICPA 2016g), and communications with the audit committee or those charged with governance (PCAOB 2012; AICPA 2016h). These requirements include obtaining a clear understanding of matters such as deadlines and reporting requirements, as well as who the auditor will report to (audit committee or others charged with governance of the entity). This initial stage is similar in the client retention model, as the auditor is required to identify any modifications to the engagement terms (PCAOB 2003d; AICPA 2016g) and identify those charged with governance and any changes to the group (PCAOB 2012; AICPA 2016h). In addition, the auditor is required to identify any changes in the entity that might impact whether the client should be retained (PCAOB 2003d; AICPA 2016g).

⁴ Prior research indicates the client acceptance and retention decision-making processes are a collective effort that may require input from various members of the audit firm (e.g., Ayers and Kaplan 2003; Johnstone and Bedard 2003; Gendron 2001; Ayers and Kaplan 1998). To simplify the discussion, I use the term “auditor” throughout this section to indicate the work that might be performed by various members within an audit firm in the client acceptance and retention decision-making processes.

2.6 Stage 2 – Evaluating Client-Specific and Firm-Specific Matters

Once the auditor has obtained an understanding of the prospective engagement, he will move to the second stage of the models. This stage contains two groups of considerations that are made concurrently throughout the acceptance and retention processes: those that are specific to the (prospective) client entity and those that are specific to the audit firm. When considering an initial engagement, the auditor must communicate with the predecessor auditor (PCAOB 2003e; AICPA 2016g). This communication is important “because the predecessor auditor may be able to provide information that will assist the successor auditor in determining whether to accept the engagement” (PCAOB 2003e, paragraph 2610.07). The auditor should also consider other procedures related to the entity, including evaluating the entity’s internal control structure, issues relevant to the entity’s industry, potential legal or regulatory issues, the complexity of the entity, and any publicly available information about the entity (PCAOB 2003e). Additionally, the auditor should consider any potential issues related to the integrity of management and those charged with governance (PCAOB 2003a; AICPA 2016b). Although there are no specific client retention requirements related to entity-specific considerations, the auditor should continue to evaluate the integrity of management and those charged with governance (PCAOB 2003a; AICPA 2016b) while considering any changes in the entity (PCAOB 2003d; AICPA 2016i; AICPA 2016j) and any issues that arose during the prior year audit (PCAOB 2003d; AICPA 2016i).

Along with considerations related to the (prospective) client, the auditor must also evaluate certain aspects of the audit firm before accepting or retaining a client. In both the acceptance and retention models, the auditor must first consider whether the audit firm is independent (PCAOB 2003f; AICPA 2016e). If independence is compromised, the client cannot

be accepted in the current year, regardless of any prior history or relationship with the entity. Once the auditor confirms the audit firm is independent of the entity, the auditor must then consider characteristics of the planned team members and determine whether the client can be accepted/retained. Under both models, the auditor should ensure the prospective engagement team holds all appropriate qualifications (PCAOB 2003g; AICPA 2016e), the appropriate training and knowledge (PCAOB 2003h; AICPA 2016e), and the skills necessary to appropriately evaluate audit evidence to complete the engagement (PCAOB 2003i; AICPA 2016e). In other words, the auditor has to consider whether the firm has the capabilities necessary to perform the audit, or has the ability to obtain the skills and knowledge required before beginning the audit.

2.7 Stage 3 – Reaching the Final (Acceptance or Retention) Decision

Once the auditor has gained an understanding of the engagement and considered any potential issues related to the (prospective) client entity and the audit firm, the auditor will then move to the third stage in which the client acceptance or retention decision is made. At this stage, the auditor will assess the information obtained in the prior steps and perform an overall risk assessment of the (prospective) client. The decision of whether or not to accept or retain a client requires the auditor to consider whether the overall audit risk can be reduced to an acceptable level (PCAOB 2010a; AICPA 2016j) based on the information obtained during the client acceptance and/or retention processes. The auditor should also consider whether sufficient appropriate evidence can be obtained to support the audit opinion based on information the auditor has learned about the (prospective) client (PCAOB 2010c; AICPA 2016k). The auditor will weigh these considerations, especially related to audit risk, when making the final decision to accept or retain the client.

2.8 Audit Risk Assessment Within the Models

The overarching factor that drives the models of the client acceptance and client retention processes relates to the third step in the models: the required risk assessment that auditors must perform prior to accepting or retaining a client. The first and second stages of both models influence the third stage, allowing the auditor to make a more informed risk assessment. Extant literature implies that risk assessment is a primary component in both the client acceptance process (e.g., Asare et al. 2005; Johnstone and Bedard 2003; Beaulieu 2001; Johnstone and Bedard 2001; Cohen and Hanno 2000; Johnstone 2000) and the client retention process (e.g., Bedard and Johnstone 2004; Chang and Hwang 2003). Thus, it is important to understand the types of risks that shape these processes.

Johnstone (2000) proposes a client acceptance model that classifies the client acceptance decision into two phases: the risk evaluation phase and the risk adaptation stage. In the risk evaluation phase, auditors assess the risk that the prospective client will cause a loss for the firm because of litigation or the client engagement being unprofitable (Johnstone 2000). Consistent with her proposed model, Johnstone (2000) finds that auditors consider both audit risk and the client's business risk when determining the risk of loss related to the prospective client, and use these risk evaluations to reject clients viewed as having higher risks of litigation or financial loss for the firm. This result is consistent with findings of other research that examines specific aspects of risk assessment on client acceptance and retention decisions. KPMG's client acceptance and retention decision-aid software assesses higher risk scores for prospective or current clients that introduce excessive litigation risk and/or for those clients the software deems are inconsistent with the firm's overall client portfolio objectives (Bell et al. 2002). Although decision-aid software can identify those higher risk clients, auditors may be able to utilize other

factors to offset some of those risks. For example, auditors negotiate fees based on audit effort costs plus any expected costs of litigation (i.e., a risk premium), and then determine client acceptance or retention based on whether the fee that can be collected is sufficient to cover the anticipated costs of the engagement (Gramling et al. 1998). Based on these studies, litigation risk and portfolio risk appear to be primary drivers in the risk assessment decisions related to client acceptance and retention.

2.9 Litigation and Reputation Risk

One reason why litigation risk may be a primary driver of the risk assessment process is that the subjective nature of auditing gives rise to the risk of lawsuits. The auditor's primary responsibility is managing audit risk to an acceptably low level, meaning the auditor effectively reduces the chance that the firm will issue a clean opinion when a material misstatement exists (PCAOB 2010a). The terms "managing" and "acceptably" are based on the auditor's professional discretion, which introduces the potential for litigation between the auditor and client or the auditor and shareholders. Thus, failure to capture a material misstatement potentially is a failure to meet the required auditing standards and opens up the audit firm to potential lawsuits.

In the face of heightened litigation risk, auditors are less likely to permit clients to report aggressively (Hackenbrack and Nelson 1996). Moreover, Gramling et al. (1998) find that the legal liability regime (i.e., proportional versus joint and several liability) impacts an auditor's willingness to contract with high-risk firms. Other research suggests that experience plays an important role in auditors' reaction to litigation risk. For example, experienced auditors appear to more carefully consider the risk of future lawsuits (McCracken 2003) and are more likely to recommend income-reducing adjustments when choosing between competing goals of managing

client relationships and complying with professional standards (Asare et al. 2009). It is likely that this apparent mindfulness of the risk of litigation is a key factor that engagement partners consider as part of the client acceptance and retention processes, particularly if firms are aware of the mediating impact of experience.

Litigation also has a substantial effect on a firm's reputation. Indeed, auditors are less willing to settle litigation and will incur additional legal costs if they believe a particular case will harm the firm's reputation (McCracken 2003). The interconnectedness between litigation and reputation is explicitly addressed in PwC's audit software, which incorporates both legal issues that may arise as well as reputational harm that might occur (Winograd et al. 2000).

Auditor reputation includes the publicity that arises out of auditor litigation. Extant research has found that an auditor's failure to detect fraud can impact not only the client where fraud is subsequently discovered, but also impacts other clients associated with the same audit firm. Krishnamurthy et al. (2006) examine the most notable example of reputation cost, the impact of the Enron investigation on Arthur Andersen's reputation. They find a negative market reaction in a cross-section of Arthur Andersen clients after the announcement of the firm's criminal indictment, noting a more negative reaction when audit fee ratios indicate higher non-audit fees (i.e., the existence of potential independence issues). Research also finds an audit firm's reputation can be impacted by regulatory findings. Boone et al. (2014) find that although Deloitte's audit quality was consistent with other Big 4 firms during the period under study, the PCAOB's 2007 censure of Deloitte was associated with a decline in audit client market share for the firm. This study suggests that the PCAOB's censure harmed Deloitte's reputation among both existing and prospective clients.

Reputation risk is seen by some as increasing with auditor tenure. Analytical models suggest that failure to detect past frauds can negatively impact the auditor's reputation, which can make the auditor hesitant to report fraud in subsequent years (Corona and Randhawa 2010). Similarly, studies indicate that auditors are able to find ways to align with client reporting objectives, even when those objectives are aggressive. Auditors are more likely to use vague accounting criteria to justify an existing client's use of aggressive reporting disclosures when engagement risk is not viewed as high (Hackenbrack and Nelson 1996). When the pressure to retain a client is high, auditors are more willing to allow aggressive client reporting, but that willingness decreases when the client's business risks are high (Chang and Hwang 2003). A survey of practicing auditors finds that the number of years of experience with the client, prominence of the client, and the client's prestige all result in higher levels of identification with the client by the auditor (Bamber and Iyer 2007). In turn, greater client identification is associated with a higher likelihood that the auditor will concede to client preferences (Bamber and Iyer 2007).

Prior research has investigated the ways that audit firms manage litigation risk, including through client acceptance and retention; the nature, timing, and extent of audit procedures; as well as through audit fees (e.g., Bedard and Johnstone 2004; Johnstone and Bedard 2003; Johnstone 2000). In their review of the archival audit literature, DeFond and Zhang (2014) note litigation risk research consistently finds that auditors do not tend to accept high risk clients and are more likely to discontinue auditing high risk clients. However, little is known about the significant processes and procedures firms implement to make these complex and important client acceptance and resignation decisions. To my knowledge, no research exists that analyzes

the development and implementation of client acceptance and retention policies and procedures across audit firms. The goal of this paper is to fill this existing gap in audit research.

2.10 Portfolio Risk

Somewhat related to the concept of litigation and reputation risk is the idea of portfolio risk. Portfolio risk represents the collective risk of a firm's or a partner's clients. Auditors leverage audit risk within a group of clients, as opposed to within a single audit, by considering the expected return of an individual audit,⁵ the expected returns for other audits in the portfolio, and the firm's investment in the portfolio (Simunic and Stein 1990). Bedard et al. (2008) note that firms consider an overall portfolio strategy when deciding whether or not to accept or retain an existing client, which requires assessing the risk of these clients, the impact on the overall portfolio, and the potential tradeoff between risk and the audit fee. Using a field study, Johnstone and Bedard (2004) find that one large audit firm uses three primary approaches to manage its client portfolio: discontinuing existing relationships with higher risk clients, accepting new lower risk clients, and focusing on audit risk factors rather than client financial risk factors. They find that the firm's overall portfolio risk declined over time as the firm accepted lower risk clients and removed the higher risk clients from its portfolio (Johnstone and Bedard 2004).

Extant research also examines audit firm client portfolio composition based on risk characteristics of publicly traded clients. The reduction in audit work as a result of the PCAOB's replacement of Auditing Standard No. 2 with Auditing Standard No. 5 (AS 5), along with the number of firms switching to non-Big 4 firms due to the 2008 recession, suggested that Big 4 firms may have been more likely to accept higher risk clients to counteract decreasing revenues during the economic recession and AS 5 implementation period (Schroeder and Hogan 2013).

⁵ Expected return on an individual audit consists of the audit fee less costs, including potential post-audit costs such as litigation.

However, what Schroeder and Hogan (2013) actually find is the overall audit risk of Big 4 clients decreased over the study period, driven by reduced audit risk for continuing clients; only financial risks increase for Big 4 clients during this period, consistent with the impact of the recession. This finding suggests that Big 4 auditors actively manage their client portfolios to reduce the firm's overall audit risk, despite the potential impact on firm profitability (Schroeder and Hogan 2013). Hogan and Martin (2009) observe that between 2000 and 2004, the new clients of mid-tier audit firms have higher business risk (i.e., litigation and reputation risk) than departing clients, which appears to be driven primarily by mid-tier firms accepting larger and riskier clients from the Big 4. While the results related to client business risk and audit risk are mixed, they suggest that mid-tier firms may manage client portfolios based on assessments of client profitability and/or potential reporting issues (Hogan and Martin 2009).

Partner risk preferences also play a role in the composition of a partner's overall client portfolio. Amir et al. (2014) find that audit partners in Sweden who have higher risk propensity (based on past criminal convictions) are associated with a portfolio of clients with higher financial risk, lower corporate governance, and lower quality of earnings. If audit firms are aware of this likelihood, it is probable that firms develop client acceptance and retention requirements that limit the likelihood that a partner can maintain a high-risk portfolio. In the U.S., firms have created automated systems that can examine client portfolios at the partner, regional, and national levels (Bell et al. 2002; Winograd 2000), but it is unclear how and if those systems are actually reviewed regularly to examine portfolio risk as part of the client acceptance and retention decision-making processes.

While the literature identifies the types of general assessments or market factors that influence client acceptance and retention judgments, it is not clear what specific strategies or

analyses firms use to make these judgments. It is necessary to understand how audit firms determine what aspects of the (prospective) client and the partner's or firm's portfolio are most significant in order to evaluate overall engagement and portfolio risk. Additionally, it is important to obtain an understanding of how firms determine the relative weights of various factors influencing the client acceptance and retention processes to identify those factors that are most important to firms. The results of this study contribute to the existing literature on the processes and procedures developed by audit firms to assess and evaluate risks that may arise from prospective and/or continuing clients.

2.11 Summary

The studies discussed above indicate that firms are concerned with potential litigation, the possibility of reputational damage, and the possible impact to the partner or firm because of the cumulative risk of their client portfolio. These concerns can impact client acceptance decisions, as firms are likely to reject prospective clients that increase the risk of litigation or reputational damage, as well as those that increase the overall risk of the firm's client base. These potential issues are most likely addressed during the firm's evaluation of client-specific matters, as well as during the final decision process, which are included as the second and third stages of the proposed model of the client acceptance process. Extant research also indicates that the client retention process could be viewed by the audit firm as a significant process necessary in order to reduce the firm's potential litigation, reputation, and portfolio risk, likely as part of the second and third stages of the model of the client retention process.

The auditor's litigation/reputation and portfolio risks discussed above are likely not exhaustive; the results of this field study identify additional theories that drive the client acceptance and retention decision-making processes for the audit firms under study. It is also

possible that the decisions and opinions of the firms and the firms' partners I interview for this research may not be influenced by only a single principle or belief. Rather, firms may utilize a combination of various theories and strategies in order to structure the requirements for client acceptance and client retention. For example, one firm may recognize litigation and reputation risk as the greatest risk to the firm, but also recognize efficiency constraints are necessary to minimize the procedures required as part of the acceptance/retention processes. Another firm may also view litigation and reputation risk as significant, and deem those risks as so significant that effectiveness is emphasized over efficiency, thereby increasing the extent of procedures performed. Thus, these two firms, both of which view litigation and reputation risk as significant, could have markedly different acceptance and retention policies and procedures in place to address the concerns specific to each firm.

Similarly, a combination of considerations may be used by the local office partners when performing the firm's established client acceptance/retention procedures. Continuing the previous example, assuming both firms view litigation and reputation risk as the key concern for the firm, the local office partners may act in very different ways based upon the structure of the firm's procedures as well as the institutional pressures applied by the firm. For example, the partner may respond to the established procedures differently if he is invested in the processes versus if he feels the processes are developed by a faceless policy-setting group. If one partner feels as though he has significant input into the firm's processes and procedures, he may be more likely to adhere to the spirit of the procedures in place. Alternatively, if a partner feels she is handed procedures to follow with little or no personal input, she may be more likely to adhere to the letter of the law, potentially searching for ways to circumvent certain procedures while still technically following the specific policies in place at the firm.

Because of the uncertainty of the dynamics that exist within each of the firms, I explore several research questions rather than hypotheses. My study is designed from an interpretivist perspective⁶; the interview protocols have been developed under the qualitative approach of phenomenology, whereby individuals with direct experience in a phenomenon (i.e., client acceptance and retention) are interviewed in order to understand how these individual experiences give rise to commonalities that help explain the meaning of the phenomenon (Patton 2014). The interview protocols and data collection are guided by the central themes within the models of the client acceptance and retention processes, but the data collection process allows flexibility and openness in the event that new and/or unexpected themes arise during the interviews (Gendron 2009). Additionally, it is possible that the results of this study provide a basis for generating theory about how firms develop and implement client acceptance and retention policies and procedures (Patton 2014). This process is similar to a grounded theory approach that uses data gained through social science research to derive theory (Glaser and Strauss 1967) and suggests “interviews with subjects may start with a phenomenological interest in subjective understandings, but the primary interest is not the stories themselves. Rather, they are a means of eliciting information on the social situation under examination” (Suddaby 2006, 635). As such, my research methodology is designed to gather information about client acceptance and retention processes across various firms without preconceived hypotheses of the underlying social situation.

⁶ The interpretivist approach to qualitative research focuses on in-depth analysis of a global concern. This approach analyzes human behavior to explain the complexity of the phenomenon under study as a result of the social construct(s) that help shape the reality. Refer to Malsch and Salterio (2016) and Power and Gendron (2015) for further discussion of qualitative methodology specific to audit research.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Research Design

I use interviews with audit partners at several international, national, and regional firms to obtain information about client acceptance and retention procedures at various firms in the United States. Interviewees include both Risk Management partners and local office partners for each firm participating in the study. The use of both Risk Management partners and local office partners in this study is important for two reasons. The primary reason is to examine any differences that may exist in the client acceptance and/or retention decision processes between those who develop the policies and procedures and those who are responsible for applying those same policies and procedures within a firm. However, it is also notable that differences may exist between these partner groups simply because of experience. Ayers and Kaplan (1998) find that risk review partners are more conservative in their client acceptance decisions than engagement partners, primarily due to risk review partners having more experience and greater concern about poor financial condition and potential legal consequences of accepting a moderately risky prospective client. These results suggest that opinions of the riskiness of potential and continuing clients may differ between the local office partner and the Risk Management partner.

3.2 Interview Questionnaire Design

Questionnaires serve as the basis for semi-structured interviews, with open-ended probing questions designed to gather as much information as possible from the participants without restriction. The questionnaires were developed based on information-gathering discussions with partners and senior managers from several audit firms, ranging from international to regional firms. The purpose of these informal discussions was to understand the

baseline requirements for both client acceptance and client retention across various firms, and the discussions provided a high-level understanding of some of the differences and similarities in basic client acceptance and retention procedures across firms. For example, it is notable that one of the most complex processes mentioned in the preliminary discussions (i.e., a client acceptance committee for higher-risk prospects) did not occur at a Big 4 firm; rather, it occurred at a mid-tier firm. Thus, these preliminary discussions quickly indicated that differences in the types and extent of client acceptance and retention procedures among the firms may not be driven by firm size.

Based on the information-gathering discussions held with audit professionals described above and guidance in the professional auditing standards, I developed two semi-structured interview protocols (refer to Appendices A and B). I also considered findings from extant literature when developing the protocols, but placed limited reliance on this literature to allow for multivocality during data collection, which suggests “diverse theories can be simultaneously descriptive of a reality” (Gendron 2009, 128). Part I of the interview protocol for both the risk management and local office partners contains the informed consent and preliminary questions the subjects are asked to answer prior to the interview. These questions are designed to gather relevant background information about the participant’s work history and experience. The local office partners also are asked to describe their understanding of how client acceptance and retention policies and procedures are developed within the firm and whether the individual is involved in the policy-making process. These questions allow for potential analyses related to the office partner’s experience with acceptance/retention and the risk review processes (Ayers and Kaplan 1998). Parts II and III of both protocols provide the participant with background

information on the study and the researcher. Part IV consists of the semi-structured interview questions that form the basis of the live discussion with participants.

3.3 Risk Management Partner Interview Protocol

The first semi-structured interview protocol (Appendix A) is specific to Risk Management partners at the participating firms. The questions developed within Part IV of this instrument are designed to gather information specific to Risk Management's considerations for firm-wide client acceptance and retention policies and procedures. The first goal of this series of questions is to gain knowledge about how firm-wide policies and procedures related to both client acceptance and client retention are developed, including how specific factors and assessments are derived within the client acceptance and retention processes. Although Johnstone (2000) identifies risk assessment as the primary factor in her client acceptance model, these questions can provide additional information about specific factors underlying the risk assessment process. These specific factors may include management integrity (e.g. Beaulieu 2001; Cohen and Hanno 2000), the auditor's industry expertise (e.g., Hsieh and Lin 2016), and profitability (e.g., Hackenbrack and Hogan 2005), or other factors not previously identified in extant research. These questions can also provide information about if and how firms implement the considerations required by the PCAOB (PCAOB 2003a) and AICPA (AICPA 2016b). These questions provide an understanding of the design and implementation of the steps an engagement partner (or prospective engagement partner) must follow at each firm. Additionally, the questions are intended to determine the identity of the parties who influence the policy-setting process and the nature of their influence at each firm. As previous research has indicated, experience (e.g., Ayers and Kaplan 2003), reputation (e.g., Corona and Randhawa 2010), and the risk review process (e.g., Ayers and Kaplan 2003, 1998) impact client acceptance and retention. Thus, the

identification of those individuals who influence the policy-setting process can provide insight into whether and how firms have incorporated these areas, as well as others not previously identified, into the acceptance and/or retention processes.

The second goal of the risk management questionnaire is to understand what aspects of the client acceptance and client retention processes are key matters for the firm's risk management department. Similar to the previous goal, the identification of these matters could enhance Johnstone's (2000) risk model of client acceptance and allow for the development of a similar model for client retention. I utilize two approaches to identify these key matters. The first is a direct question to the Risk Management partner that allows him, individually, to identify those issues he sees as primary to the acceptance and retention processes. I then use an exemplar approach based on experience questions (Patton 2014) and ask the Risk Management partner to describe particular acceptance and retention scenarios. These questions focus on situations where the engagement partner's client acceptance and client retention conclusions (separately) differed from the conclusions of partners at a higher level in the approval process. By using this approach, I look to identify the key aspects of the acceptance/retention decision-making process in a natural setting (situations that actually occurred) so as to observe whether those issues a Risk Management partner identifies as key are similarly considered by local office partners. If experience (Ayers and Kaplan 2003, 1998) and/or the firm's organizational structure (Gendron 2002) impact client acceptance (and potentially retention), examining specific examples of these two factors could provide significant insight into the acceptance and retention processes.

The last group of questions for risk management is used to understand why firms require certain procedures as part of the client acceptance/retention processes. Based on information-gathering discussions held with audit professionals, I obtained anecdotal evidence that suggests

there is a concern that firms may be sacrificing efficiency to ensure that audit risk is minimized. This group of questions allows me to examine some of the reasons firms may be less efficient or less effective during client acceptance/retention decisions. For example, understanding reasons clients are never rejected may indicate aspects of the client acceptance/retention process where formal procedures are not necessary because other parts of the process may already address certain business and/or audit risks. Similarly, asking the reasons for the majority of client rejections occur provides insight into the particular risks or concerns that are driving certain of the acceptance and retention decisions.

3.4 Local Office Partner Interview Protocol

The second semi-structured interview protocol (Appendix B) is specific to interviews of the local office partners at participating firms. The questions found within Parts I and IV of this protocol gather information related to considerations of prospective and continuing engagement partners that stem from firm-wide client acceptance and retention policies and procedures. These questions enable me to examine how local office partners implement the policies and procedures developed by the firm's risk management group, including how the local office partners view the roles of risk management and local office partners within the firm related to client acceptance and retention. Specifically, these questions provide information about the local office partners' understanding of the client acceptance and retention policies (Part IV), as well as their understanding of how these policies are developed within the firm (Part I). This set of questions provides insight into whether local office partners look to follow the letter of the law or the spirit of the law when following the established procedures.

The second set of questions for local office partners is similar to that of the risk management interview protocol. Using two approaches, I examine the key matters identified by

the local office partners during client acceptance/retention. Like the risk management interview protocol, I utilize both direct questions and an exemplar approach based on experience questions (Patton 2014) to determine key matters. As noted above, the goal of these questions is to compare the opinions of local office partners with those of Risk Management partners to identify differences regarding key issues related to client acceptance and retention, such as the role of experience (e.g., Ayers and Kaplan 2003), reputation (e.g., Corona and Randhawa 2010), and retention incentives (e.g., Chang and Hwang 2003). I also ask local office partners to describe procedures they perform that are beyond required ones to understand the complete assessment made by local office partners.

The final purpose of this interview protocol is to examine practices that occur less frequently as part of client acceptance and retention. The questions in the final section of the interview protocol inquire about situations such as consultations that occur outside of the formal acceptance and retention processes, as well as the local office partner's ability to appeal acceptance or retention decisions made by those at higher approval levels. The goal of this series of questions is to determine whether local office partners perceive that they are limited to the firm's prescribed policies and procedures or whether they perceive that they are able to perform any additional procedures they deem appropriate. These additional procedures examine whether the flexible client acceptance decision-making processes identified by Gendron (2001) are still utilized in the post-SOX era for each participating firm, and if that flexibility extends to firms' client retention decision-making processes. If the firm's policies and procedures are viewed by the local office partner as the only policies and procedures available, local office partners may feel disconnected from the formal process and may find ways to work around or avoid certain firm-level requirements that are inconsistent with or might inhibit the partner's desired outcome

of client acceptance and/or retention, despite the potential risk to the firm. On the other hand, if the local office partner perceives that she is able to perform additional procedures as part of these processes to make the desired outcome more likely, the local office partner may feel more engaged in the process and perceive a high degree of goal congruency between the partner and firm. In addition to a partner's goal congruency with risk management's firm policies and procedures, there may be other factors that influence the extent of procedures that a local office partner is willing to perform as part of the client acceptance and retention processes. The open-ended questions included in this interview allow me to examine other beliefs and/or opinions held by the local office partners that may directly or indirectly influence the client acceptance and/or retention processes within a firm.

When discussing the client acceptance process in both of the interview protocols, the questions focus on prospective clients that have entered the formal client acceptance process rather than prospects that still require additional vetting by the potential engagement partner before the acceptance process begins. Johnstone and Bedard (2003) distinguish these two processes, noting that the first phase of the client acceptance process consists of practice development activities while the second phase includes the acceptance decision-making process. This distinction is necessary, as there are preliminary assessments that are performed by the prospective engagement partner to determine whether the client meets a certain set of minimum criteria before the engagement partner is willing to submit the prospect into the formal process. For example, if a prospective engagement partner performs a preliminary search and finds that the CFO of a prospective client was engaged in fraud at a former employer, the partner may make an immediate decision to decline the company's request for a proposal without submitting the prospective client into the firm's formal acceptance process.

3.5 Participants and the Recruiting Process

I interviewed one Risk Management partner and three local office audit partners⁷ at five different firms included in the top 25 accounting firms as reported by *Accounting Today*.⁸ The firms represent international, national, and large regional firms across the United States. My efforts to recruit participants began by making phone calls and sending emails to personal contacts who serve as partners at various audit firms. The contacts at each firm either referred me to a formal request process required by the firm (three firms) or obtained the necessary internal approvals on my behalf (four firms). These efforts yielded six firms that agreed to participate in this study; one of the seven firms asked declined to participate. During the course of the interview process, one of the six participating firms was unable to recruit participants for interviews in a timely manner and is not included in the results of this study.

In each case, the primary contact person or the individual in charge of the formal request process recommended participants for the study, and I was either provided with email addresses for the individual partners or copied on emails from the primary contact partner to the individual partners. I followed up by sending an email to each prospective participant that included an informed consent, instructions, and demographic questions; background information about the study; and a researcher biography (Parts I, II, and III, respectively, of the appropriate risk management or local office partner protocol). Prospective participants were asked to respond directly to me if they were willing to participate in the study. For each firm, one Risk

⁷ I initially asked each firm to provide at least three local office partners as a starting point for the study. This request assumed that three partners would be the minimum number necessary for data saturation to occur. During the interview process for each firm, I found that the third partner clarified any differences or conflicting information between the responses of the first two partners for each firm. Additionally, participant responses ceased to provide new insights into the research topic (Malsch and Salterio 2016).

⁸ Firm rankings are based on Accounting Today's rankings of the 2017 Top 100 Firms, based on 2016 performance (revenue). The rankings can be found here: <https://www.accountingtoday.com/the-2017-top-100-firms-and-regional-leaders>.

Management partner and three local office partners agreed to participate, for a total of 20 interviews. Upon receipt of the participant's email agreeing to participate in the study, I worked with each individual partner to schedule a time for his or her interview.

CHAPTER FOUR

DATA ANALYSIS

4.1 Data Gathering

Interviews with participants were scheduled based on the individual participant's availability. I completed 20 phone interviews between February 2018 and August 2018. Participants were asked to return the demographic and preliminary questionnaires prior to the scheduled phone interviews. If the participant did not return the questionnaire prior to the interview, I reminded the participant during the interview to complete the form. All but three participants returned a completed form.⁹ Phone interviews averaged 68.3 minutes across all participants. Interviews averaged 60.7 minutes for local office partners, with a minimum length of 36 minutes and a maximum length of 125 minutes. Phone interviews with Risk Management partners averaged 90.8 minutes, with a minimum length of 75 minutes and a maximum length of 105 minutes.

All participants granted permission for me to record the interviews. I assumed the role of active listener, using the interview protocols as a guide to ask questions about the client acceptance and client retention processes. I used the interview protocols to structure questions to keep participants generally on topic, but participants were allowed to speak freely and at length about the general topics posed with minimal input or discussion from me (Power and Gendron 2015; Yin 2014; Gendron and Spira 2010). I also asked follow-up questions if interviewees introduced information that raised additional questions, as well as questions not included in the protocols when participants introduced topics that gave new insights into the client acceptance and/or retention processes (Gendron and Spira 2010). After the interviews were completed, I

⁹ After reminding these participants during the interview to return the forms, I also emailed the participants and reminded the participants to complete and return the forms. To date, these questionnaires have not been received.

transcribed¹⁰ the interviews and reviewed the transcriptions multiple times for accuracy. I then reviewed the transcription files and redacted the files, as appropriate, to remove any references that could jeopardize the anonymity of participants, such as firm or partner names, office or region locations, identifiable job titles, software tools, etc.¹¹ I then used NVivo© software¹² to assist with my analysis of the interviews, allowing me to catalog the transcripts and identify themes both within firms and across firms for each of the major subsections of the interviews.

4.2 Demographic Information

Table 1 presents the results of the demographic questionnaires for the local office partners; Table 2 presents the results of the demographic questionnaires for the Risk Management partners; Table 3 presents the combined demographics for all participants. Local office partner participants were primarily male (73.3%) and averaged approximately 26.6 years of audit experience, with approximately 20.1 of those years at the current firm and 13.4 years at the partner level. Over half (53.3%) of the local office partners interviewed had experience with a Big 4 firm, and 26.3% had experience in multiple offices within the same firm. Additionally, three local office partners (at three different firms) indicated they had some prior experience in policy-making processes for the current firm.

Risk Management partners were also primarily male (60%) and averaged approximately 28.5 years of experience, with approximately 16.9 of those years at the current firm and 11.4 years at the partner level. Eighty percent of the Risk Management partners had Big 4 experience.

¹⁰ I utilized the online software Temi© to perform the initial transcription, which uses speech-to-text capabilities. I then reviewed each text output and compared it to the original audit recording to ensure transcription accuracy.

¹¹ Any redacted information that is quoted will be identified throughout this analysis section as being in brackets and all capital letters. The wording found within brackets will either identify sensitive information that has been redacted (i.e., [REDACTED]) or information that was modified to make it unidentifiable (i.e., [NON-SPECIFIC JOB TITLE]).

¹² Kenno et al. (2017) state that a number of software packages are available for data coding of qualitative interview studies, of which NVivo© is one of the leading software packages.

All risk partners appropriately indicated they were involved in policy-making processes for the firm, evidencing the partners paid appropriate attention to the questions while filling out the questionnaire.

4.3 Overview of Data Analysis Discussion

The remainder of this Chapter presents the findings from the interviews with local office partners and Risk Management partners from each of the five participating firms. The data analysis begins with Section 4.4, which presents an overview of the client acceptance and client retention processes for each firm, as described by the local office partners. On occasion, additional information from a firm's Risk Management partner supplements the discussion. This section also provides information from Risk Management partners who describe how the client acceptance and client retention procedures for each firm are developed. Section 4.4 concludes with the key factors the local office partners consider as part of the client acceptance and retention processes and additional procedures they perform outside of the formal client acceptance and retention processes at their respective firms.

Sections 4.5 through 4.9 discuss the findings of this study related to client acceptance. The discussion includes the focuses in the client acceptance process for local office partners, the client acceptance focuses for the firm's policymakers, and the various partners' opinions of differences in views of client acceptance risk at the firm between the local partners and the policymakers. Each of these subsections includes between-firm and within-firm analyses. The client acceptance discussion ends with examples of "pushback" either received (local office partners) or given (Risk Management partners) during the client acceptance process.

Sections 4.10 through 4.14 examine the study's findings related to client retention. Similar to client acceptance, the discussion includes both local office partner and policymaker

focuses during client retention as well as discussion about the differences in views of risk related to the client retention process between local office and Risk Management partners. These subsections also include between-firm and within-firm analyses of each aspect of client retention. Lastly, the discussion on client retention concludes with examples of “pushback” given (Risk Management partners) or received (local office partners) during the client retention approval process.

Chapter Four concludes with a discussion of other topics discussed during the interviews or other themes that arose during the interviews. These topics include questions about whether consultations occur as part of client acceptance and retention and if local partners are able to appeal acceptance and retention decisions made by higher-level approvers in the processes. Additionally, local office partners discussed whether factors unrelated to risk (i.e., mismatches between the client and the audit partner) are considered as part of the client retention process.

4.4 Client Acceptance and Client Retention Processes

Each local office partner was asked to describe the client acceptance and client retention processes at his or her firm. The partners provided a high-level description of these processes, including consideration of how the firm’s procedures address the requirements of the various auditing standards. During the interviews, if the local office partner did not discuss certain aspects of the process (e.g., understanding the entity, management integrity, independence, etc.), I provided occasional prompts to help the partner recall these components. Table 3 presents a summary of the findings for these descriptive questions.

All five firms use some sort of questionnaire or checklist as the basis for their acceptance and retention analyses. Three of the five firms (Firm A, Firm D, and Firm E)¹³ use questionnaires

¹³ To retain anonymity, I refer to participating firms as Firm A, Firm B, Firm C, Firm D, and Firm E. Individual participants are given name designations based on the type of partner (LOP or RM for local office partner and Risk

that are driven by database applications. The other two firms (Firm B and Firm C) use form-based questionnaires. Firm A's client acceptance and retention questionnaires and Firm D's client acceptance and retention software tools require approval of the new or continuing client before a charge code for the current year audit is generated. For all five firms, client retention questionnaires or databases that set forth the primary retention considerations are consistent with the client acceptance questionnaires/databases, but the questions are more abridged and focused on changes from the prior year, primarily surrounding risk factors and economics.

The questionnaires or databases and the overall process at all five firms are similar regardless of the client (i.e., privately-held or publicly traded). For public companies, the questionnaires/databases include questions specific to public company considerations. Additionally, some firms require a higher level of approval for public company acceptance or retention decisions. Firm A, Firm C, and Firm E require public company clients to be approved by the firm's Risk Committee (discussed below) while Firm B requires the highest level of approval (Risk Management) for all public companies. Some partners also noted that considerations like independence procedures (Firm B, Firm D, and Firm E) and background checks (Firm A and Firm C) are typically more onerous for public company (prospective) clients.

The client acceptance and client retention processes for Firm D and Firm E are based upon risk ratings that are calculated by the database system. Firm D's software calculates two risk ratings for audit clients: one for overall risk and a second for income tax-based risk due to the increased income tax-based accounting restatements in recent years, as well as recent tax

Management, respectively), a numerical identification for local office partners interviewed within each firm (1 through 3), and the firm designation (A through E). For example, LOP-1A is local office partner 1 from Firm A while LOP-2D is local office partner 2 from Firm D and RM-E is the Risk Management partner from Firm E.

reforms. The risk rating calculations are based on factors like industry, geographic locations, financial strength of the business, going concern issues, history of material weaknesses or significant deficiencies, and complexity of the client. These risk ratings rank clients into four tiers whereby higher tiers translate into additional quality control procedures, such as secondary reviews (and additional hours), as part of the audit. For Firm E, the overall risk rating falls into three tiers, and each tier has a required level of approval for a client to be accepted or retained. Factors that influence the risk ratings at Firm E include things such as whether the client is public or private, whether there are capital market transactions, overall complexity of the client, history of material weaknesses, industry classifications, and financial factors like going concern.

4.4.1 Approval Processes

The approval process for new and continuing clients varies greatly among the firms, although participants from all five firms indicated the review structure is tiered and that client retention decisions occur annually. The tiers for Firm A are based on prescribed criteria such as whether the prospective client is public or private, industry and other regulatory environment matters, and fee level. The office managing partner's¹⁴ approval is required for all client acceptance matters and, although there is no risk rating at Firm A, higher risk clients require up to two higher levels of approval. Those higher levels consist of (1) a regional industry liaison from the National¹⁵ office and (2) the firm's Risk Committee (see Section 4.4.1.1, below). If there are no significant changes in the client from the prior year, only the engagement partner's

¹⁴ To maintain anonymity, I do not use specific job titles in this discussion. Rather, generic titles (i.e., managing partner, regional managing partner, regional technical partner) are used to define the individual role described by the participant during our discussion.

¹⁵ Note that all firms use regional and/or national descriptive classifications, including the regional firms included in this study. National roles describe the top tier for the firm, regardless of whether the firm is international, national, or regional. Similarly, all firms describe a regional role as one that is focused in a particular geographic area. So for regional firms, this "regional" designation may be a state or similar geographic area, while for a national firm, the "regional" designation may include several states or similar geographic areas.

approval is required to retain a client, but higher levels of approval consistent with acceptance (industry liaison and Risk Committee) are required when the client risk profile has changed.

Firm B's acceptance approval tiers are also prescribed based on the engagement size (fee level) and whether the client is publicly traded or privately held. All new clients require approval from the office and regional managing partners as well as the regional technical partner. If a prospective client is publicly traded and/or exceeds the prescribed fee level, the head regional managing partner and the National Risk partner must approve acceptance. For continuing clients, similar to Firm A, only the engagement partner is required to approve retention if there are no changes to the client profile in the current year. If changes occur during the year, retention is approved following the same tiered levels as client acceptance.

Firm C has two separate approval processes for both client acceptance and client retention: one is based on quality/risk criteria while fees require separate approval by the regional audit partner. For quality/risk approvals, the prospective engagement partner approves the new client and then sends it to the regional technical partner for approval. If the prospective client meets certain criteria (publicly traded and "the larger, more complex, uh, riskier engagements" (LOP-1C)), it is then sent to the firm's Risk Committee (see Section 4.4.1.1, below) for approval. Thus, for Firm C, there could be two different acceptance decision outcomes based on risk and fee.

Firm D also has both risk and fee considerations for client acceptance and retention. Firm D requires the firm's technical practice group to review all client acceptance decisions from a risk perspective. Client retention approvals are more regionalized, requiring just the regional audit and regional technical partners to approve. From the fee side, required business line approvals are based on the fee level, such as the regional partner, an industry leader, etc.

Additionally, there may be further retention considerations that occur at a national level of review, primarily when the retention decision potentially has a significant impact on the firm. “And those further discussion ones are going to typically be large clients where the decision to stay with the client or not is sensitive” (LOP-1D).

Firm E has a tiered approval process based on the risk ratings for both client acceptance and client retention. Regional approval is required at the lowest level, which includes the regional managing partner and the regional technical partner. Two national levels of review occur above the regional level with Risk Committee (see Section 4.4.1.1, below) approval required for those clients deemed to be highest risk (i.e., public and higher risk companies). One partner from Firm E noted the importance of the tiered model of approval:

Every particular situation is fact and circumstance based. There's no one size fits all. It does require judgment, uh, which is why we bring multiple people to the conversation to ensure that we've got varying points of view that go into that judgement. (LOP-1E)

Most of the firms (Firm A, Firm B, Firm D, and Firm E) have additional levels of review outside of the normal tiered client retention process that occur at the regional or national level. For Firm A, this review is primarily a regional review of engagement economics. Firm B requires each partner to prepare a form with all of his or her clients on it and all of the risk factors for each client. The firm's National audit department reviews that form annually. Firm D has a preliminary retention form that is completed for each client by the engagement partner, and the regional technical partners (along with some assistants) review each form for approval. Additionally, some clients are discussed at the national level as part of the annual retention review process. Firm E holds regional meetings where each partner will meet with the regional audit partner and regional technical partner to discuss his or her client base and all of the risk factors for the individual clients.

One interesting facet of the client retention approval process for the firms is that Firm A and Firm B both allow the engagement partners to approve retention if there are no changes in risk in the current year for non-public companies. The remaining firms require at least a regional level of approval for client retention each year. This change model is reasonable, as the auditing standards only recommend the auditor consider changes in the entity and prior year issues as part of the retention process (refer to Stage 2 of the Model of the Client Retention Process in Figure 2) (PCAOB 2003d; AICPA 2016g). However, it is interesting that there is such diversity in practice among the firms. Although Firm D provides for a more regionalized approval process for continuing clients, it is still more stringent than allowing only the engagement partner to approve retention. Firm C and Firm E require annual retention approvals that are the same as the initial client acceptance approvals. Based on these differences, a continuing client could go through entirely different approval considerations depending on the firm that serves as the auditor.

4.4.1.1 Risk Committee¹⁶

As mentioned in the section above, three firms interviewed (Firm A, Firm C, and Firm E) have Risk Committees within the client acceptance and retention approval process. For all three firms, the purpose of the Risk Committee is to review and approve client acceptance and retention for publicly traded and higher risk (prospective) clients. Firm A's Risk Committee consists of five to six individuals who are primarily in the National practice. Committee members include the head of Risk Management and the head of Assurance for the firm, as well as other partners in the National office. The Risk Committee at Firm C consists of four partners

¹⁶ The three firms have different names for this committee. Due to anonymity concerns, I generically use "Risk Committee" to describe the group that is responsible for the approval of the highest risk tier of clients at each of the three firms.

and include regional service partners, in-house counsel, and the head of Assurance for the firm. The head of Risk Management appoints these individuals, but any changes would include consultations with the head of the firm and the leader of the firm's audit practice (RM-C). Firm E's Risk Committee has three to four partners on a rotational basis and includes National technical and Risk Management partners as well as representation from line partners at the firm.

At all three firms, the decisions made at the Risk Committee level are group decisions, "so it's not just one person's opinion" (LOP-3E). Partners at the three firms indicated that the decision process for the Risk Committee "is a pretty iterative process, they'll come back with a lot of questions" (LOP-3A). The Risk Committee at Firm E generally structures the process as "an interview with the [prospective] partner ... [to] obtain an understanding of what the elevated risk factors are and how we have decided to address them" (LOP-2E). Thus, the role of these Risk Committees is to better understand and ensure the engagement team has appropriately responded to risk factors, not necessarily to simply serve as a gatekeeper in the client acceptance and retention processes.

Based on the descriptions provided by the partners at Firm A, Firm C, and Firm E, these Risk Committees are akin to other consultation or subject matter expert groups within the firms. Audit teams utilize specialists in other aspects of the audit process, such as auditing estimates and/or fair value (Griffith 2017; Glover et al. 2016), consultations around complex transactions (Wright and Bhattacharjee 2018), and forensic consultations (Jenkins et al. 2018). As discussed above, the committees include specialists within the firm whose duties include aspects of risk management and firm-wide decision-making. Thus, the use of Risk Committees for Firm A, Firm C, and Firm E appear to be a broader approach to subject matter experts in the realm of high-risk client acceptance and retention decisions.

4.4.2 Development of Client Acceptance and Retention Procedures

The Risk Management partners at each of the five participating firms described how the policies and procedures around client acceptance and retention are developed and modified. At all five firms, the Risk Management partner stated that the policies had been implemented prior to the individual's tenure as Risk Management partner, so they were unable to say how the original policies were established. However, all five partners also noted that they were aware of (and/or had experienced) changes or modifications to these procedures in recent times. The remainder of this section describes how the client acceptance and retention procedures are developed at each firm. I begin with Firm C, as modifications to this firm's procedures are less extensive than the procedures at the other firms interviewed. The subsequent firms are discussed in order of increasing complexity of the modification process.

Firm C utilizes a standardized practice aid checklist for client acceptance and retention, so the firm relies heavily on the practice aid providers to update the forms for new rules or new guidance. Risk Management reviews the updates to the practice aid to ensure the changes are sufficient and appropriate. Firm C's Risk Management will add additional forms or considerations in certain situations.

So we will do some supplements. So for example, we looked at, um, the PCAOB requirements for client evaluation and how those are addressed and we didn't feel like [PRACTICE AID] had done that deeply enough. So we created our own form that goes through the requirements, uh, very specifically and say, Is this there? And if it is there, where do we address it in the work papers or document how we're overcoming, uh, those things that... have a bearing on acceptance. But we try to keep those, uh, more limited, because... the burden then shifts from [PRACTICE AID] pushing out an update to us updating our own forms. (RM-C)

In addition to the practice aid updates, the firm's Risk Management group also meets with other similar sized firms regularly to discuss policies and procedures. These meetings allow Firm C to consider aspects of other established procedures and determine if or how those components

might fit into Firm C's structure. From there, Firm C decides whether the procedures used by these other firms need to be considered in its own policies and procedures, including client acceptance and retention.

And so when you design a process, you want to make sure that you're touching all of the ones that your gut tells you are risky, and then maybe some more. Right? ... But you want to make sure you're not designing a process that is not going to identify the things that... as a partner you know are just risky. But you've got to design the questions and things to, to, uh, kind of get to that end. (RM-C)

Once Firm C has evaluated the client acceptance and retention processes and made changes, the firm will go through its insurance carrier, which includes "experts in underwriting for accounting firms" (RM-C) to ensure the carrier is satisfied with the revised policies and procedures from an insurance risk standpoint. "[T]hey don't set our policies. I don't want it to come across that we just say whatever the insurance company says. But they're certainly in agreement with it and if we're not doing enough, they will certainly... weigh in" (RM-C).

Firm E performs client acceptance and retention evaluation processes continuously during the year. However, events that occur during the year could trigger considerations at any point in time. Risk Management is involved in the review and approval process for any policy changes, along with the group that oversees technical policies and procedures. The firm has regular informal discussions about whether changes in acceptance or retention are necessary, including changes to their software tool, policy, risk ratings or weightings, questions, and guidance. Additionally, RM-E regularly reviews the results of the client acceptance and retention processes to determine whether any new questions should be added to the forms.

There is a question or an item in the client acceptance record that anybody in the process could [use to] elevate [the risk and subsequent review] higher than what it's currently showing, maybe because there's a risk there that didn't have a specific question. Now if we start to accumulate enough of those, then we may need to add some questions. Because there's something new that's kind of starting to pop up. (RM-E)

Firm D evaluates acceptance processes periodically, but generally does not go through much change. Retention, on the other hand, gets “an annual refresh” (RM-D). Every year, Risk Management will review changes in firm policy, system changes, and any necessary enhancements to the process. Risk Management processes and tests the changes and requests the firm’s leadership review the modifications before rolling out guidance to the firm. Firm D has recently made changes to the client retention process that include enhanced risk questions, enhanced risk scores that utilize data analytics, and the implementation of a new software tool. Additionally, the firm implemented trainings to help the partners better understand risk ratings.

Firm A recently performed an “exhaustive research project” (RM-A) of client acceptance and retention content providers and resources used by other firms to examine the questions used to make acceptance and retention decisions. Based on this research, Risk Management at Firm A assembled a list of over 100 possible questions to consider. Each question was examined for importance, redundancy, and relevance in an effort to “balance efficiency with, you know, what’s really important” (RM-A). The firm then narrowed down the list to approximately 20 to 30 key items for acceptance and 10 significant change factors for continuance. The firm focused heavily on client acceptance, noting that the risk is generally greater at that initial acceptance point.

I mean, you can avoid all of that damage if, on acceptance, you do a good job and don't accept clients that, you know, are going to get you into trouble down the road. But once you accept it, whether you decide to not work with that client anymore and get out of the relationship or whether you accept and continue it, even though maybe it's not a great relationship, you know, one way or another, there's going to be some damage done, whether it's to your reputation or, or financially or, or just strain and stress on your, on your employees because the client's hard to deal with and, and all that type of stuff. So you can avoid all that damage by doing a good job on acceptance. (RM-A)

Firm A also uses its legal claims history to identify past issues that could have been addressed through the acceptance or retention process. The client acceptance and retention processes are updated continuously, generally based on issues identified by the firm's Chief Risk Officer.

The Risk Management partner at Firm B also discussed significant revisions to the firm's client acceptance and continuance processes. At the time of our discussion, Firm B had not implemented any changes, but RM-B stated, "So my focus first and foremost is to streamline... the tools. Right? Not necessarily fundamentally changing what we consider on acceptance, but how we get that documented and available for people to review." This process includes potentially implementing a risk rating process (similar to Firm D and Firm E). "That's... the whole objective of creating this rating is so that we can really isolate and, and focus particular responses to the higher risk matters" (RM-B). This process includes identifying "attributes that are better indicators of that risk... [and] looking at that, the risk profile indicators" (RM-B). At the conclusion of this assessment and implementation, Firm B plans to establish a formal process to review these procedures, possibly on an annual or bi-annual basis.

4.4.3 Key Factors in Client Acceptance

Although firms utilize checklists and software, participants noted certain key issues that drive the client acceptance decision-making process. During the local office partner interviews, the following aspects came up most frequently (listed in order of frequency): risk (13 partners), background checks (13 partners), independence (11 partners), inquiries of predecessors and others (11 partners), fees (10 partners), industry (nine partners), management integrity (eight partners), financial viability (seven partners), expertise (six partners), and capacity (two partners).

Risk was the most common aspect of the discussion, and partners noted that risk played into most of the other key issues. The main theme related to risk was the idea that client acceptance is a process used to identify risks related to a prospective client, and the main concern for audit partners is to identify and respond to that risk. “It isn’t we wouldn’t accept them but, but just that we’re identifying key risk drivers... so that we then, before we accept it, have reflected and thought about how we would manage that risk” (LOP-3D). Responses to risk at most firms include considerations such as having secondary review partners or industry specialists assigned to the engagement.

One way that firms gather information about risks related to client acceptance is through background checks and inquiries of third parties (such as predecessor auditors, bankers, and attorneys). Firm B, Firm D, and Firm E require background checks on key personnel (such as executives, those who can influence financial reporting, and Board and Audit Committee members) for all prospective clients. Firm B requires the head of Risk Management and the firm’s legal department to make the decision on acceptance if an issue is identified in the background checks. Firm E has a coding mechanism for the severity of background checks where the lowest level means no issues were noted and the highest level means the prospective client cannot be accepted. Firm A and Firm C only require background checks for prospective public companies, including the officers, key Board members, and Audit Committee chairperson. Firm C also requires background checks if there is a reason to believe there may be risk issues for the prospective client.

All five firms indicated that inquiries of predecessor auditors are required client acceptance procedures, which is fitting since this predecessor inquiry is required by auditing standards (refer to Stage 2 of the Model of the Client Acceptance Process found in Figure 1)

(PCAOB 2003e; AICPA 2016g). However, only Firm B and Firm D stated that inquiries of bankers, attorneys, and other third parties are required under firm policy. LOP-1C did note “we typically have a client or good friend in the industry that has knowledge of those folks that’s kind of represented for them.” Additionally, the Risk Management partner from Firm C provided some insight into why the firm does not require these additional inquiries:

[The prior Risk Management partner] had an interesting perspective. You know, if the company is still with that banker... what are the chances the banker's going to say, yeah, these guys are shady, but I'm still working with them. Or the lawyer's going to say these guys are shady, but I still do work for them. And it's almost like you knew [what] the answer was going to be almost by design. What... the steps should've been is call the former banker and find out why they resigned. (RM-C)

For Firm B and Firm D, partners indicated that the main concern of these inquiries is gaining an understanding of management integrity.

Concerns over management integrity appear to be pervasive throughout other factors for client acceptance. “[W]e do get into management integrity ... [I] wouldn't say significant part of it, but it's, it's probably one of the more important parts of it” (LOP-2C). Four of the five firms (Firm B, Firm C, Firm D, and Firm E) specifically mentioned the importance and direct considerations of management integrity. Firm A did not directly discuss the acceptance procedures related to management integrity, but other parts of phone interviews indicated that the firm, similar to Firm C, utilizes background searches (where required), conflict checks, and discussions with the predecessor auditor to identify any potential management integrity issues. Firm B and Firm D perform these same functions but also discuss possible integrity concerns with third parties (e.g., bankers and attorneys) as well as inquires within the firm to determine whether any individuals within the firm can speak to management’s integrity based on prior relationships. Firm C and Firm E both noted that the databases or checklists used for client

acceptance include questions specifically related to management integrity. These questions are key for these firms because:

[O]ur belief is that historical results are absolutely indicative of future performance as it relates to matters of ethics and integrity. ...[I]f somebody's done something in, in the past, uh, it's, there's a high likelihood they're going to do it again in the future when presented the opportunity. And so that, that becomes essentially a no fly zone for us. And, and that's why we have the ... process... [T]hese calls are not made by the individual audit partner or team. (LOP-1E)

Thus, the factor of management integrity is included as both a direct consideration (i.e., database questions) and within other aspects of the client acceptance process, such as inquiries of third parties and background searches.

Other client acceptance factors explicitly mentioned during various interviews include independence, financial viability, fee, and expertise considerations. Independence is required for an auditor to accept a client (refer to Stage 2 of the Model of the Client Acceptance Process found in Figure 1) (PCAOB 2003f; AICPA 2016e). All five firms have implemented a conflict-of-interest or independence check process. Firm B, Firm D, and Firm E utilize databases for engagement teams to confirm independence. Conflict checks are sent to all partners at Firm A for public companies, at Firm B for entities with international operations, at Firm C for non-routine services, and at Firm E for all services, including international operations. Firm D has the most extensive database, which allows prospective engagement teams to search for any conflicts of interest, including direct investments by employees and any prohibited services performed during the lookback period for publicly traded companies.

Firms also evaluate expertise during the acceptance process (Stage 2 of the client acceptance model), which includes considerations of engagement team members' qualifications (PCAOB 2003g; AICPA 2016e), training/knowledge (PCAOB 2003h; AICPA 2016e), and skills (PCAOB 2003i; AICPA 2016e). Partner responses also indicate that industry considerations fall

under this part of the analysis, as the client acceptance procedures for all five firms require industry considerations by the prospective engagement team when assessing the level of expertise required on the engagement as well as industry-related risk factors. The comments made by some of the local office partner participants related to expertise indicate that this factor has been emphasized as part of the firm's audit quality considerations:

If you accept a client but you don't have the right skills in place and the right locations to serve ... or if you allow a ... partner to accept a client that's going to overextend them or, or place them in a position where they personally don't have the time to, to serve their book of business, then you're just set up from the start for ... a much more difficult execution and you've really raised the quality risk to an unacceptable level. (LOP-2E)

Lastly, the client acceptance process includes fee considerations. These considerations include expected realization, financial viability of the prospective client (including risks related to factors such as going concern), and whether fees are commensurate with the risk. As noted above, Firm C has separate risk and fee approvals for client acceptance, while Firm A, Firm B, and Firm D have higher tiers of approval required when fees exceed certain thresholds. Firm E does not have any established review criteria related to fee considerations.

4.4.4 Key Factors in Client Retention

There were two primary aspects of client retention raised during my discussions with local office partner participants: risk and change. Discussions with most partners indicate that these factors are intertwined in the client retention process, as the changes analyzed by the engagement partners are focused on what new risk factors might be raised (or elevated) for the engagement. For each of the firms, as discussed above, the questions found in the client retention questionnaire or database focus on changes that have occurred since the prior year audit. This assessment is required for all five firms for each client. "All clients, regardless of risk rating, are subject to client continuance" (LOP-1D).

For some firms, the continuance decision seems more of a formality (Firm A, Firm B, and Firm C). Partners from Firm A stated that the client retention process was relatively informal up until a couple of years ago when it became a more structured process requiring approvals outside of the engagement partner. The new process focuses more on “all those risk rating questions, financial deterioration, any changes in management, any change in the organization, [and] changes in the audit team” (LOP-3A). LOP-3C indicated that the level of information provided for client retention evaluations is less than the information provided for client acceptance decisions. “[I]t’s less about accepting the client at that point and it’s more about what level of second review we might need” (LOP-3C).

Client retention considerations at Firm D focus on the risk rating calculations. The regional technical partners at Firm D discuss the risk ratings on various jobs with the engagement partners.

“And so they’ll say, you know, this client, they had a significant deficiency last year, so they had some internal control problems. And you rated a [2] risk over all. But you know, that’s a flag, that’s an indicator of [3] risk. Why isn’t the conclusion it’s a [3]? And that’s an example of one maybe when you’re arguing over the risk rating with the technical partner.” (LOP-1D)

There are also discussions about whether or not to retain a client. But for Firm D, as mentioned, these discussions generally seem to focus around risk related to the continuing client and risk to the firm. For Firm D, the overall risk rating is important because it relates to the audit for the upcoming year.

And then we continue that year and then we collectively decide, do we still think that this, for this year, that this company is [MEDIUM] or are they now [HIGH] risk? ... If something changes... that can trigger a need to reevaluate. ... Do we still think we’re comfortable that ...this is still the right risk rating? Because, again, the minute I change the risk rating, I trigger a change in protocols in a lot of different areas. Scope of the audit, people involved, the degree to which people are involved, um, detailed reviews. All of those things that are prescribed. (LOP-3D)

For Firm E, client retention is “a revalidation of the risk factors indicating whether or not... they’ve changed” (LOP-2E). The retention assessment is “a more scaled down process [than acceptance], but it’s the same, same risk factors” (LOP-3E). In some cases, if the change is significant enough, Firm E will require an existing client to go back through the formal acceptance process, rather than continuance, due to increased risk considerations. This situation generally occurs when there are substantial ownership changes, future IPOs, etc. (LOP-2E).

Six different partners representing four of the five firms (Firm A, Firm C, Firm D, and Firm E) also mentioned economics as a consideration in client retention. “But the economic reality is that for us to be able to spend sufficient resources on an engagement to ensure quality, um, it's got to be economically rewarding to the business side of the firm” (LOP-2E). Partners LOP-3A and LOP-1D mentioned that low realization on the prior year audit(s) may require additional consideration for retention, especially if there is higher risk (LOP-1D). Partners LOP-1C and LOP-3C noted that the client retention decision at Firm C requires a regional partner to review and approve the economics of a continuing client, which is consistent with the approvals required for acceptance decisions. Partner LOP-2C felt that client retention is generally routine unless an outlier, such as poor economics, requires additional discussion. Partner LOP-3E noted it is “economics and risk factors that you go through” in the retention decision process.

4.4.5 Other Client Acceptance Procedures Performed

Despite the fact that each firm has formal policies related to the client acceptance process, I inquired of the local partners as to whether there may be additional procedures they perform as part of client acceptance that are not prescribed by the firm’s official policies and procedures. These additional procedures generally occur prior to beginning the formal client acceptance process and relate to either gathering information about the prospective client or

ensuring that the firm will be able to take on the client. Twelve of the fifteen partners interviewed identified additional procedures they perform above and beyond those required by their firms. Table 5 provides a summary of these other client acceptance procedures by firm; Tables 7 through 11 summarize the responses individually provided by the three local office partners for each firm.

Partners from each of the five firms indicated they perform additional procedures that allow them to assess management integrity for prospective clients. As one partner noted, "...[I]f I don't have a comfort level of integrity with management ...we never even get to the point of needing a [RISK COMMITTEE] review because I won't put it in front of anybody. I won't sign the opinion" (LOP-1E). One partner mentioned playing golf with management at a prospective client as offering an opportunity to assess management integrity:

[I]f I'm playing golf with a prospect, we tee off on number three, I don't see them for the next 30 minutes because they're banging around in the woods somewhere, and we walk off the green and I asked 'em what they had, and they say they had a par, then, you know, the way you keep your score on a golf course is pretty indicative of how you keep your books. ...I learn a lot about the integrity of management through things like that. (LOP-1E)

Additional client acceptance procedures also may be in the form of discussions with individuals familiar with the company (LOP-1C, LOP-1D, and LOP-3D), searching for additional background on the company using tools such as Google (LOP-2A), or spending time with the prospective client management (LOP-2C, LOP-1E, and LOP-2E). Partners at all five firms also stated that they perform additional due diligence procedures around the prospective client. This due diligence includes gathering information about the company and management (LOP-2A, LOP-1B, LOP-1C, LOP-2C, LOP-3D, and LOP-2E) and identifying potential issues (LOP-2A, LOP-1C, LOP-2C, and LOP-3E). Specifically, partners stated background information

comes from prior experience with members of management (LOP-1B) as well as discussions with third parties and contacts in the industry (LOP-1C, LOP-1D, LOP-3D, and LOP-1E).

The last major area partners mentioned they focus on in these additional procedures is firm-specific considerations. Partners at four of the five firms described procedures that include discussions with other partners, consideration of firm demands such as availability and expertise (LOP-1A, LOP-3C, and LOP-3D), and making sure the prospective client is worth the time and effort of client acceptance (LOP-1A, LOP-2A, LOP-2C LOP-2D, and LOP-3D):

That's where, I mean, there's a gazillion companies in [REGION], but there's only going to be so many... that I'm going to try to get through client acceptance in any one year. So those are going to be business decisions on my part that you can't be all things to all people, so what companies in [REGION] have the right risk reward trade off to where I think this should be one of the new clients we should place our bets on this year... where the upside is for the firm. (LOP-2D)

For some of the participants, this idea of whether the prospective client is worth the pursuit includes determining whether the client is a “good fit” for the firm (LOP-2C and LOP-3E).

Three of the partners stated they only perform their firm’s standard procedures. LOP-3A and LOP-1B mentioned that any procedures they might consider performing outside of the require procedures would still be covered by the firm’s processes. “I don’t think there’s anything that I look at that wouldn’t have been considered in some fashion” (LOP-3A). One partner even indicated the required procedures are too much work. “Nope, they cover everything. It's plenty enough to do, let me tell you. It's a significant amount of time. It's crazy. It lasts, it takes too long” (LOP-3B). When asked to clarify, however, LOP-3B indicated that the time factor is generally associated with comments from the regional technical partner who approves client acceptance and the time required to address and respond to those matters. So it does not seem that Firm B has too many required procedures; rather, the required procedures are just extensive and time consuming.

4.4.6 Other Client Retention Procedures Performed

For procedures performed outside of the formal client retention process, audit partners seem to focus their procedures on specific aspects of the client. This approach is different from the additional procedures used to gather additional general information during client acceptance (i.e., due diligence and management integrity assessments). A primary reason for this difference is because client acceptance is an attempt to learn more information about an unknown client, while client retention considerations are based on prior experience with the client. “[A]nswering those questions is not going to require the same degree of analysis because you have institutional knowledge of the client... we know the people. We just had a year working closely with them” (LOP-3D).

When asked about any additional procedures they might perform as part of the client retention process, local office partners’ responses generally fell into one of three groups: due diligence, reflecting on the prior year audit and the future opportunities with the client, and financial or economic considerations. Table 12 summarizes the other client retention procedures performed by firm and Tables 14 through 18 summarize the individual responses for each of the three local office partners by firm. Five partners stated that they do not perform any additional procedures around client retention, and three of those five partners were from Firm B (in addition to LOP-3A and LOP-1C).

Due diligence procedures include keeping up with clients regularly (LOP-3C and LOP-3D) and considering the “big picture” (LOP-1E) around the client retention decision. Partners also consider future plans the client may have (LOP-2A, LOP-2C, and LOP-2E) and areas that might be potentially problematic for the client (LOP-1D and LOP-2A). This assessment includes trying to work through those areas with the higher-level partners who approve retention before

the formal client retention process begins (LOP-3E). Similarly, partners at Firm A, Firm C, and Firm E examine the prior year audit to evaluate what future audits may entail. This consideration includes reviewing issues noted during the audit (LOP-1A, LOP-2C, LOP-2E, and LOP-3E) and whether the audit can be improved (LOP-1A). When audit issues are identified, partners consider management’s responses to those findings (LOP-2E) and how those issues might impact future audits (LOP-3E).

Partners also consider the impact of the audit on the engagement staff (LOP-2C and LOP-2E). If the audit was a difficult engagement “we’ll discuss [among the staff] whether or not it’s something we want to continue” (LOP-2C). So, for LOP-2C, the engagement team gets some say in the client retention decision. Some partners mentioned they also consider what opportunities the engagement provides for the audit staff, particularly related to training (LOP-1E), and whether or not any identified issues from the prior year audit can be improved in future audits (LOP-2C).

4.5 Client Acceptance Focuses for Local Office Partners

After the local office partners explained the overall processes of client acceptance and retention, I asked these partners to discuss factors they considered as primary focuses when making an initial decision about whether to recommend the prospective client for acceptance through the formal process. Table 5 summarizes the local office partner responses by firm.

4.5.1 Between-Firm Analyses of Client Acceptance Focuses

Nine of the local office partners across all five firms specifically mentioned the word “risk” when describing areas of focus, going on to describe particular aspects of risk and risk factors they consider as a primary concern for client acceptance. Risk includes considerations such as “are we going to be taking on too much risk associated with taking on that client?”

(LOP-1A) as well as the company's history, ability to pay, and management experience or capabilities (LOP-1B). Partners are concerned about both the client's potential impact to themselves and the firm. "I don't want to even put myself out there... and cause risk to the firm" (LOP-3C). This initial risk analysis by the local office partner is a way to protect the individual partner as well as the firm as a whole. "So obviously no client is more important than the firm and uh, I think that definitely becomes evident during the client acceptance procedures" (LOP-1B).

Partners from all five of the firms mentioned management integrity as a primary concern in the client acceptance process. This finding is consistent with Ethridge et al. (2007), who find that auditors consider management integrity to be the primary factor in assessing engagement risk during client acceptance decisions. The partners in the current study mentioned that integrity issues may arise as part of background investigations into members of management (including Google© searches), concerns about questionable activities identified in the financial statements, or other information about the company. These results are comparable to Kassem (2018) who finds Egyptian Big 4 auditors use similar approaches (e.g., Google© searches, inquiries of management, background investigations, restatement history) to assess management integrity. The primary concern related to management integrity for the local office partners in this study seems to be driven by the inability to respond to management integrity issues as part of the planned audit approach.

[I]f you don't get the best right up front, you're going to lose. And so there's... no amount of audit procedures that you can perform that can overcome... the suspicion of integrity issues associated with management or those charged with governance. (LOP-1E)

The partners are aware that the risk of association with clients of low integrity can impact the firm's reputation.

[T]he biggest... thing that prevents us [moving] forward is anything integrity, um, reputation risk associated with the company. ...[I]f someone comes to us for a proposal and their audit firm resigned and did not want to work with them anymore for kind of risk reasons, that's probably not a client, no matter what the fee, that I'm ever going to get through. (LOP-2D)

Part of the reason for this concern over management integrity is because the reputation risk attached to bringing in bad clients cannot be overcome by simply raising the fee and performing additional audit procedures.

[T]hose integrity issues around top management are kind of the deal killer to where you... couldn't give me a fee high enough to work with a company and bring them in because once you do become associated with them and put your, an audit opinion on it, now you own the risk. So the best decision we can make is just to never be associated with a company regardless of the fees, they're going to expose the firm to, to, uh, reputational risk because of integrity issues. And uh, likewise, we will walk away from companies, regardless of fee, if they're going to expose us to that. But it's better if we never bring them in to begin with. Because once, once they're in, you know, it's a little tougher to work your way out. You could expose firm to risk by resigning, you know, as well. Um, so it's better just to never bring them in as a client. (LOP-2D)

The challenge in this process, partners note, is the difficulty they face in trying to identify integrity issues. At times, the issues may be obvious (e.g., past fraud and investigations).

However, the heightened concern during client acceptance relates to the lack of institutional knowledge about the client and management.

[T]he integrity factor is a key one. Within the context of that, the easy answer is this guy got sued or sanctioned by the SEC, we're not doing business with them. ... It's more challenging when you're trying to get to the "aggressive person" where it kind of looks sketchy, but, you know, they're not being restated, but they're always leaning to one edge. You know, that's, that's a harder call. But if we think that that's really what they're about and we size that up correctly, like that's, that's the biggest issue for me. (LOP-3D)

One partner did note that management integrity issues are not very common in client acceptance.

“[F]or the most part I find it unusual that people would, uh, approach us if they have integrity issues” (LOP-1B).

In addition to management integrity issues, the local office partners consider the potential needs of the prospective client. These needs include industry concerns (Firm A, Firm B, Firm C, and Firm E); the resources and expertise required to perform the audit (Firm A, Firm C, and Firm E); background about the company and management, including experience (Firm B and Firm D); viability of the company, including going concern (Firm A, Firm B, Firm C, Firm D, and Firm E); and engagement economics (Firm A and Firm C). These considerations indicate the firms are performing some, if not all, of the Stage 2 procedures identified in the Model of the Client Acceptance Process (Figure 1), even if those procedures are not explicitly required by the auditing standards. As discussed above, partners from all five firms consider management integrity. Entity-related matters include the prospective client's needs, the industry in which the company operates, and the company's background, including management's experience. Partners from all five firms consider at least one of these aspects. Firm-specific matters include the qualifications and experience of the engagement team (including industry experience and training) as well as the ability to service the client with due professional care. Partners from Firm A, Firm C, and Firm E include some aspect of the firm-specific matters that are recommended by the auditing standards as part of the client acceptance decision process.

LOP-1A and LOP-2C mentioned economics as one of the key factors they consider in the client acceptance assessment. LOP-3A felt "[i]t's much more about economics on the private company side." Related, LOP-1A and LOP-1D said they consider other services the firm might provide to the client and whether that work is more profitable and/or less risky to the firm than an audit engagement. Although other partners did not mention the potential profitability of the engagement, some do consider the company's ability to pay (LOP-3A and LOP-1B).

Two partners did note that client acceptance considerations have changed over time for their respective firms. However, the opinions of how the acceptance process has changed is distinctively different. LOP-3A discussed how there are fewer issues that prevent Firm A from accepting clients, as opposed to prior years.

Private company clients? ... I would not have reservations of putting most clients through acceptance. Or continuance for that matter. I think the profession has really changed over the years. I could tell you, I could not say that same thing six or seven years ago. Six or seven years ago, we would turn down engagements that had going concern opinions, whether private or public... and that... really changed. (LOP-3A)

On the other hand, LOP-1B says the client acceptance process has become more difficult.

I remember some of the crap we did back in the day growing up. How did this get through client acceptance? And um nowadays I get told no for client acceptance, you're like, I remember doing some client that, like, we probably shouldn't have. How did they get through client acceptance and I can't even get like a maybe on this one? (LOP-1B)

It is possible that these differing views relate to the differences between the two firms as a whole.

Additionally, these two partners primarily serve different types of clients. LOP-1B primarily works with healthcare clients, while LOP-3A focuses mainly on publicly traded clients.

4.5.2 Within-Firm Analyses of Client Acceptance Focuses

There is considerable variation in the areas of focus for client acceptance for the individual partners within each firm. Tables 7 through 11 summarize the individual responses provided by the three local office partners for each firm.

At Firm A, only one partner (LOP-2A) mentioned management integrity as a key focus, although LOP-3A did mention that client acceptance would not move forward if there were any allegations of fraud or investigations into the company. Two partners (LOP-1A and LOP-3A) mentioned economics, although LOP-2A brought it up as a matter considered alongside the timing of the audit work (i.e., whether the fee corresponded with the timing of work for busy season). Partner LOP-1A seemed to focus mainly on economics, which is consistent with

responses in other areas of client acceptance and retention (refer to Sections 4.4.3 and 4.4.4), but also considers going concern and industry considerations. During our conversation, LOP-1A noted that most of the pushback received in the client acceptance and retention processes related to either going concern or industry-specific risk and fee assessments (e.g., healthcare and pension plans). LOP-3A mentioned only the strength of the management team as a focal point for client acceptance, mostly because this partner's primary practice involves publicly traded companies. LOP-3A focuses on whether the management team can address the risks on future audits related to any prior audit or financial reporting issues. LOP-2A focuses a lot more on the company as a whole, examining issues such as industry needs, economic viability, the timing and associated deadlines for the audit, and concerns over any integrity issues that may arise during the acceptance process. As identified in other aspects of client acceptance and client retention (refer to Sections 4.4.3 and 4.4.4), LOP-2A appears to take a broader view of a client while performing client acceptance and retention procedures.

The focus of Firm C partners' primary client acceptance procedures was also diverse. Only one partner mentioned that management integrity and reputation are key factors considered (LOP-1C). LOP-3C focuses mainly on the firm-specific considerations of client acceptance, ensuring the firm is independent and has the expertise and resources necessary. LOP-2C also considers whether the firm has the ability to service the client (i.e., resources), but also said, "[N]ormally it would be... an economic factor" that prevents a prospect from being put into the formal client acceptance process. LOP-2C also examines the reputations of the business and ownership before deciding whether to propose the firm accept the prospect as a client. LOP-1C goes further than LOP-2C in these considerations, noting that primary acceptance conditions focus on the company's management. However, as LOP-1C specializes in higher education,

“there's very few private colleges that we wouldn't accept, I don't think.” The biggest issues for LOP-1C would relate to factors that could affect accreditation (including going concern) and ensuring that management has a plan to address those issues.

For Firm B, there was consistency among the issues partners consider as major focal areas for client acceptance. Although only LOP-1B explicitly mentioned management integrity (noting integrity issues are generally not a concern), LOP-2B and LOP-3B discussed concerns related to investigations into the company and concerns about risks around management. LOP-2B considers “first impressions” of prospective clients, and focuses on identifying potential risk issues or possible areas of concern that could impact the audit. LOP-1B and LOP-3B explained that they consider the prospective client, the company’s needs, and whether the prospect is a good fit for the firm. These factors are similar to LOP-2B’s “first impressions.” LOP-1B and LOP-3B also look at the history and background of the company and management. The background information coincides with LOP-2B’s search for potential issues, although it seems that LOP-2B dives a little deeper into the client information than the other two partners from Firm B before putting the client into the firm’s formal acceptance process.

The partners at Firm D emphasize the importance of management in their primary areas of focus for client acceptance. LOP-2D and LOP-3D specifically mentioned they are concerned with management integrity, and LOP-1D noted that it was important that the prospective client have the right management people in place. LOP-3D also mentioned management’s expertise and sophistication as a primary concentration, along with the company’s business model and viability. LOP-1D similarly mentioned viability, noting that an area of emphasis for LOP-1D is start-up entities, so investors and funding, along with potential going concern issues, is a key matter. Both LOP-1D and LOP-3D mentioned independence concerns, but for LOP-3D “there’s

no judgment involved with independence... that is a stop sign.” LOP-1D shared that it is important to consider other non-audit work the firm might be doing that could be profitable for the firm with no risk. LOP-1D and LOP-2D also stated it was important to understand why the company might be changing auditors and whether it was a sign that “they’ve got too many problems” (LOP-1D).

At Firm E, all three partners mentioned management integrity (and/or reputation) as a primary concern for client acceptance. LOP-1E also considers the industry of the company before recommending the prospective client for acceptance, while LOP-2E strives to ensure the firm has the skills and experience needed, which can include industry considerations as well as management’s expectations for the audit. LOP-1E and LOP-3E ensure the company is financially viable before entering into the formal acceptance process. LOP-2E’s concerns also focus on ensuring the prospective client is “a good strategic fit for what we’re trying to accomplish with the practice.” LOP-3E performs procedures that probe various company-specific matters, including the reasons for changing auditors, changes in management, history of the company, negative publicity, issues around internal controls, prior issues that have not been addressed, and the potential for restatements.

4.5.3 Summary of Client Acceptance Focuses

Taken together, the results discussed above indicate that the local office partners from all five of the firms focus on risk, management integrity, and the financial viability of prospective clients during the client acceptance process. In addition, at least one partner from each firm mentioned industry needs and/or necessary expertise as a key focus. Thus, it appears that the local office partners examine a broad range of factors as part of the client acceptance process.

However, the individual partners within each firm did not have consistent emphases, nor did the partners focus solely on risk, management integrity, and financial viability in client acceptance considerations. At Firm A, the only consistent consideration across all three partners was risk, although the three partners focus on different aspects of risk. Two of the partners are concerned about financial viability while only one partner identified management integrity as a key focus. Similarly, all three of Firm B's partners consider risk, although the three partners differed in whether the risk focus was across various aspects of the company or isolated to the history of the company and management. Additionally, only one partner considers management integrity and financial viability to be important. Although partners at Firm C cover all three primary focal areas, one partner at Firm C does not focus on any of the three primary factors, while the other two partners differ between the importance of risk versus management integrity and financial viability. Each of the partners at Firm D mention two of the three major factors, although none of the partners identified the same two focal areas. Firm E's partners each mentioned management integrity as a key factor. However, only one partner focuses on all three factors, while the other two partners differ between the importance of risk and financial viability.

4.6 Client Acceptance Focuses for Policymakers

After discussing their own areas of focus for client acceptance, I asked local office partners to discuss those areas that they felt their respective firm's policymakers viewed as most important in the client acceptance process. I asked the partners to respond based on their own opinions and personal experiences. This instruction allowed the partners to provide open feedback, rather than feeling as though they had to provide formal responses on behalf of the firm. The Risk Management partners were asked to discuss the key areas they wanted local office partners to consider during the client acceptance process. The purpose of these questions

was to examine whether the local office partners are truly aware of the areas of focus according to the firm's policymakers, or if the local office partner's view of the key areas for policymakers could be influenced by other factors, such as the types of pushback received in prior experiences (see Section 4.8). Table 5 summarizes the local office partner responses for each firm. Table 6 summarizes the Risk Management partner responses by firm.

4.6.1 Between-Firm Analyses of Policymaker Focuses

Local office partners from four of the five firms (Firm A, Firm B, Firm C, and Firm D) included risk as primary concerns for firm policymakers. The partners' descriptions of the risks that concern policymakers generally concluded that the policymakers take a broader view of risk around client acceptance (i.e., overall risk to the firm, several risk factors together, risk of material misstatement and restatement, the risk profile of the company).

[T]hey're looking at the firm as a whole. And I think it goes back to risk and I go, they might have something more of a strategic plan involved ... I think they can step back and say, does this make sense for the firm? Like it might make sense for me as a partner saying bump up my book, but they might say, well, it bumps up [LOP-1A's] book, but [LOP-1A's] going to be taking resources, that during prime busy season that, you know, we could be getting more money somewhere else with those same resources ... I think, you know, revenue is a driver and risk is a driver. I keep going back to risk, but, you know, as I said, I think they're a little risk averse and um, they just want to make sure that the client makes sense. (LOP-1A)

This concern surrounding risk can include audit risk, but that risk expands to reputation risk (LOP-1A, LOP-1B, LOP-2D, and LOP-2E), litigation risk (LOP-3B and LOP-2E), industry risks (LOP-1A and LOP-3E), risk of material misstatement (LOP-2C, LOP-1D, and LOP-2D), and risk of business failure (LOP-3B, LOP-3D, and LOP-3E). Some local office partners noted that the decision makers at the firm are very risk averse and conservative when it comes to risk (LOP-1A, LOP-3B, and LOP-1D). However, this theme did not resonate within any of the firms;

it appears to be an individual opinion, as opposed to a collective opinion of the local office partners within each firm.

The local office partners at four of the five firms (Firm B, Firm C, Firm D, and Firm E) also mentioned policymakers' focus on management integrity. "I think integrity of management is important, it's probably most important" (LOP-1C). This focus may stem from potential audit failures. "[I]f you take the ultimate, what could go wrong? Then the biggest, the biggest negative ramification fact to us... is gonna be integrity, integrity driven" (LOP-3D). Management integrity concerns also include reputational risks and the impact on the audit.

[I]s there risk that we have criminals that we're dealing with that aren't honest and truthful with us, um, or even non-criminals that are not honest and truthful with us. Um, which is even harder to know, but. (LOP-3B)

As discussed in Section 4.5, local office partners for all five firms also view management integrity as a key factor in client acceptance decisions.

Partners from two firms (Firm A and Firm B) believe that the firm's policymakers use the client acceptance process rather broadly to minimize risk to the firm. The local office partners see the process as a strategic approach by the firm (LOP-1A), so the process itself as a whole is important. "[T]hat's... our initial tool to protect ourselves. So, you know, is there any one thing in there that's most critical? No, I don't think there's... a key critical component. The process itself is a key critical component" (LOP-2A). Thus, these partners view that the factors within the client acceptance process are considered as a whole by the key decision makers at the firm in order to make appropriate decisions about prospective clients.

4.6.2 Within-Firm Analyses of Policymaker Focuses

Although the local office partners identified the breadth of the assessment process, the importance of broader risk factors, and management integrity as key policymaker issues for the

firms, the partners within each firm had different views of the factors viewed as most important to policymakers in the client acceptance process. Tables 7 through 11 summarize the responses individually provided by the three local office partners and Risk Management partner for each firm.

As noted above, several local office partners mentioned overall risk as a primary factor for policymakers. All three local office partners at Firm D discussed the firm's concerns with risk. The only other factor mentioned by Firm D's local office partners was management-related issues. LOP-2D and LOP-3D mentioned concerns over management integrity. LOP-2D stated that policymakers consider the backgrounds and skillsets of the prospective client's management group. Similarly, the ultimate client acceptance decision-makers also consider the skillsets of the engagement team. "The challenge, does local office have the resources and skill sets. So there's a... variety of ways we slice it, which then someone sitting high above looks at and, uh, asks me follow-up questions, etc." (LOP-2D).

The Risk Management partner at Firm D did discuss risk as a primary concern for client acceptance. However, RM-D focused specifically on business risk, rather than just general risk related to a prospective client. RM-D felt the local office partners should focus on gathering an extensive understanding about the prospective client that will allow the local office partner to adequately assess "where significant risk may lie." RM-D also discussed the importance of consultations with the regional leadership at the firm prior to beginning the acceptance process, noting that these discussions allow the partner to "find a consensus view about whether to proceed or not." These consultations allow the local partners to vet important matters that could affect client acceptance before going through the formal process. "It would be fool hearted for a partner to be going through the formal process if there was any doubt about whether or not it

gets, would get accepted. ... And then that's why I would say the dialogue starts much earlier on if there was any question" (RM-D). The local office partners did not discuss the emphasis on these preliminary meetings as a significant client acceptance focus.

At Firm E, the local office partners identified several areas they felt policymakers signal as important. LOP-1E and LOP-3E are generally aligned in their views of these focal areas, which they identified as management integrity, the financial viability of the business, issues that may be complex (LOP-3E), and whether the engagement team is able to address those issues (LOP-1E). LOP-3E also felt that, in addition to these risk factors, engagement economics are important to the policymakers. Although LOP-1E identified multiple factors, "underlying integrity of management and those charged with governance and the financial viability of the enterprise and the industry in which they operate... [are] the two things... that we're challenged on." LOP-1E also indicated these two concerns are "the same two that I thought were most critical." Similarly, LOP-2E felt that the concerns of the policymakers align with the same things LOP-2E focuses on in the client acceptance assessment. This focus includes risk (audit, litigation, and reputation risk), whether it is "a level of risk that we can manage," and ensuring that the prospective client is "a good economic fit... to the firm in terms of profitability and growth" (LOP-2E). The key concern for policymakers is not necessarily one particular aspect of this assessment. "I don't know that there's any one factor that's most important... think it's the, the handful of factors... that all have to be addressed in the present in order to have an effective client acceptance and continuance program" (LOP-2E).

The local office partner responses are indicative of the concerns raised by the Risk Management partner from for Firm E. The items discussed by the local office partners focused on somewhat specific aspects of risk. RM-E felt that the local office partners should be looking

at risk from a broader lens, focusing on risk to the firm. “[I]t's not are they focused on the risks to be able to get that audit done. They're good at that. It's the broader risk management to the firm” (RM-E).

At Firm C, LOP-3C mentioned that the bundle of information, as a whole, is important to the policymakers and key decision makers at Firm C. However, as Firm C uses a checklist-driven process for the formal client acceptance procedures, “I think that the internal developed form that we have that spells out any additional risk factors above and beyond the [PRACTICE AID] forms, that's probably the, the most critical form that's used” (LOP-3C). Thus, this local office partner views the extra considerations that the firm layered over the standard checklist (broader client-related considerations including all services performed, financial statements, and key risk factors the prospective engagement partner things should be highlighted) as the key items in the acceptance process, which allow the policymakers take a broader approach to client acceptance. LOP-1C believes there are two primary focal points for the policymakers in client acceptance: integrity of management and whether Firm C has the necessary resources to service the prospective client. LOP-2C agreed that the firm’s experience and capabilities are key for policymakers. However, LOP-2C also believes that the policymakers are concerned with Firm C’s exposure from users of the financial statements, as well as economics.

Interestingly, RM-C specifically agreed with LOP-3C. While the points raised by LOP-1C and LOP-2C may be a small part of this view, RM-C felt that the biggest issue local partners need to consider is making sure the risk factors are appropriately documented on the form submitted with the client acceptance package. RM-C’s concern in client acceptance is that the local partners may see that the prospective client has some matter, such as a warrant, but the lack of prior experience with that particular item may make the local office partner believe the issue is

low risk. “[W]e don't rely on, on the local partners [to identify and address highly risky or complex issues] because I think you'd end up with a bad result” (RM-C). The regional technical partner who reviews and approves client acceptance would be the one who most likely identifies that item as an issue and helps the local partner address the risk.

The local office partners at Firm A also had differing opinions on what policymakers thought was most important in the client acceptance process. LOP-3A was very adamant that the firm's focus is ensuring the prospective client does not create any significant risks to the firm. “I think the firm is more concerned with how much risk is the firm going to take on. I think it's clear that that's what they care about the most” (LOP-3A). LOP-1A also mentioned the importance of risk, but clarified the assessment as “they're looking at the firm as a whole.” However, LOP-1A also believes the firm balances risk and revenue, considering both financial and industry focuses, as well as possible concerns around reputational risk. LOP-2A had a very different opinion about the focuses of the policymakers. “I don't think there's a, a key critical component. The process itself is a key critical component” (LOP-2A). However, LOP-2A also stated that certain factors may weight more heavily than others, such as if “the CEO had been indicted for something, yes, that's going to weigh more heavily than... maybe the CFO hasn't paid child support... it's a qualitative analysis of what you find out as well.” So despite the process as a whole being important, there are some aspects of the process that may be more important “on a case by case basis” (LOP-2A).

Despite the difference in opinions among the local office partners, none of the client service partners at Firm A mentioned management integrity, which RM-A stated is “one of the key things... maybe the biggest thing.” RM-A also felt it was important that the engagement partners look closely at the prospective client to understand what is happening at the company, in

the industry, and the overall complexity of the audit. The local office partners need to use this information gathered and determine whether the firm has the expertise and capacity to address the issues related to that client. Some of these areas were raised by LOP-1A, but none of the partners identified concerns over resources and expertise. Along with management integrity, “I think those are the two things when I look at... issues that we've had to deal with after the fact, [those areas] are the two most important things that would have avoided those on the front end” (RM-A).

Consistent with Firm A and Firm C, the opinions of the local office partners at Firm B are quite diverse. Similar to LOP-2A, partner LOP-2B also believed that all of the factors in the client acceptance assessment are important to the policymakers. “I think all of it goes together... you need all of that information to make a good informed decision” (LOP-2B). LOP-3B agreed that the approach of policymakers was more broad, but generally focused on risk. This focus included risk related to litigation, business failure, and concerns about management integrity and honesty. LOP-1B, quite simply, stated that policymakers are most concerned with management integrity.

RM-B did mention management integrity, along with several other factors. RM-B felt it was important that local office partners understand the prospective client, including industry, expertise needs, and available resources. “I think they do a pretty good job, but I think it, it could be more in depth” (RM-B). One specific area RM-B thought local office partners needed to focus on during this process is considering not just the risks for the prospective client, but how those risks will be addressed during the audit.

I think sometimes there is... a belief... that we'll figure out a way to get it done. And that's largely true, but the more complicated something is, the more it needs an actual plan. Right? And not just a promise that we'll get it done. Because that's where we've also

found where... problems have arisen, right, is if people are stretched too thin. So best to just acknowledge that up front and, and put together a workable plan. (RM-B)

4.6.3 Summary of Policymaker Focuses

Broadly speaking, the local office partners stated that they believe risk considerations and management integrity are the most significant client acceptance factors for their firm's policymakers. Risk factors may include a wide range of matters, including areas such as industry issues, financial viability, and expertise and/or resource requirements. In general, the local office partners' views of what policymakers focus on for client acceptance differ from what Risk Management partners state are the primary issues in the acceptance decision.

The local office partners at Firm A believe the firm's policymakers focus primarily on risk and the impact of a prospective client on the firm as a whole. However, none of the local office partners identified management integrity, which is the primary factor in client acceptance according to Firm A's Risk Management partner. At Firm B, the local office partners view broader aspects of the company and risk as key for policymakers at the firm. The Risk Management partner at Firm B agreed that several factors related to the company are important when making client acceptance decisions, but mentioned that local office partners need to be more thorough when examining prospective clients. Policymakers at Firm C are most concerned with whether the local partner properly identifies key matters, generally documented on an internally developed form that is part of the client acceptance package. Only one local office partner at Firm C identified this form as important in the acceptance process; the other two local partners identified management integrity, exposure to risk, and economics as key factors, which are the same factors identified as key focuses for the local office partners (see Section 4.5). The local office partners at Firm D see overall risk as the primary issue for policymakers in addition to potential management integrity issues, which is consistent with the focus areas for local office

partners at Firm D (see Section 4.5). However, the Risk Management partner at Firm D believes that the primary client acceptance concerns relate to business risk, not overall risk, and consulting on potential client acceptance issues before the process begins, rather than during the process. The Risk Management partner at Firm E, on the other hand, sees the biggest area of concern as overall risk to the firm, not an individual aspect of risk. One local office partner identified this broader view of risk as the primary concern for policymakers, while the other local office partners discussed management integrity, financial viability, and major or complex risk areas as focal points, which were consistent with their own views of key concerns for client acceptance (see Section 4.5).

4.7 Views of Differences in Client Acceptance Risk Perception

After asking local office partners about those aspects of the client acceptance process they and the policymakers at the firm viewed as most important, I inquired whether there were any differences between local office partners and Risk Management partners in their perception of risk related to client acceptance. Table 5 summarizes the responses by firm. I also posed this question to the Risk Management partners at each firm; the responses are summarized in Table 6.

4.7.1 Between-Firm Analyses of Differences in Client Acceptance Risk Perception

Twelve local office partners, representing all five firms, mentioned there are differences between the two levels related to views of the amount of risk found in a prospective client. Most partners thought the difference relates to the perspective of the partners at each level. “I think the amount of risk that a firm is willing to take is different at a national level. I think the National folks have a better appreciation for the entire risk profile” (LOP-3A). Four of the five Risk Management partners (RM-A, RM-B, RM-C, and RM-D) agreed that the differing views of risk were the primary differences between local partners and Risk Management. According to the

local office partners, the different viewpoints relate to two primary factors: differences in exposure to risk (Firm A, Firm B, and Firm C) and differences in partner job responsibilities for each level (Firm B, Firm, D, and Firm E).

These two factors are somewhat similar. The differences in exposure are partially due to the job responsibilities required of each partner. For example, the local office partners focus more in their own individual offices than the firm as a whole by the very nature of the role. However, the local office partner should also have some awareness of and consider the impacts of their decisions on the firm as a whole. The differences in exposure relate more to the increased information available to the higher-level partners. “[T]hey certainly are aware on a more global basis for the firm of, of where they feel like risk could lie” (LOP-3C). Additionally, experience related to past decisions plays a role in this difference. Local office partners may not see unusual client acceptance decisions frequently as opposed to the regional or national partners who review acceptance decisions based on select criteria that make each decision somewhat unusual or complex.

[J]ust given that they have much more exposure... over the whole firm, if you will, and they see what's happening. Where compared to me, I might not have that exposure. So their experience I think is, is good. That's the good reason why they're part of the process, because they have that experience that we might not have had on our jobs, um, before. I can, you know, leverage off their experience. (LOP-2B)

The differences in job responsibilities relate more to the role each partner serves for the individual firm. “I think everybody's got the same end goal in mind. They're just by virtue of their roles focused on different aspects of that end goal” (LOP-2E). Each partner is responsible for protecting the firm as a whole. However, the local office partners are required to perform several functions as part of their jobs, while Risk Management partners are specifically responsible for considering the risks to the firm.

[P]artners in the field, we're wearing lots of different hats. So it's just, uh, one role that we take which is... a minor role of everything that we do. So the risk folks are going to be ultra, ultra conservative and focused solely on that. Um, which is why they're there I guess. (LOP-3B)

I think the, the way to think about it is... it's not so much differing opinions or differing priorities. It's just different points of view. So if you think about someone in our [RISK MANAGEMENT] group, they spend all their time thinking about, um, not just whether or not we can comply with the standards, but also what are the indirect costs if, if a client is going to be subject to litigation, even if we have nothing to do with it, what, what are the costs to us purely by being involved and being deposed. (LOP-2E)

The local office partners generally do not view the differences in these roles and perspectives as adversarial. Instead, it is an opportunity for the firm to take a group-based approach to client acceptance and ensure individual partners do not hold all of the power in this acceptance decision.

I think most partners realize that when we accept a client, that's when the risk is highest. And so we're probably okay with the fact that somebody else has to say, yeah, we're, we're good with you bringing this client on to the firm. (LOP-2C)

Additionally, the various levels of approval required by each firm allows for improved dialogue about challenging client acceptance decisions and the risks related to those decisions.

I wouldn't say there are areas that are fundamentally or presumptively where you have a, you know, a different view. I would say in a given situation, there is going to be, you know, a healthy back and forth where all parties are challenging each other. (LOP-3D)

Part of the process of challenging the merits of certain decisions relates to differences in perspective. In some cases, the local office partner recognized the client acceptance process as a way of protecting the firm from decisions based on the bias of local office partners who are usually measured based on revenue levels.

[T]hat's why we have people who aren't measured at all based upon revenue that are helping us with these risk considerations. Um, to ensure that we're, you know, properly evaluating the merits on a completely objective basis. Because while as professionals we are bound and required to be independent, it's almost impossible to be 100 percent objective. (LOP-1E)

However, these differences in views between the two partner groups were not always viewed in a positive light. Some local office partners viewed the challenges from those higher levels of approval as simply a nuisance or as a lack of understanding at the higher level. This perspective, in general, came from Firm B.

[D]epending on the person, um, they may be ultra, ultra conservative and they just ask a lot of questions, I mean, dive deeper into getting more information. And, um, I think it's a little overboard there. (LOP-3B)

I'm like, you know, [BIG 4 FIRM] really put them through... the ringer and... it was good for me... because like now you already have a client that was already well trained. ...I want to say it's like sometimes we don't, our national group really doesn't see the details of what a client actually went through or a prospect went through, um, and where they're at today compared to. (LOP-1B)

However, one partner from Firm E (LOP-3E) also mentioned that there were differences in the perceptions of risk due to lack of understanding. This issue generally centered on economics and the regional or National partner's view of appropriate economics as opposed to the local office partner who is more aware of the local economic market factors.

4.7.2 Within-Firm Analyses of Differences in Client Acceptance Risk Perception

Because of the consistency among the firms in overall responses as discussed above, the responses for each individual firm were also relatively consistent among the partners. Tables 7 through 11 summarize the responses individually provided by the three local office partners and Risk Management partner for each firm.

The partners at Firm D all agreed that the main driver of these differences in risk perception were due to the differences in roles required by the two partner groups. LOP-3D also mentioned that the point of having these different groups of partners in the process was to make sure the different parties challenge one another because they each have different viewpoints and, at the end of the process, “everybody that approves everything has to agree and be on the same

page.” These differing viewpoints were an important issue raised by RM-D. The Risk Management partner at Firm D felt that local partners might be bringing prospective clients to the firm that do not fit the firm’s profile in terms of viability and continued growth. Oftentimes there is a difference in the view of the risk and the potential fit of these companies at Firm D.

The partners at Firm E also generally agreed that variances in risk perception relate to differences in the role of each partner (LOP-1E and LOP-2E). However, LOP-3E felt that the main differences that arise are generally due to economic considerations, and usually requires the local office partner to educate the Risk Management partners on local market conditions. RM-E did not discuss economic factors or differences in roles. Rather, RM-E felt that the biggest challenge in client acceptance relates to the view of risk and the team’s ability to overcome it.

That's always the challenge. ... Is them viewing... this is easy to overcome. We just need to do X, Y, and Z. And then us helping them to understand are they going be able to do X, Y, and Z. Now the risk function has to ask the right questions, though. Because it's easy to swoop in and say, no, we're not going to do that. But to really understand what's happening and what's causing it. And so maybe we can work at it from that angle. ... Reality is usually somewhere in the middle. And it's a matter of finding out what that is. ... That we, we probe to get at the real underlying issue before we make our conclusions. That's more of an art than a science, though. (RM-E)

For the remaining firms, the majority of the partners in each firm identified differences in views of risk to the firm as the primary difference in client acceptance risk perception. At Firm A, two partners (LOP-1A and LOP-3A) mentioned that those partners at a higher level have a broader view of risk to the firm. LOP-1A also noted that this view is related to the fact that the partners at the two levels have different focuses related to specific aspects of their jobs. LOP-2A did not believe there were any differences between the two partner levels, as even local partners are charged with protecting the firm from risk. RM-A felt that the focuses on risk are different between the two partner groups. The local partners tend to view risk as simply the risk of

litigation and fail to consider the risk of material misstatement, regardless of the users of the financial statements and the likelihood of being sued.

So I think that's really the, the difference. If they could look at it more independently of whether you think you would ever get a [legal] claim as a result of this engagement. Evaluate it that way as opposed to just thinking about like, well, if I don't think there's a claim, it could be the riskiest job in the world, but I'm just betting that, you know, there'll never be a claim resulting from it, and that's how I evaluate risk. I think that's... the biggest issue that we deal with. (RM-A)

Similar to LOP-2A, LOP-1C felt that different perceptions of risk between the two partner levels is rare. On the other hand, the other two partners at Firm C (LOP-2C and LOP-3C) thought that the two partner levels have different views of risk. Additionally, LOP-2C mentioned that most local partners saw this additional level of approval as an additional level necessary to protect the firm. RM-C agreed with these two partners, noting that Risk Management partners tend to be more risk averse. Interestingly, RM-C explained that this conservative approach for Risk Management is by design. Partners at the firm take personality tests, which help Firm C determine the appropriate role for the partner. “We have, um, obviously, a diverse group of partners. But we try to have the people that are making the risk decisions be those more conservative type people” (RM-C). So by design, LOP-2C and LOP-3C are correct that the partner views of risk are different, as Firm C has intentionally placed more conservative partners in the risk roles for the firm.

Two of the partners from Firm B (LOP-1B and LOP-3B) saw this difference in risk perception as a more negative aspect of client acceptance. LOP-3B saw the difference as simply an increased level of conservatism from the Risk Management partners. LOP-1B felt that the Risk Management group tends to focus on the negative factors identified during the client acceptance process. However, LOP-1B also noted the Risk Management partners are “the first line defense... the gatekeepers. ... I can definitely get their point of view.” LOP-2B took a slightly

different viewpoint from the other two local office partners, noting that the Risk Management partner's view comes from a more firm-wide perspective and experience. This viewpoint can help the local office partner with these client acceptance decisions because "I can, you know, leverage off their experience" (LOP-2B). RM-B felt the difference between the two partner groups related more to the views toward the prospective client. For RM-B, local partners might have a "degree of optimism" about the prospect and its ability to overcome issues, where Risk Management looks for the company to have put a plan into place before deciding to accept.

4.7.3 Summary of Differences in Client Acceptance Risk Perception

The local office partners and Risk Management partners consistently observed that different views of client acceptance risk are likely a factor of varying roles and responsibilities between the two partner groups. However, the discussion of the roles and responsibilities differed for individual partners. At Firm A, the local partners were inconsistent with how these roles might cause differences in risk evaluations, ranging from no differences to perception of local office partner capabilities. The Risk Management partner at Firm A saw the difference in risk perception as a function of how risk is defined (litigation risk versus risk of material misstatement). Firm B's local office partners and Risk Management partner saw the differences in views of risk as a factor of experience and the relationship with a prospective client. The local office partners at Firm C differed slightly in their responses, with only one engagement partner directly identifying the same factor as the Risk Management partner: the level of conservatism. At Firm D, all three local office partners agreed that the difference in views of risk relate to the roles of the difference partner levels. However, RM-D stated that the different view is associated more with local partners not considering how prospective companies fit into Firm D's portfolio. All four partners at Firm E saw the difference in risk perception as a function of the partner's

position. However, the local partners saw it as a difference in viewpoint while RM-E felt this difference was attributable to the local office partner's view that risks can easily be addressed during the audit rather than understanding the true issue during client acceptance.

4.8 Examples of Pushback Received in Client Acceptance Decisions

In each interview, I completed the discussion on client acceptance by asking the local office partners and Risk Management partners to describe situations where a local office partner had proposed a client for acceptance (i.e., entered the prospect into the formal acceptance procedures and performed the initial approval), but received pushback from a higher level of approval in the process. These situations included examples of a time where the prospective client was rejected and where the prospect was eventually accepted after further discussion or debate. The partners described (at a high level) the situation and explained their understanding of the issues that caused concern for the higher-level approver. Table 5 summarizes the local office partner responses to these questions by firm, Table 6 summarizes the Risk Management response by firm, and Tables 7 through 11 summarize the individual responses for the local office partners and Risk Management partner for each firm.

Examples from four of the firms (Firm B, Firm C, Firm D, and Firm E) related to issues that arose in the background checks performed by the firm as part of the client acceptance process. Of note is the fact that three of these firms are the only firms in this study that require background checks on all prospective clients. Firm A and Firm C require background checks only for publicly traded companies.

I won an engagement... we came up with something on a background check ... I believe personally the severity of what came up in the background check was not severe, and I, and I have a pretty conservative approach to it. Um, our risk team had a more conservative view than I had. And at the end of the day... they carry the, the ultimate decision. And you know, as a, as the engagement partner on that particular opportunity, I

was frustrated and disappointed. As a partner of [FIRM E], I'm thrilled that they would toe the line like that. (LOP-1E)

The fact that the background checks identify key concerns for those performing higher-level approvals for client acceptance indicates why the policy is a requirement for some of the firms. “I mean... those background checks rarely produce anything... more than just comical humor... but [the example provided] was one where the background check was the deal killer” (LOP-2D).

Two partners from Firm A (LOP-1A and LOP-2A) provided examples of times when there was concern that the fee was too low based on the risk being assumed by the firm, but in both examples, the company was eventually accepted as a client after the fee situation was addressed.

I think that's the benefit of having [REDACTED NUMBER OF] partners and our system where we're broken up into like regions and office managers, you kind of can go to them directly, say, hey look, this is the situation, and if they think it's good for the region, they'll have your back and, you know, push for it, too. (LOP-1A)

LOP-2A and LOP-3A both felt Firm A pushes back if there is concern whether the right people were on the engagement. RM-A agreed that the size of the client and the resources required are common pushback examples. RM-A also noted that the majority of client acceptance rejections at Firm A occur because of issues with competence and the resources required to perform the audit, as well as management integrity issues. LOP-2A had not had this issue happen, but was aware that it was a concern and made sure to address the issue when proposing a client where a partner with the proper expertise had to be brought in as the engagement partner (LOP-2A remained on the account as the relationship partner). For LOP-3A, there was concern that the engagement partner did not have enough experience to adequately serve a publicly traded client. Firm A's Risk Committee agreed to accept the client once a strong concurring partner was assigned to the audit.

I've had instances where, and a lot of it has to do with the partner. They'll take the work, the firm will accept the work, if they believe that the right partner is servicing the account. And they'll allocate it as such. (LOP-3A)

The partners at Firm D also provided mixed examples of pushback received on client acceptance decisions. However, RM-D noted that rejections in the client acceptance review process are not very common, as prospective clients with significant issues would likely have been discussed before the local partner started the formal acceptance process. RM-D also believes pushback would primarily result from independence issues that may arise as part of the formal acceptance process. LOP-2D's experiences related primarily to issues surrounding the backgrounds of management and possible investigations into the prospective client. LOP-3D also mentioned that background searches and issues around management integrity caused approvers at higher levels in the review process to ask additional questions. Overall, the pushback is the result of technical partners trying to understand industry issues or concerns (LOP-2D and LOP-3D). Firm D also utilizes industry experts who are not necessarily part of the formal approval process to help weigh in on difficult client acceptance decisions when those in charge of acceptance need help with industry-specific concerns (LOP-2D). LOP-3D shared that decisions to terminate the client acceptance process are "more common when you are a private company who are looking to ultimately go public," primarily when the company does not seem truly prepared to go through an IPO process. This issue generally centers on concerns about whether the management team is the right team to lead the process. LOP-1D's example of client acceptance pushback took the opposite position, noting that the approvers were concerned about resource demands on the engagement team and the firm in a situation where "we're going to increase our risk if we take them on because then we're going to stretch our resources too thin." So Firm D appears to cover a broad spectrum of issues during the client acceptance approval

review process, ranging from potential issues with the prospective client to potential issues within the engagement team.

The examples provided by Firm B local office partners and the Risk Management partner were around concerns over the future of the company. RM-B discussed examples of pushback that generally relate to business that are high risk but have the potential to be very successful. The pushback generally occurs when Risk Management believes this engagement is similar to prior experiences where the company failed, so the firm is less likely to take on another similar situation. LOP-1B described a situation where a prospective client was involved in a lawsuit that also named the predecessor auditor. The client was eventually accepted, but the partner's description of the situation raises an interesting perspective on another firm's client retention process:

[MID-TIER FIRM] was in the lawsuit, [BIG 4 FIRM] was in the lawsuit, as well, um, or named in the lawsuit. But, you know, they still audited them until the decision didn't go their way, which is kind of strange. I would think it, once you were named that that's where they should have dropped them. But... we had to overcome that, that piece. (LOP-1B)

LOP-2B and LOP-3B both described situations where going concern was an issue that complicated the approval of acceptance at higher levels in the process. Outside of concerns about future concerns about the prospective engagement, RM-B noted that the majority of recent client acceptance rejections related to industries where the firm did not have the ability or willingness to get involved, such as digital asset offerings and cannabis (see Section 5.1.9).

Two of Firm C's partners pointed to four main issues where partners at the higher regional level requested additional information and/or additional considerations by the partner during the client acceptance process. (Partner LOP-1C had no examples of pushback situations during client acceptance.) "Always economics" (LOP-2C). LOP-3C mentioned there could be

issues that come up when reviewing the background information for key members of management, particularly issues with related parties. LOP-3C also provided an example where Firm C believed it was independent of a prospective client, but “while we would probably ultimately be independent, there could be the appearance that we may not be, and so... we didn't engage.” Lastly, although this partner had not experienced it personally:

I do know there are times where larger clients that have a bit more exposure, that have a bit more risk, particularly with respect to investors, outside investors, uh, they, they vet that pretty carefully to see if it's something that we feel confident that we're going to come out on the, on the good end of it. (LOP-2C).

RM-C clarified this assumption somewhat, saying that the most frequent rejections in client acceptance are due to risks around specific transactions. This concern generally is accompanied by a lack of expertise within the firm to address that risk.

Consistent with the other firms, the local office partners at Firm E identified examples of client acceptance pushback related to management integrity concerns (LOP-2E and LOP-3E) and situations where individuals within Firm E had previous experience with someone in the prospective client's management team that was negative, and it resulted in the firm walking away from the prospective engagement (LOP-1E).

The frustrating part for me was this is one where it actually was not public information. No other firm that was proposing on this could have known what we do... it came from... an experience that we had related to a company where this individual had been at previously. ...I felt like... we went with belts and suspenders. (LOP-1E)

RM-E agreed that pushback resulted from issues that arose during background checks, related to management integrity issues, also saying that the majority of client acceptance rejections stem from background issues. The firm has also pushed back on issues with management surrounding qualifications and experience (LOP-2E). RM-E stated that the expertise concerns were usually around the firm's abilities to service a prospective client, as well as potential capacity and timing

issues. Other issues that have been raised at Firm E include concerns about whether or not the economics are appropriate for the risk assumed (LOP-3E) and where the higher-level reviewers requiring additional information to gain a better understanding of the situation (LOP-1E and LOP-3E).

During these discussions, one partner stated that if partners properly followed the client acceptance procedures, reviewers would not push back. “[I]f somebody's asking you for more information, it's because you haven't put enough in to begin with. They're not asking for anything additional that should be in there” (LOP-2A). However, this opinion was a minority opinion, as the remaining partners were able to identify examples of receiving pushback but also explained why they believe reviewers might have these follow-up questions.

I think sometimes those people want to have the one-on-one discussion to make sure they fully understand it. Um, because again, it's hard to get all the factors laid out perfectly in that explanation in there. (LOP-3E)

I think, you know, from a business viability standpoint, they're... not experts in every industry. Right? They're going to challenge you to try to understand. (LOP-3D)

Similarly, the review process was also described as a way for reviewers to make sure the prospective engagement team thought through all of the risk factors. “They're going to challenge you to try to understand. ... [T]hey want to see that they're getting [THE INDUSTRY], more explanation, and then they'll ask you about how you're gonna manage it” (LOP-3D). This process enables those in charge of risk management at the firms to understand why the local partner wants to accept the client and helps the local partner to understand why the Risk Management partners have concerns about the prospective client. “[W]e're not gonna be good until, you know, we're all together. So figure it out” (LOP-2B). In some cases, however, the partners view the process as more of a formality to get approval from regional or national partners. “I really don't

know. I never really understood it. I just, I just got the information they told me to get” (LOP-3B).

Despite the uncertainty in some cases about what concerns the regional and national approvers may have, several partners noted that the client acceptance process is an incredibly important risk management tool for their respective firm (eight partners across all five firms). This positive view of the client acceptance process also includes the challenges engagement partners face from higher levels of review. “I can think of two that were really closer calls for me in the last few years, and both of them ended badly. So I think that speaks to why this process should challenge the local partner” (LOP-2D). As discussed previously, the local office partners do not always view the role of the reviewer as adversarial. Rather, this process is a way for those partners at a higher level to ensure that the engagement teams and the firm, as a whole, are making correct decisions about client acceptance.

The key is... making sure that... a quality judgment's being rendered by the engagement team first and foremost, because they're the ones that are closest to the facts. You know, a national technical person on their best day is not out there interacting with Fred and Jane, you know, around accounting pronouncements and their behavior. (LOP-3D)

4.9 Summary of Client Acceptance Findings

The local office partners identified five primary focus areas for client acceptance: risk, management integrity, financial viability of the prospective client, industry knowledge, and expertise requirements. However, the partners within each of the five firms varied significantly as to which of these areas was most significant. Additionally, the local office partners identified other areas they consider during client acceptance outside of the five primary areas, but these other focal areas were not consistently mentioned across the local partner group. Within Firm A and Firm C, there was significant variance in the partners' areas of focus for client acceptance.

Partners at Firm B, Firm D, and Firm E had greater consistency in their responses, although none of the partners within a single firm named the same areas of focus for client acceptance.

The local office partners also varied in those aspects of client acceptance they thought were the primary concerns for their firm's policymakers. The Risk Management partners stated their concerns focused on management integrity, general risks to the firm, and detailed analyses of prospective clients. Only the local office partners from Firm B were close in identifying the Risk Management themes correctly, while only a single local partner at two firms correctly identified the area(s) of focus for their firm's policymakers.

Despite the differences in the primary factors for policymakers, the local office partners and Risk Management partners generally agreed that the differences in how risk is perceived for client acceptance decisions is a factor of the roles and responsibilities for local office partners versus Risk Management partners. However, this agreement is a general consensus across the local office and Risk Management partners as a whole; there are differences within most of the firms about why risk may be viewed differently. The local office partners within each firm varied in how they viewed differences in risk perception. The local office partners and Risk Management partners at three of the five firms also had different reasons for disparities in client acceptance risk. Only the local office partners and Risk Management partner at Firm B and at Firm E generally agreed that the roles of each partner contributed to the divergence in how prospective client risk is viewed between the partner levels.

4.10 Client Retention Focuses for Local Office Partners

After the local office partners discussed the examples of client acceptance pushback, I shifted the interviews to discuss client retention. Although the series of questions posed about the two processes were relatively similar, I felt it was important to discuss the client acceptance and

client retention processes separately and in entirety, rather than allowing the conversation to jump back and forth between the two processes, for two main reasons. First, continuous discussion about one specific topic allowed the participants to stay focused on one particular process and the complete aspects of it, rather than having to recall specific or individual aspects about two different processes simultaneously. Second, this approach allowed for stream of consciousness thinking, as the semi-structured approach generally allowed the conversation to naturally flow into discussions about specific aspects of the process as the participants introduced them. To start the discussion about client retention, I asked the local office partners to discuss those factors that he/she considered most important when deciding whether to retain a company as a client. Table 12 summarizes the responses, by firm, from the local office partners.

4.10.1 Between-Firm Analyses of Client Retention Focuses

All fifteen local office partners described client retention as a process of revisiting the prior year audit to consider any issues or difficulties related to the client that may indicate they do not want to continue the relationship. Local office partners from all five firms mentioned difficulties with the client (e.g., disagreements with management, concerns about the financial condition of the company, material weaknesses, etc.) as reasons they may decide to walk away from a client. Partners from four of the five offices (Firm A, Firm B, Firm D, and Firm E) specifically stated that they also consider the impact the client (and client management) has had on the engagement team.

I'll take a little bit of consideration about my people... that have to actually go out and do the work there. I mean, if, if the client is particularly difficult and particularly demanding... unreasonably so, um, maybe that's somebody I don't want to have my people exposed to. ...[C]all it whatever you want. The aggravation factor or... the pain in the tail factor. You know, that does get weighed into things. (LOP-2A)

For those local office partners who included evaluations of the impact of the engagement on the auditors, this consideration appears to have two primary purposes. The first is concern about the audit staff (nine partners).

I felt there was great risk to me as a partner for my reputation. And I felt it was just absolutely destroying our people. Um, from all angles. ...[I]t was establishing a bad mindset as to what's acceptable to our people. It was killing our people from their fire drills and just how they do things. Everyone hated the client. So it was just negative everywhere. And then as a partner I felt personal risk. (LOP-2D)

With these clients that are difficult and present a risk to the engagement team, the local office partners are also concerned that the challenges are not isolated to the audit staff. There is an additional risk that these difficult clients could treat their own employees in a similar manner, causing the partner to consider whether there is increased risk related to financial statement misstatements.

[W]e have discussions, uh, partners with the managing partners, on a regular basis about if there are any clients out there that [are] bullies almost. If that's the right way to say it. Where, you know, staff is too scared to go ask questions because if that's the case, that's a big red flag. Um, from how do you audit and what is this guy, girl, trying to hide? Like, why would you be like that? And um, and that seems if they're like that with us, they're most likely to be like that with other people in their department, in trusting, so everybody's too scared to ask the question. So maybe stuff doesn't get recorded, stuff, you know, just gets brushed under the table. So, um, so that's definitely the discussions we've had. (LOP-2B)

Along with the possibility of heightened misstatement or fraud risk, the partners also consider that the difficult clients could be indicative of management integrity issues. Ten partners across all five firms consider management integrity to be a key issue when making client retention decisions.

[O]ne could be, well, one that's, that's probably newer to kind of help people look at things is the PITA factor. ...[W]hich PITA is pain in the, and you can fill in the blank there. I had a client that... we walked away from. ...[T]hey had a CFO who was, you know, verbally demeaning and abusive to our people and... there's not a fee that's worth, um, putting our people in that situation. ...[I]t also begins to question the underlying integrity, right? The, you know, me thinks the lady doth protest too much. Um, you know,

once, once they start pounding the fist on the table, you've gotta understand... where there's smoke, there's fire and, and there's probably a reason that they're that defensive about it. (LOP-1E)

The local office partners do not solely consider these difficulties encountered during past audits in the client retention process. Management integrity issues could be the result of experience with the client. “[S]o integrity of management obviously for acceptance is a different process than continuance because once you know management it’s different” (LOP-2D). Management integrity issues could stem from fraud allegations or new information that arises as part of the client retention process (LOP-1A, LOP-3A, LOP-1C, LOP-2C, and LOP-2E).

Local office partners also consider the economics of the engagement when making client retention decisions. Eight local office partners who discussed economic factors represented all five firms. However, economics alone may not cause a partner to dismiss a client. “[U]sually it when it comes to financially, we don't drop them, we just kind of say, hey, here's our fees, and we tell them fees, and have them say no” (LOP-1B). Some partners acknowledged that the fees were a piece, but not necessarily the entire factor, that may cause the relationship to terminate (LOP-1A, LOP-2A, LOP-1B, LOP-2D, and LOP-3E).

One additional aspect local office partners consider is what factors have changed from the prior year that might cause concern (six partners representing all five firms). Changes in and of themselves may not result in termination of a client relationship. It is possible that these changes are indicators of new risk that require a different audit response. “[The changes identified] more likely [are] driving dramatically different risk management procedures for the coming year” (LOP-3D). However, local office partners from four firms (Firm A, Firm C, Firm D, and Firm E) consistently mentioned two specific changes they are most concerned about in the retention process: financial condition (six partners) and internal controls (three partners). The

partners are concerned with the increased risk that could result from these changes. “I mean, it's most important that they pay their bills and their financial results do not create risk for the firm. Unnecessary risks. I mean, we're in the risk business” (LOP-3A).

4.10.2 Within-Firm Analyses of Client Retention Focuses

Although there were four broad categories the local partners consider as major factors in the client retention process, there is variation in the local office partner responses within each firm. Tables 14 through 18 summarize the individual responses from the three local office partners for each firm.

Firm B local office partners provided the most consistency. All four partners discussed the “pain and suffering aspect” (LOP-1B) as a major factor. LOP-2B discusses this concern in terms of viewing management as “bullies.” LOP-3B simply states, “We have to be treated with respect.” LOP-2B and LOP-3B also mentioned that if there were significant issues, either problems that arose in the prior year audit (LOP-2B) or situations such as the client being “raided by the FBI” (LOP-3B), it could result in the termination of an existing client relationship. The Risk Management partner for Firm B further supported the local office partners’ view that issues with management were key in client retention decisions. When asked what some of the common issues were at the firm that caused client relationships to end, RM-B said it generally related to client relationship difficulties and the impact on the audit team.

And one of the things that we do consider is, is wear and tear on our people. ... There's not an endless supply of those. And so we do find that sometimes those troublesome clients that, you know, need a lot of hand holding for not much money, um, really take its toll on our team. ... And some of those might be accompanied by, and besides, they're a pain in the behind... which always elevates risks in my mind, right? So you know, fraud and incompetence look an awful lot alike. (RM-B)

All three partners from Firm C discussed management integrity or fraud allegations as issues that would cause them to terminate an audit client. Somewhat related to this item, LOP-2C

also noted that if there were issues in prior audits that would be difficult to overcome, it could cause the firm to discontinue the relationship. LOP-1C stated that issues with financial viability and engagement economics are primary factors in the retention decision. LOP-3C, on the other hand, was concerned with internal control risk and litigation risk when making client retention decisions.

LOP-3E provided the most extensive range of focuses when evaluating client retention. LOP-3E's listing includes issues with management integrity and the client relationship (along with LOP-2E), internal controls, engagement economics (along with LOP-2E), the financial health of the client (along with LOP-1E), and considerations of whether the client is a good fit for the firm (along with LOP-2E). In addition to some of these items, LOP-2E considers the results of prior year audits, including the prior year audit findings and management's responses. LOP-1E added that the "PITA" factor was most important, noting that it is important to protect the audit team from clients who treat them poorly. However, LOP-1E also noted that this situation typically occurs "when there's a change in management... from... who we accepted initially."

Tone at the top is also important in Firm D. LOP-1D seems to be primarily concerned with aspects of the client that give rise to additional specific risks. These factors included risks related to internal controls, material misstatement, and going concern, in addition to poor tone at the top. LOP-3D also focuses on concerns about management behavior, including management turnover. Additionally, LOP-3D looks for significant changes in the company, including turnover and going concern. The focal point for LOP-3D is the changes that will require modification to the risk procedures in the upcoming audit. LOP-2D, on the other hand, focuses more on the impact of the client on the local office. LOP-2D is most concerned with how the client treats the

audit staff, how the engagement impacts staff morale, and the how the engagement affects the office's ability to serve other clients. LOP-2D also considers engagement economics, but believes reputational risks and the treatment of staff are the primary client retention concerns (refer to Section 4.13 for an example of this partner's concern over these factors).

For Firm A, two partners (LOP-1A and LOP-2A) agreed that the primary factors in client retention are economics and issues or difficulties with the client. Both partners consider the impact of the client on the engagement team. Both also consider whether there are any major issues related to the client, including scope limitations (LOP-1A) or "contentious issues" that required multiple consultations within the firm (LOP-2A). LOP-3A agreed that concerns about economics and whether the client can pay the bills is a major concern during the client retention process. LOP-3A also added allegations of fraud and additional risks related to the client's financial results as primary factors in client retention.

4.10.3 Summary of Client Retention Focuses

Local office partners from all five firms identified client difficulties, management integrity concerns, engagement economics, and changes from the prior year as key factors they consider in client retention decisions. The partners at Firm A all identified client issues as a concern, although the partners differed on the types of client issues they consider, including financial issues, complex accounting issues, client difficulties, and engagement economics. Firm B's local office partners all identified issues with management (including difficulties or integrity concerns) as the key client retention factors they consider. All three partners at Firm C mentioned management integrity or fraud issues as significant concerns, but differed in the importance of the other factors that they view as key in client retention decisions, including engagement economics, financial issues, and client difficulties. At Firm D, the partners varied

greatly on those issues considered most important in the client retention decision. While all three partners discussed client difficulties, they classified difficulties differently, with two partners focusing on financial and risk-related concerns and the other partner considering the impact of the difficult client on the engagement team. The local office partners at Firm E also had different areas of focus for client retention, with some overlap in concerns around management, financial viability, and the auditor-client relationship.

4.11 Client Retention Focuses for Policymakers

After reflecting on their own primary considerations for client retention, local office partners were asked to identify those factors they thought were important areas of focus for the policymakers at their respective firms. I asked the partners to respond based on their own opinions, using personal experience to form their answers. This instruction allowed the partners to provide open feedback based on opinion, rather than feeling as though they had to provide formal responses on behalf of the firm. Table 12 provides a summary of the local office partner responses by firm. Risk Management partners discussed areas they wanted local office partners to consider as part of the client retention process. The purpose of these two question sets was to examine whether the local office partners are truly aware of the areas of focus for the firm's policymakers, or if other factors influence the local office partner's view of the key areas for policymakers, such as the types of pushback received in prior experiences (see Section 4.13).

4.11.1 Between-Firm Analyses of Policymaker Focuses

The only consistent theme from Firm A's local office partners was economics. One partner noted that that the firm can serve a limited number of clients based on the available audit staff, so Firm A's policymakers are trying to ensure the firm utilizes audit staff on profitable engagements. "[W]e're always strapped for people. ... I think they look at economics a lot to

make sure that, you know, are we serving the right type of clients... with the staffing we have” (LOP-1A). Firm C and Firm E partners also thought that engagement economics was a major focus for policymakers at their respective firms. However, these concerns over economics are secondary to the focus on risk by the policymakers.

Even if the engagement is highly profitable, if the people who are kind of in control of our risk management feel as if this client is too risky to serve, then regardless of the engagement economics, they'll ... not approve it. (LOP-2C)

Eight local office partners across four firms (Firm B, Firm C, Firm D, and Firm E) brought up various risk factors that they believe are important to the policymakers. Firm C local office partners felt the focus in risk relates to changes from the prior year. This opinion is consistent with the local office partners’ own focuses, as the local partners at Firm C stated they view changes from the prior year as a major concern when evaluating client retention (see Section 4.10.2).

The local office partners at these four firms described overall risk (Firm B and Firm D) or significant risk issues (Firm C and Firm E) as those that are most important for policymakers. The specific aspects of risk included internal controls (LOP-2C, LOP-1D, and LOP-3D), reputation (LOP-2D and LOP-2E), and economics (LOP-2C, LOP-2D, LOP-2E, and LOP-3E). One partner noted that Firm D has made efforts to address some of these specific risk concerns within the required client retention processes.

So that's the firm's focus is what are the best questions we can ask to hone in on the risk. ... You know, cause a lot of people have a saying, the most important thing you can do as a firm is pick the right clients. You know? Cause ... one bad audit relationship where you ultimately get sued wipes out multiple good audit relationships. In terms of economics, you know? So you gotta be with the right clients from a risk perspective. (LOP-1D)

The only other major factor mentioned by the local office partners is management integrity. Seven partners across four firms (Firm B, Firm C, Firm D, and Firm E) felt

management integrity is a key risk focus for policymakers, with the majority of the management integrity discussion coming from Firm B and Firm D partners.

They're going to go look at the profile and flag, what is there, are there integrity issues? Has there been change or a change in behavior around the mentality of controls or accounting principles? Do we find that they're pushing the envelope on issues? Is it aggressive? ... I mean, we, we flush all that out. (LOP-3D)

Several local office partners (ten across the five firms) described management integrity as a factor they personally view as most significant when evaluating acceptance. However, it is notable that of these ten partners who individually view management integrity as significant, only five local office partners also felt it was important to policymakers at the firm.

4.11.2 Within-Firm Analyses of Policymaker Focuses

Although there is consistency among the various firms about the focal areas of client retention for policymakers at each firm, the partners within each firm generally shared differing views of the particular aspects that are most important to policymakers. Tables 14 through 18 summarize the responses individually provided by the three local office partners and Risk Management partner for each firm.

Firm C local office partners mentioned several different areas of focus for policymakers. LOP-1C believes the policymakers focus on three major factors: management integrity, the firm's ability to service the client, and whether the fees are appropriate for the risk assumed. LOP-2C agreed with LOP-1C, noting that "usually economics will quite often drive the decision about whether to continue or not." However, LOP-2C also said that risk partners would decline retention of a client if the risk was too high. The risk areas that often drive this type of decision are risky accounting issues and financial viability concerns. LOP-3C simply felt that policymakers are concerned about significant changes from the prior year. The Risk Management partner at Firm C agreed with LOP-1C, stating that the primary client retention

concerns center around management integrity and firm capabilities. Despite LOP-1C's concerns about fees, RM-C stated that "fees are a completely separate matter" and that Risk Management focuses are purely concerned with the firm's capabilities.

At Firm A, LOP-1A felt the firm is primarily concerned with economics, but also that the staff are appropriately utilized on engagements, based on staffing constraints. LOP-2A agreed that economics play a role in the retention decision, but made a point to say there is not really a single item that is more important than another factor. LOP-2A only mentioned fees noting, "[I]t's easy to say... the fee one might be a little bit more important only because it is a bright line. You can say, hey, we've been paid or we haven't been paid. Um, I don't know that it makes it more important, um, but it certainly makes it easier to quantify." LOP-3A had a distinctively different response to the question, saying that the purpose of policy makers in the retention process was to ensure the local office partners follow the quality control standards set for by regulators "because we're not always going to know exactly what those are." RM-A shared a completely different perspective than the local office partners at Firm A. RM-A discussed the importance of partners taking their time and thinking through client trends and other factors that could impact client retention.

[Engagement partners] just quickly click a few buttons, don't really think about it, and just continue an engagement. ... And, and if you don't really sit down and think about it, you can really miss kind of those trends. ... I think, you know, partners are in a hurry and they just assume that they're going to continue all their clients. (RM-A)

The real focus for Risk Management at Firm A is the changes that occur year over year or over a series of years because "if we did a good job on acceptance... we are really looking for what's changed at the client or in the relationship that would cause us to rethink why we accepted them in the first place" (RM-A).

The local office partners at Firm E also had different views of what factors in client retention are most important to policymakers at the firm. LOP-1E felt the overall process itself is of key importance, as it is “based on the facts and circumstances at that point in time, as opposed to assuming that [if a client meets the criteria] on one day that it automatically meets the criteria on all future dates.” LOP-2E and LOP-3E both agreed that the fact that situations change is important in the client retention process. However, the partners differ on what aspects of change are most important. Both agree that going concern issues are important. However, LOP-3E focused more on minimum levels of economics. This partner also mentioned the policymakers are concerned with key risk factors that the firm might be unable to address (integrity, going concern, and accounting issues). LOP-2E felt policymakers are most concerned about any new risk factors that could affect audit quality, but those risk factors are generally not audit-related (reputational risks, viability, and economic concerns). RM-E agreed that local partners need to focus on broader risks to the firm, but said that Firm E’s current focus in on new questions that were added to the required client retention considerations. For client retention, the firm is concerned with whether the client is difficult to work with, if the client is hard on the audit staff, if management struggles to meet deadlines, and if the company pays on time. Firm E, through these questions, is concerned with “what stress is it putting to the overall firm, and should we be focused on the clients that don’t do that and therefore be able to do it throughout the year” (RM-E).

Firm D’s local office partners all believed management integrity issues are a key factor for Firm D. LOP-3D felt the policymakers at Firm D focus primarily on two areas: management integrity and the controls environment. LOP-1D agreed with these two areas, but included additional considerations. LOP-1D believes Firm D’s policies focus on risks surrounding

management (tone, skillset, understanding of internal controls, and pressure to meet earnings expectations). LOP-2D agreed that management integrity is a concern, but also felt economics are a key element of the client retention analysis. These considerations are not specific questions or targets that are answered a certain way, but a broader view of the client. “[Y]ou may not have hit a specific integrity issue, you may not have hit a certain economic issue, but the sum total of how you answered all these questions [creates a view that] this client must be riskier than others” (LOP-2D). Thus, according to LOP-2D, the policymakers at Firm D consider a broad view of risk factors during the client retention assessment. RM-D responded that overall risk at the client and, most importantly, how the firm will address that risk is the primary consideration for client retention.

Similar to the broad view approach mentioned for Firm D, local office partners from Firm B stated that the policymaker focuses surrounding client retention are somewhat general. LOP-3B believes the concerns of policymakers are the same for client retention and client acceptance: general risk of the company. LOP-1B mentioned that while management integrity is certainly a key factor, the policymakers at Firm B also consider whether the client is “the right fit for the firm.” LOP-2B also thought the firm focuses on issues with management. However, in LOP-2B’s experience, the policymakers at the firm also seem concerned about going concern and past issues related to material weaknesses or significant deficiencies. When asked about the primary concerns around client retention, RM-B replied, “[For local partners] to try and do that sooner.” The issues that can arise during the client retention process can be dealt with earlier, giving the firm more opportunities to work through the options. When partners wait until later in the process to bring these issues up, it gives Firm B fewer options to deal with the risk (RM-B).

4.11.3 Summary of Policymaker Focuses

The local office partners across the five firms identified higher risk matters (four firms), engagement economics (three firms), changes from the prior year (two firms), and management integrity (two firms) as the primary issues for policymakers at their respective firms. However, only one Risk Management partner (RM-C) agreed with a local office partner from the same firm (LOP-1C). The Risk Management partner at Firm A prefers that partners focus on changes and think through issues rather than assuming clients will automatically continue in the next year. However, the local office partners at Firm A think policymakers are concerned with staffing issues, engagement economics, and quality control standards. At Firm B, the local office partners identified the policymakers' primary concerns as issues with management, issues from the prior year audit, and changes from the prior year. However, RM-B wants partners at Firm B to begin thinking about retention sooner so that more options are available to address the client risks raised during the client retention process. At Firm C, one local office partner identified the key issues raised by the Risk Management partner, which are concerns about management integrity and whether the firm has the necessary capabilities to continue working with the client. The other local office partners at Firm C think policymakers focus on risk, changes from the prior year, and the financial viability of the client. All three partners at Firm D felt management integrity is a key matter for policymakers at the firm, but the three partners also separately focused on other issues the policymakers view as key (e.g., internal controls, management pressures, and engagement economics). The Risk Management partner at Firm D did not discuss any of these issues and instead noted risk assessment and, more importantly, the engagement team's response to address the identified risks is key in the retention decision. The local office partners at Firm E also had varied responses, primarily related to risk and viability of the

continuing client. RM-E, on the other hand, stated that the biggest issues around client retention are not focused specifically on the client or its financial reporting but that the policymakers are most focused on identifying problematic clients (difficult to deal with, etc.) and how those clients impact the audit staff at the firm.

4.12 Views of Differences in Client Retention Risk Perception

After the local office partners discussed their individual focuses for client retention and those aspects of retention they thought policymakers held as most important, I asked the local office partners to consider whether there might be differences in how local office partners and Risk Management partners view and evaluate risk during client retention. I also asked Risk Management partners whether there could be a difference in the perception of client retention risks between the two partner groups. Table 12 summarizes the responses, by firm, from the local office partners. Table 13 summarizes the responses, by firm, from the Risk Management partners.

4.12.1 Between-Firm Analyses of Differences in Client Retention Risk Perception

Nine local office partners across all five firms classified the differences in risk perception for client retention as a factor of risk: risk tolerance (sensitivity) and the overall view of risk and/or its severity. In general, the local office partners view the Risk Management partners as more conservative or more risk averse.

[T]he risk folks are more conservative, focused on risk. And the engagement partners want to retain the client and keep their revenue. So there's a little bit of conflict there but just kind of innate, I guess. (LOP-3B)

As noted by LOP-3B, part of the difference in the view of risk is due to the requirements of the engagement partner's role to bring revenue into the firm. Twelve local office partners across all

five firms stated that the difference in roles causes variation in risk perception between the two partner groups.

So you've got your book of business and... there are those, and those are the large percentage, that view their work, you know, based upon their book. ...I think... it becomes increasingly more challenging to be objective the longer you are in a relationship. ...[I]f I've just gone through the courtship, ...it was hard to make that phone call to the CEO and say, you know, dude, really sorry you had to go tell your private equity owners what you did, you know, some time ago and I still can't accept you. Um, that, that was hard. It'd be a whole lot harder to go tell a client of four or five years the same thing. (LOP-1E)

Three of the five Risk Management partners (RM-B, RM-C, and RM-D) also saw the difference in risk perception as a function of the differences in partner roles, primarily due to biases that may arise because of the auditor-client relationship. It seems that the local office partners are cognizant of this conflict, as local partners see the role of Risk Management as a form of protection to ensure the engagement partners are not subjecting the firm to additional risk.

Usually the people approving it up the line are... more risk averse because that's what the process is about. And most of the line partners... have a personal relationship with those clients and... we generally like the ones we're serving and, you know, so we're more defensive where the firm is trying to challenge us. Which I think is good. That's how the process should work. That process should be there to keep somebody like me from exposing the firm to risk. The people up the line are not the ones that are exposing us to risk. I am. So that's what the role should be. ...I should be out there trying to grow the business. This is where we make the money. Not in, not in our quality and risk management practice. But that's why they're there, to keep me from going off the rails. (LOP-2D)

[T]he local partners probably have a motivation to try to... continue to serve clients even in situations where it may be ill advised to continue serving that client because they have goals that, that need to be met. Clients help them achieve those goals. Whereas those in charge of evaluating risk and making the approvals have no such goals... their goal is to protect the firm. And to ensure that appropriate engagement economics are met. Uh, so it's kind of a counterbalance. It's a little bit almost like the balance of power, so to speak. And they usually work it out. Uh, and so it's not where one takes a firm stand, the other one takes a firm stand, and they're at a standoff. It's not that... it generates more discussion and... those that approve... will ask questions, request meetings, to gain a further understanding of why exactly the, the local partner is recommending we serve a client. (LOP-2C)

The “counterbalance” mentioned by LOP-2C is not only the result of variation in risk perception, but also due to the information asymmetry between Risk Management and the local office partners. For two of the firms (Firm D and Firm E), the local partners specifically mentioned that the engagement partners have the knowledge and experience specific to the client. The Risk Management partners use the client retention process to draw this information out of the engagement team in order to make an informed decision.

[T]he engagement team is the one that's closest to the facts relative to the client. ... And so some of those facts are explicit and objective and some of those are qualitative, right? [T]he national person who is not on the account... they don't know. ...I think, you know, folks that are higher up are going to have a more conservative view on its face, and then the burden of proof is there to, you know, by people that are closer to the facts whether it's qualitative or whatever... to explain why they arrived at a judgment. (LOP-3D)

I think our risk management team, very similar to our technical... experts on, on particular accounting or auditing issues, I think are exceptionally well balanced. ...I think they ask questions in an unbiased way that, that looks at both... is the engagement partner big overly critical of a situation as well under critical? ...[T]hey're trying to get the understanding of issues. So it's not always a situation where our risk management team would de facto come in more conservatively than an engagement partner. (LOP-1E)

As these two partners indicate, they view the role of Risk Management as more of a sounding board to ensure the client retention decision is based on fair and unbiased considerations. This evaluation can help the process, as LOP-3D and LOP-1E stated. However, it is also possible that there is a negative impact on the client retention process when a partner with no direct interest in the client relationship has the power to make retention decisions.

You know, the line partners who are very involved in the day to day from a continuance standpoint. It's you know what you know, and you know what you've been involved with day to day. And I think the, the national office and the [RISK COMMITTEE] tend to take a more detached, dispassionate view of things. Which is some, sometimes good, sometimes maybe we walk away from opportunities that we shouldn't. But I, I think it does provide that necessary detachment to allow, uh, somebody to get beyond the, the personal relationships and look at the, the big picture of, of the risk. (LOP-2E)

Therefore, while the overall view is this impartial reviewer provides appropriate insight into the client retention process, there may be situations where some form of personal perspective is necessary to make an appropriate client retention decision for the firm.

4.12.2 Within-Firm Analyses of Differences in Client Retention Risk Perception

As discussed above (Section 4.12.1), the firms were generally aligned in the local office partners' opinions that differences in views of risk between policy makers and local office partners varied based on each partner level's rating of severity of risk and sensitivity to risk. For some firms, the local office partners within each office provided consistent explanations for the differences. However, some firms had great discrepancy among the local office partners in what factors caused the differences between the local partners and Risk Management in evaluating client retention risk. Tables 14 through 18 summarize the responses individually provided by the three local office partners and Risk Management partner for each firm.

The local office partners at Firm A had very differing views of how local office partners and Risk Management partners might view risk differently in the client retention process. LOP-2A does not see any differences, but attributes that belief to the process itself.

Because the continuance process, it is generated at the local offices, and that gets done at the local offices and is reviewed by an industry expert or the quality control expert. ...[T]hat's where that process kind of ends, it never really gets kicked upstairs to, you know, a higher risk authority level or risk authority person, um, unless there's some real issue or disagreement between the line partner and the reviewer. (LOP-2A)

The Risk Management partner for Firm A agrees with LOP-2A. “[The client retention questions are] all those major things that you would think to ask about. So I think... we're pretty well aligned at this point to what's important... and what should be focused on” (RM-A). LOP-3A, on the other hand, felt that the two partner groups might have differing views of the engagement partner, specifically related to skillset and capabilities. Because the local partner wants to

maintain a book of business, the engagement partner is incentivized to service clients. So the local partners might view themselves as the best candidate to service a client while the National office has a different view of that partner's skillset. LOP-1A agreed there might be differences between the local partners and the National partners driven by a local partner's book of business. However, these differences generally manifest themselves in staffing issues and economics, where the firm may prefer to staff a larger and/or more profitable job while the local partner would want to staff his own job.

LOP-3E also mentioned differing views in acceptable economics between the Risk Management partners and the local office partners. But when it comes to risk, LOP-3E believes that all levels tend to look at risk the same way once all of the information is known across the different reviewers. LOP-2E disagreed, noting that the local office partners and Risk Management partners have a difference in perspective attributable to the local partner's relationship with the client. Risk Management is able to separate personal aspects of the client (i.e., day-to-day interactions) from the overall risk, while local office partners generally are unable to view the two separately. LOP-1E agreed, saying:

[I]t becomes increasingly more challenging to be objective the longer you are in a relationship. ... And so, it, it is important to have... risk management look at this, who's not encumbered by the measurements of retaining a client and rather is encumbered by the measurements of the risk profile of our clients. (LOP-1E)

Firm E's Risk Management partner did not say that the differences stemmed specifically from the roles and responsibilities of the two partner groups, but did believe that local partners did not dig in deep enough to truly understand what is causing the issue. Rather, the local partners generally assume the problem can be overcome by performing some procedures during the audit. Risk Management, on the other hand, is usually concerned with whether those procedures can be

done or will truly address the issue, so the risk partners want to know what the root cause of the issue is (RM-E).

As discussed above (see Section 4.12.1), Firm C local office partners felt policymakers at the firm focus on changes from the prior year, consistent with the areas the local office partners for Firm C stated they focus on when evaluating client retention (see Section 4.10.2). However, RM-C felt that the biggest difference in the client retention process comes in the assessment of the quality of a client's management team. The prior year interaction and results (e.g. report modifications, etc.) can impact the skepticism of the technical abilities of the client, and that assessment could differ between the engagement partner and the higher-level reviewers in the client retention process. It is notable that despite the belief the partners generally are aligned, the local office partners from Firm C all recognized there are differences that exist between how risk is perceived at the local level versus the Risk Management level. Two partners (LOP-1C and LOP-2C) mentioned the two levels have differing goals and functions within the firm, and those differences cause differing views of risk. The Risk Management partners generally will view risk more severely than local partners, and this difference in views is usually driven by the local office partner's role to generate revenue and retain clients (LOP-2C). In certain situations (i.e., questions of financial viability), "there's probably local partners that would be willing to give the client the benefit of the doubt more than the firm might" (LOP-1C). Similarly, LOP-3C can see situations where local office partners may think there is no risk when there have been no changes at the client, while the goal of Risk Management is "to protect us and, and keep a good quality control in place."

LOP-3B agreed with Firm C's local office partners, saying that the nature of the local office partner's role to generate revenue can create a form of conflict with the Risk Management

partners who are there to reduce risk to the firm. RM-B agreed with this assessment, noting that it can be a challenge for the engagement partner to step back from the situation and get “the 30,000 foot view.” LOP-3B also felt that the Risk Management partners tend to be more conservative. LOP-1B echoed this thought, noting that the regional and National Risk Management partners tend to have a lower risk threshold. However, “there's also certain line partners that we work with... that had... low, low risk tolerance levels” (LOP-1B). Therefore, this view of risk tolerance is somewhat formed by stereotypes; there can be some exceptions to the expectation that Risk Management will always be more conservative. It could simply be that the view of Risk Management is impacted by experience. The main difference mentioned by LOP-2B is that the partners in Risk Management see several scenarios that the local office partners do not get to see, and those experiences provide a different perspective on the engagement that could be beneficial. RM-B also said that experience is a factor in these decisions, saying that when Risk Management uses these prior experiences to inform the local partners and help in this decision-making process, it gives the engagement partners “confidence” that can then be carried forward to future engagements. “They say, oh, I've seen this before. You know? I can start to take the right steps, right? I can start to take impactful steps, um, even before we bring the group together” (RM-B).

The local office partners from Firm D also agreed that the views of risk for Risk Management versus engagement partners could differ based on the different types of exposure (LOP-1D and LOP-3D) and nature of the role (LOP-2D and LOP-3D). Some of this difference may be due to Risk Management partners being more conservative (LOP-3D). Two of the partners (LOP-2D and LOP-3D) also mentioned that the local office partner’s relationship with his or her clients can lead to different views of client risk. However, the partners differed slightly

in how they thought these relationships could influence the client retention assessment. LOP-3D, consistent with partners from some of the other firms (LOP-3B, LOP-1C, LOP-1E, and LOP-2E), felt that engagement partners would have a higher risk tolerance because they are more familiar with their clients and are motivated to retain them. LOP-2D agreed that Risk Management's view would generally be more risk averse than that of the local office partner. However, there are situations where the engagement partner might view the client as more risky than Risk Management.

Every now and then it's the flip. ...[Risk Management sees] a company that doesn't look like it's risky and it's making a lot of money, they just don't realize the toll it's having on our people. ...[T]here are clients that... constantly put you through fire drills and when they do, they pay you well. And sometimes that's just brutal on the office. And the people up the line just see great numbers in an industry that doesn't look like a lot of risk and they think this is wonderful, but they don't realize, you know, I had people that just never made it home that night, they worked all night in the office. They missed the kids, you know, play at the kid's school or things that are more important in life. And... that's rare. Usually it's the other way. (LOP-2D)

So despite the various discussions across all five firms about lower levels of risk tolerance and risk sensitivity and higher levels of conservatism for Risk Management partners, there are situations, at least for LOP-2D, where local office partners may take a more conservative approach to client retention than Risk Management. RM-D felt that the biggest difference between the two groups was not necessarily a matter of conservatism but objectivity.

[Y]ou always have to guard against complacency. ... You know... potentially a false positive given your history with the company. Versus needing to always take, you know, sort of an objective lens to this. Right? You know, they could have been so bad three years ago, it's not that bad now, but... it's still bad, right? That's how you tell. ... Cause it's [the engagement partner's view that] ... it was so bad and so it's still bad, but your response is, gee, you know, it's so much better. But anybody else looking at it would say, No, it's still really bad, so God knows what you went through before. (RM-D)

So the bigger concern for Risk Management, and what RM-D views as the difference between the perception of risk between Risk Management and local partners, is the possibility that the

engagement partner's view of the client is biased by past experience rather than objective and better able to identify potential risks related to that client.

4.12.3 Summary of Differences in Client Retention Risk Perception

The local office partners generally agreed that the primary differences in the views of client retention risk are a factor of how risk is evaluated in terms of severity and allowable risk and/or due to differences in the roles and responsibilities for each partner group. Firm A is the exception to this consistency as the Risk Management partner believes the two levels of partners are generally aligned in their views of risk. One Firm A local partner believes this alignment is because the main retention decision is housed at the local and regional level and rarely gets to higher levels of review. However, the other two partners believe that differences do exist between Risk Management and local office partners' views of risk and those differences are attributable to partner roles, responsibilities, and views of the engagement partner's skillset. At Firm B, the local partners and Risk Management partner generally agree that the differences in client retention risk perception are related to the roles of each partner level and experience. However, two local partners also felt that the level of conservatism and risk tolerance differed between the two partner groups. Firm C's local partners believe Risk Management focuses on client changes year over year, consistent with the local partners' own focal areas (see Section 4.11), although they agree there may be differences in the views of risk because of the different responsibilities for each partner group. RM-C agreed more with the latter aspect noted by local partners, seeing the difference as a factor of the client relationship limiting the engagement partner's objective view of the client's capabilities and skillset. The Risk Management partner at Firm D agreed with RM-C, noting that the main difference between local partners and policymakers is objectivity. The local office partners at Firm D saw the difference as a factor of

experience and responsibilities for the different partner levels, although these differences generally relate to the client relationship experience for the local partner. The local office partners at Firm E also believe there are differences related to the relationship with the client at the local level, although one local partner said the differences disappear once all of the information is shared across the decision makers in the client retention process. The Risk Management partner at Firm E believes the basis for differing risk perceptions is because the engagement partner generally does not perform a thorough enough assessment during client retention to identify risks and develop appropriate responses to these risks prior to the audit planning process.

4.13 Examples of Pushback Received in Client Retention Decisions

Similar to the client acceptance topic, I concluded the client retention discussion by asking both local office and Risk Management partners to describe examples of situations where they had received or given pushback on client retention decisions. These examples included decisions where the firm terminated the client during the process and decisions where the firm eventually retained the client after additional consideration. Tables 12 and 13 summarize the firm level responses from the local office partners and Risk Management partners, respectively, while Tables 14 through 18 summarize the individual responses for each partner by firm.

The majority of the examples (ten partners across all five firms) mentioned the level of risk the firm would assume by retaining the client. In some cases, the fees were insufficient to cover the risk (LOP-1A, LOP-1B, and LOP-1D).

So for us to be able to take on that additional risk, that additional scrutiny, we had to at least be making a decent amount of money on it. If we're not making any money and you know, for us to subject ourselves to PCAOB reviews and we're not even breaking even, there's no reason to do it. (LOP-1A)

In other risk-related situations, the firm was concerned about management integrity (LOP-2B, LOP-2C, and LOP-3D), the complexity of issues identified (LOP-2C), concerns over the company's viability and/or going concern (LOP-3A, LOP-2B, LOP-3C, and LOP-3D), and issues the company has to address before the firm will agree to continue the relationship (LOP-1B and LOP-2E).

[W]e could raise all these red flags and management would not fix it. So we're like we've got to drop them. They're not fixing it. Like, we don't want to be associated with that. So that's kind of what generated all of the discussion of dropping them. (LOP-1B)

The Risk Management partners also discussed these same issues, saying that the most common reasons why client relationships are terminated relate to management integrity or fraud issues (RM-A, RM-B, RM-C, RM-D, and RM-E), the complexity of the audit and/or the capabilities of the client (RM-A, RM-C, RM-D, and RM-E), and concerns over the company's ability to continue (RM-B, RM-D, and RM-E).

Local office partners also discussed examples about specific concerns from the firm's Risk Management partners. Some of these issues were client-specific issues, including difficulties related to the engagement such as "the PITA issue" (LOP-1E), concerns about the impact on the audit staff (LOP-2A), and the number of audit adjustments in prior audits (LOP-2E). In the local office partner examples, Risk Management at various firms had also identified issues where the firm (and/or management) may not have the necessary skillset to continue the relationship (LOP-3A and LOP-2E).

Most of the Risk Management examples were consistent with these specific issues discussed by the local office partners. RM-E noted that pushback on Firm E's client retention decisions usually is because of significant financial difficulties the client may be facing or issues that relate to concerns about management integrity or fraud. The pushback at Firm E may also

come from new areas for the client that may have increased risk (RM-E). These situations generally stem from new opportunities or new markets the client is considering. RM-C told of a similar example, stating that pushback generally comes from issues where the firm does not have the necessary capabilities to continue a client relationship. At Firm D, most pushback is not because of a specific aspect or factor, but from classifications of risk designations in the firm's risk rating software (RM-D).

It would be incredibly surprising to me if it got to this point in the process and [new concerns over retention are] getting raised for the first time. It's usually something that's raised either way before the formality of this process starts. Um, but what we do focus on is do you have the right risk designation... cause usually at this point we've all agreed to continue. And so is it at the highest risk designation or is it at something that's moderate, low, etc. And from that point, that risk designation drives a whole series of quality, incremental quality controls and risk management. (RM-D)

Lastly, four local office partners across three firms discussed examples where the Risk Management partners needed additional information to understand some of the issues raised. “[T]he risk management people that sit on top of it, you know, they provide the objectivity, but nobody understands the underlying factors better than the engagement partner” (LOP-1E). One partner (LOP-1A) provided an example where the higher-level partners needed more information about the engagement economics. Another partner did not provide a specific example, but noted that the pushback may arise simply from inadequate explanations.

I don't have any recent example, but I can imagine that I probably didn't do a good enough job documenting the company's business plan and how they were going to address the financial issue. And, you know, when I got some pushback I probably went back and did a better job of that, and they bought off on it at that point. It wasn't that I really changed their mind. It's just that I was able to provide more information than I probably did the first time. (LOP-1C)

In these examples, the three partners concluded that the differences between the engagement partner and Risk Management were not necessarily about the risk as much as the need for additional information. “I mean, most of the time, I think everybody agrees what the risk factors

are. It's then making sure everybody has enough information to make [an] informed decision” (LOP-3E). RM-B felt that the need for information could flow in both directions, including helping the engagement partner understand and evaluate the information supporting why the firm should not retain the client.

And it's not so much that they come in... defending... their client to keep, but, but they come in trying to find ways to keep. And we just say what, why? Why are you trying so hard? You know... when you take it all in, right, this is not good for you, it's not good for the firm. ...[W]hatever that reason is, just to really help people come to a collective decision. (RM-B)

Admittedly, when I posed questions about client retention pushback from approving partners, I expected that the examples would be situations where the local office partner wanted to retain the client and the final decision-makers (those at the regional or national level of approval) declined retention. However, one partner (LOP-2D) shared a story with me about an experience convincing Firm D to drop one of the firm’s largest clients in the region.

But it, it wasn't easy, I couldn't just go to them and say I want to resign and the firm said fine. This was too big. You know, this was, you know, audit fee of [REDACTED] and other services of another kind. And, you know, so it, we had to fight to get there but personally I couldn't, I just couldn't do it. (LOP-2D)

The request was based on concerns LOP-2D and another partner on the engagement shared over the CFO and tone at the top. Firm D eventually agreed to resign if the client would not make a change in CFOs; the company fired the CFO and the client was retained. The decision went through all levels of review and all the way to the head of Firm D, with LOP-2D’s future with the firm at risk.

And that really weighed on me. Because I also knew it was such a big client to me that I would no longer have a role in [OFFICE]. So hopefully the firm would transfer me somewhere. But I didn't have a spot here in [OFFICE]. (LOP-2D)

This story also highlights an important aspect of the client retention process, that “at the end of the day we're still people so we can't design the perfect questionnaire, you know, to weed

these out” (LOP-2D). A major determinant of the client retention process is its reliance on the local office partners to provide all of the necessary information to make an informed retention decision. Despite the engagement partner’s conflict between maintaining a book of business and taking on too much risk (see Section 4.12), the local office partners are also concerned about individual reputation risk and personal risk as a partner (LOP-2D).

But at the end of the day there's nothing I'm more proud of than I made the risk decision for the firm and everyone along the way... I was the youngest guy in the room, and every one along the way said shit, we should have seen this coming. ... But unless... people have a good moral fiber, you know, people step back and realize that the firm says they'll back us up when we see something that's wrong. ... [I]f you haven't set that right culture, the process, the database isn't going to capture everything. That person has to have, in the partner's role, has to have the right judgment and the right belief in the firm that will do the right thing to make those calls. (LOP-2D)

Partner LOP-1E echoed this belief, adding that the importance of the client retention process is not just the formality of filling out questionnaires. It really comes down to the engagement partner and his or her ability to do the right thing.

[W]e have had... a more vocal approach in our firm, just, it's okay to walk away... and a matter of fact, celebrated, you know, examples of where we've walked away, um, for good reasons. ... [T]he risk management people that sit on top of it, you know, they provide the objectivity, but nobody understands the underlying factors better than the engagement partner. ... [A]nd it's, you know, arming that engagement partner with the confidence to be able to challenge the things that need to be challenged and make the tough calls. No different than the tough calls that we have to make every day on technical accounting matters that might be, you know, disadvantageous to our clients. (LOP-1E)

The Risk Management partner for Firm B expressed a similar sentiment, so it seems that Risk Management appreciates the conflict that the engagement partner faces when having to face difficult decisions about client retention.

[P]artners have books of business, right? And, you know, that's... noticed by people who make decisions about their careers... revenue is precious. So some part I think of the Risk Management role and responsibilities is also making sure that we have an environment where it's okay, not only is it okay, but... you're recognized for making that kind of a decision. ... [F]or a client who, um, either we took onboard because we thought it was going to go in a direction, it didn't go there, so now it doesn't match up anymore. Or one

that started out fine, headed in the right direction, and, you know, just took a bad turn somewhere, and now no longer fits. Um, whatever that reason, right, whatever that reason is, just to really help people come to a collective decision. (RM-B)

4.14 Summary of Client Retention Findings

In general, there was greater consistency among the local office partners about the client retention process at their respective firms than there was for client acceptance. All of the local office partners described client retention as a process to reexamine the prior year audit and determine whether prior year issues or difficulties indicated a reason to terminate the client relationship. Some partners (from Firm A, Firm B, Firm D, and Firm E) also use the client retention process as an opportunity to evaluate and discuss the difficulties faced during the audit with client management, specifically considering the impact of a difficult client on the engagement team. For most local office partners, management integrity is also a key factor in the retention decision. On a lesser scale, local partners also focus on engagement economics and changes at the client from the prior year when deciding whether to recommend the firm retain a client. Although the local partners discussed similar focal points for the client retention process, this consistency was more evident across the local partner group as a whole rather than within any given firm.

The local office partners also addressed four primary matters they believe represent the focal matters for policymakers at their respective firms: high risk issues, engagement economics, changes from the prior year, and management integrity. Only one of the Risk Management partners mentioned any of these four issues, with RM-C discussing management integrity concerns as a primary factor in client retention. The Risk Management partners were generally concerned with changes from the prior year and risk matters, but the key issue related to these matters was the fact that local partners needed to analyze these matters sooner in the process and

more in-depth so that they could respond appropriately during the client retention discussions. Only one local office partner properly identified the key focuses for Risk Management at that partner's firm.

Considering these differences between local office partners and Risk Management, it is not surprising that the two partner groups also disagreed on the reasons why local partners and Risk Management partners might have different views of risk in the client retention decision process. The local office partners generally saw the difference in risk perceptions as a factor of the roles and responsibilities that fall under the two partner groups. As local office partners are held accountable for revenues and client relationships, their views of risk would be different from the partner in Risk Management who are required to focus solely on minimizing and mitigating risks to the firm. The Risk Management partners generally agreed with this view. However, one Risk Management partner (RM-A) felt the views of risk were relatively consistent between the two partner groups even though the local partners from Firm A generally felt there were differences in risk assessments related to the roles of each partner group. The Risk Management partners at Firm C and Firm D also noted that these role differences generally cause issues with objectivity in the engagement partner's view of the client and its risks.

4.15 Other Considerations

At the end of each interview, I asked broad questions about the client acceptance and client retention processes for each firm. These questions were focused around whether local partners consult on client acceptance and retention decisions, if (prospective) engagement partners are able to appeal decisions by higher-level approvers, and whether firms have procedures in place to identify client service issues related to a mismatch of skills or personality traits rather than client service issues related to risk assessment. Tables 19 and 20 provide

summaries of the responses by firm provided by local office partners and Risk Management partners, respectively. Tables 21 through 25 summarize the responses from each individual local office partner and Risk Management partner for each firm.

4.15.1 Consultations

Local office partner responses indicated one major theme for when they might consult with other partners as part of the client acceptance and/or retention processes: to get assistance with a particular issue. All of the local office partners stated that they would discuss client acceptance and retention issues with other partners in order to ensure that they can address any potential issues before going through the formal process. “Because if I, for any reason, think it's not going to go through I would call that person first because I don't want to waste my time or anyone else's time” (LOP-1A). Four of the five Risk Management partners (RM-B, RM-C, RM-D, and RM-E) stated that consultations regularly occur for client acceptance and retention concerns, with Risk Management partners from two firms (Firm B and Firm D) explicitly saying they encourage discussions early in the client acceptance and retention processes.

One Risk Management partner also mentioned that consultations occasionally occur at higher levels, originating from the Risk Management groups. RM-C explained that there are situations where Risk Management or the Risk Committee may not have the experience or knowledge necessary to make certain decisions (e.g., industry-specific concerns), so the group may request assistance from other individuals in the firm who can help.

I don't try to fool myself and try to understand the transaction. I get my industry expert on the call... I'll listen to the call, I'll facilitate it, I want to make sure we're asking all the right questions and getting all the answers. But at the end of the day, my role is not necessarily the, the thumbs up or thumbs down, but make sure that the right people are talking to the right people and that we're making good, collective decisions. So it's kind of you gotta know what you don't know and then go figure out who is the, the rock star that's going to help us make, um, decisions. (RM-C)

Local office partners at Firm D (LOP-2D) and Firm E (LOP-1E) also noted the firm's Risk Management group will often reach out to industry experts, for example, to ensure the proper decision is reached on clients in higher risk industries or industries where specific expertise is needed. So the consultation process on client acceptance and retention decisions may occur before the formal process starts, but it may also include consultations by Risk Management to obtain additional information about the possible risks for a (prospective) client.

4.15.2 Appeals Process

Although the local office partners responded they were willing to discuss potential issues in order to get a preliminary approval from those ultimately responsible for client acceptance and retention decisions, the same partners were not as likely to appeal to others in the decision process in the event that they disagree with the client acceptance or retention decision. Only two local office partners described an explicit policy within the firm (LOP-1E and LOP-2E). Several of the partners provided examples or speculated as to how the process might occur. The partners who indicated they knew of the appeals process had prior experience with some form of an appeal (LOP-1A, LOP-3A, LOP-1B, LOP-2B, LOP-1D, LOP-2D, LOP-3D, and LOP-2E). Other partners stated there may be an appeals process, but they had never used it (LOP-2A, LOP-1C, LOP-2C, and LOP-3C). And one of the partners was relatively confident in how to appeal, but had not done so (LOP-2B).

The Risk Management partners were also asked about the appeals process at their respective firms. RM-A stated it would be an informal process, but that it would end with the firm's Chief Risk Officer making the final determination. RM-C and RM-E said the process would go up the chain and would end with the firm's Board of Directors. RM-D also mentioned the appeals process would move up the chain of command and end with the leader of the audit

practice. RM-B did not describe a specific process, but said that there are cases where partners will try to plead their cases with senior leadership, but that situation is pretty rare because those in leadership positions would have participated in the discussions if the (prospective) client had issues that raised significant concerns.

There was a lot of variation in the appeals process. Most partners noted the client acceptance and retention decisions are group decisions (LOP-2A, LOP-1B, LOP-2B, LOP-1C, LOP-3C, LOP-1D, LOP-2D, and LOP-3D), so the appeals process would include having additional conversations with the group or trying to bring additional people from regional or national into the group discussion.

I would not go all the way to the top in the process. I would get advocates. Either you'd want either your industry leader or your regional managing partner to be so on board with this too, that they'd be willing to go to the top to fight for it. (LOP-1A)

Partners also noted that the appeals approach could include appealing directly to individuals. This process might include going up the chain of command (LOP-1A, LOP-2A, and LOP-2E), bringing the head regional partner into the discussion (LOP-3B, LOP-1D, LOP-2D, and LOP-3E), going back to the Risk Committee (LOP-3A), or following a process that's similar to the appeal of technical matters that would require involving a National partner (LOP-1E).

Although there were differences in how the process might work, and none of the firms were completely consistent in how the appeals process might work, the local office partners were relatively consistent in where the appeals process might end. Of those partners who indicated the person or group that has the final say in these decisions, most local office partners stated the head of the audit practice and/or head of Risk Management for their respective firm was the final authority (LOP-2B, LOP-3B, LOP-1C, LOP-2C, and LOP-1E). The other local office partners

said the Risk Committee (for those firms that have one) would have the final say in the decisions (LOP-1A, LOP-3A, LOP-3C, and LOP-3E).

LOP-1D noted that any appeals would just be related to risk rating assessments, but not necessarily for overall acceptance or retention decisions. LOP-1E said that acceptance or retention decisions based on risk were typically those that would be difficult to revisit and mentioned that “neither one of us would need all five fingers on one of our hands to count the number of times where that appeals process would change the answer.” Similarly, LOP-2E stated, “I’ve occasionally, if it’s an economic decision, pushed harder. But not if it’s a risk decision.” Several partners mentioned or indicated that these decision makers (individuals and/or Risk Committee members) were in the position to make these decisions because of their roles, and that the opportunities to go above these individuals is somewhat limited.

I mean, at the end of the day, the person that is that high, it's their responsibility ... the protocols are named. They're positions and they're named people. It's not like you go, hey, we'll just go get another person to step in and, you know, fill the role. It's like, you can't go shopping, right? ... Even the appeal... can ... send a signal. (LOP-3D)

The differentiation of roles is important, as the higher decision-makers at each firm typically represent those who hold technical or risk-based positions in the firm. Thus, the individual’s position as a technical or risk-based expert indicate these firm personnel hold a specialized form of tacit knowledge (Tan and Libby 1997). The results of Bol et al. (2018) update and extend Tan and Libby’s (1997) conclusions on tacit knowledge in the audit setting, suggesting that supervisors with higher levels of tacit knowledge enhance the development of subordinates’ tacit knowledge. Thus, the fact that firms establish these roles and require higher levels of approval by firm-designated experts could play two roles. The first is to utilize the tacit knowledge (risk and technical skills) of those in positions of approval. Second, firms can use these positions to allow the higher-level approvers to develop the tacit knowledge around risk

and technical skills in the local office partners to improve future client acceptance and retention considerations and decisions.

4.15.3 Partner-Client Mismatch Versus Risk

Although the focus of the interviews centered on risk and those responsible for making client acceptance and retention decisions based on risk factors, I thought it was important to address whether there could be other factors that might play a part in these decision processes. One area I specifically asked the local office partners about was situations that may arise where issues with the audit client may not be due to risk per se but instead are the result of a mismatch between the audit partner and the client. These mismatches could be from things such as personality differences, stylistic differences, or even industry knowledge and experience. I asked the local office partner participants whether their respective audit firms had any procedures in place that might help identify these mismatches.

Partners from two of the five firms (Firm A and Firm B) mentioned annual surveys or evaluations that the firm sends to its clients. These surveys are optional, so clients may choose not to respond. Partners from Firm D and Firm E identified similar procedures at their respective firms, discussing regular interview processes (not annually) performed for significant engagements by the firm's leadership team and/or a partner unaffiliated with the audit engagement. These interviews include key members of client management (e.g., CEO, CFO, controller, Audit Committee chair) and allow the client an opportunity to voice any issues or concerns so that the firm can try to address these matters where possible. This process would help the firm identify client-partner mismatches related to industry, experience, personality, or stylistic issues.

[I]t's in those types of conversations where the candid point of view of a professional mismatch... either in skillset or personality [can be identified]. And, and both have

happened. This, this absolutely does happen. ...[I]t doesn't happen ten times in a year... but it does happen... where there's just a... mismatch... for one reason or another. (LOP-1E)

It is notable that only one or two partners from each of the firms (LOP-1A, LOP-1B, LOP-1D, LOP-2D, and LOP-1E) mentioned these surveys or interviews. It is unclear from the interviews whether the remaining partners were aware of this process and simply did not mention it or if the other partners were unaware that these client interviews occurred.

The other ways that this issue of a mismatch could be identified would be by the engagement partner (LOP-2A, LOP-2B, LOP-3B, and LOP-3C), a client relationship partner (if one exists) (LOP-2B), a direct request from the client to change partners (LOP-1A and LOP-3C), or during the client acceptance/retention process (LOP-1A, LOP-3A, LOP-1C, LOP-2C, LOP-3C, LOP-3D, LOP-2E, and LOP-3E). The challenge with relying on the engagement partner to identify this mismatch is “there’s always a difference in perception. People always think they’re better than they are... So yeah, that’s probably our most often challenge in acceptance is that situation there” (LOP-3A). Thus, it can be left up to the higher levels of approval for acceptance/retention to identify any gaps in the engagement partner’s experience or abilities and make those changes prior to the audit.

4.15.4 Other

During the interviews, some of the local office partner participants mentioned audit fees as they relate to risk and/or to the client acceptance and retention processes. Extant audit research has indicated that auditors may use increased audit fees to reduce litigation risk (Simunic and Stein 1996), business risk (Bell et al. 2000; Johnstone and Bedard 2003), and earnings manipulation risk (Bedard and Johnstone 2004). I asked some of these partners to expand a little bit about whether the size of the audit fee might mitigate client risk. Two partners mentioned the

fee would have to be high enough to cover the additional required procedures to address the risk (LOP-2A and LOP-1B).

[J]ust because it's a high risk engagement doesn't necessarily mean it's an engagement we shouldn't take. You have to evaluate all the rest of the factors. If it's a high risk engagement and they don't pay us anything, they made the decision. (LOP-2A)

However, LOP-1B noted that these additional fees could not eliminate all risks.

[I]f it's a riskier engagement, you need to be able to throw more resources at it ... bring in the right people ... you'll have to have more fees to handle that additional resource. ...[S]o not all risks can be alleviated with just higher fees, though ... I would say our rates are what they are because we're, we're trying to get a good balance between the effort and the amount of complexity the client has. (LOP-1B)

LOP-3B stated that even if the client pays high fees, it would still have to meet Firm B's criteria for acceptance. Similarly, LOP-2E mentioned that there has to be some sort of underlying business reason for the firm to take on the client and allocate the resources necessary to perform a quality audit. So while Firm E's approach is not simply to take on only highly profitable engagements and pass on the rest, the client has to "be economically rewarding to the business side of the firm" (LOP-2E).

The other partners who were asked about whether fees could be used to mitigate risk explicitly stated that their respective firms would not follow that line of thought (LOP-3A, LOP-1B, LOP-2B, LOP-2C, LOP-3C, LOP-1D, LOP-2D, LOP-3D, LOP-1E, and LOP-3E). The partners provided several insights as to their respective firm's approach to fees:

Because I don't think, it doesn't matter how high the fee is, if that risk is bad, that risk is bad. No fee's going to make up for that risk. (LOP-2B)

They care about, let me say it this way, they care about if the fees are too low. But they don't, they would never accept an engagement that created undue risks, no matter what the fees were. (LOP-3A)

[T]he real focus of client acceptance and continuance is much more on the risk side than the economic side. ... But in today's world where we live with, you know, Sarbanes Oxley,

PCAOB ... risk rules the day. In terms of client acceptance and client continuance. (LOP-1D)

So we do look at the fees from a hurdle perspective like that, but never from the perspective of, oh, this is a lot of risk and wow, they're going to pay us a lot of money. Because if the risk couldn't manifest itself, you'll be giving all the fees back, plus some. That's been our experience. (LOP-3D)

[T]here's a lot of different ways to make a dollar in our world and, and, uh, it's just not worth getting into those, those risky situations. (LOP-1E)

To conclude the interviews with both local office partners and Risk Management partners, I asked each individual whether there was anything about either client acceptance or client retention that they wanted to emphasize or if there was anything that I had not asked about the processes that was important to mention. Two of the local office partners discussed the actual process and procedure itself. One partner (LOP-2A) emphasized that the client acceptance and retention processes required a lot of judgment and did not simply rely on responses to questions on a checklist.

[I]t's not a, at least in our firm ... a checklist mentality ... there is a lot more qualitative and ... judgment that goes into the acceptance process rather than, you know, a lot of bright lines. (LOP-2A)

LOP-2C wanted to highlight the strides Firm C has made to improve the client acceptance and continuance processes. Partners at Firm C are willing to sacrifice efficiency in some instances in order to ensure the processes are effective at managing risk to the firm.

I think over the years our client acceptance and continuance process has become relatively robust and probably a little bit more intensive than some other firms because of how it covers all clients regardless of risk and relative size ...and in some cases maybe that may be more than is really necessary. But we've chose to kind of cover, you know, the entire base as opposed to trying to be selective on which ones require that approval, which ones don't. (LOP-2C)

I think it's a thorough process and ... I'm sure it's probably protected us from taking on risk that we probably didn't need to deal with. So I've always been a proponent of the process. (LOP-1C)

Two of the partners from Firm B (LOP-1B and LOP-2B) stressed the fact that the client acceptance and client retention processes are risk assessment tools used to help make good decisions and reduce risk to the firm.

I guess, you know, in the end we're, you know, we're all just people trying to make decisions... about other people is really what it comes down to. ... You can't really catch everything. ... There's bad players out there, you can't catch them all. But you try to. (LOP-1B)

[I]t's risk assessment at the end of the day. You know, we're one firm at the end of day, we have a bunch of offices throughout the country, and we're all at risk if something goes bad inside the partner group. (LOP-2B)

LOP-2E and LOP-3A highlighted the importance of this study for both academics and those in the auditing profession. As discussed previously, the client acceptance and client retention processes are the first line of defense for an audit firm's assessment of client risk (Bedard et al. 2008; Asare et al. 2005; Beaulieu 2001; Johnstone and Bedard 2001; Johnstone 2000). The significance of these processes and the role they play for the audit firm is not lost on the local office partners, as they recognize that both client acceptance and client retention pave the way for reduced risk to the firm and improved audit quality.

I think personally and as a firm, we view this process as probably the most critical in terms of ensuring we have a foundation for good audit quality. Uh, I really do think that without a robust and effective acceptance and continuance program... delivering on quality and executing effective audits becomes exponentially harder. And, uh, this needs to be a continued area of focus, uh, and continuous area of sustained... improvement, uh, as the clients that we serve become larger and more complex. (LOP-2E)

[I]t's an important part of any quality control document, if not the most the most important part, is if you can get client acceptance and continuance right, then the monitoring of the control process is a lot... easier... accept the good clients, turn down the bad clients, and then you'll have the right portfolio. (LOP-3A)

CHAPTER FIVE

DISCUSSION, CONTRIBUTIONS, AND LIMITATIONS

5.1 Discussion

This qualitative study provides insights into selected audit firms' policies and procedures related to client acceptance and retention. Although there are a number of studies in this area, I am not aware of any published research that investigates firms' development of related policies and procedures as well as their implementation by local office partners. My research is intended to fill this void in the literature. The study also responds to Gendron's (2001) call to examine the relationship between a firm's established processes and the decision outcomes of client acceptance and his call for research to examine the more difficult client-related decisions around retention (Gendron 2002).

This dissertation provides general models for the client acceptance and client retention processes and finds that the established processes at five different firms support the models. The processes and considerations used at each of these firms vary significantly, but each of the firms performs the procedures required to comply with the auditing standards. All of the partners interviewed perform the procedures required by the auditing standards, including understanding the engagement, assessing independence, communicating with the predecessor auditor (acceptance), considering changes in the entity (retention), and performing an overall risk assessment.

5.1.1 General Client Acceptance and Retention Processes

Although all five firms cover the client acceptance and retention procedures required by auditing standards, the required procedures within each of the firms vary in the use of procedures recommended by the auditing standards. All five firms have procedures to evaluate management

integrity (especially in client acceptance decisions). All five firms use background checks and discussions with the predecessor auditor to gather information about management integrity. However, background checks are required on a limited basis (i.e., public companies) for two firms (Firm A and Firm C), but are required for all prospective clients at the remaining three firms. Additionally, only two of the firms (Firm B and Firm D) require discussions with the prospective client's bankers and attorneys.

The firms have distinctively different approaches in the actual processes used to document and assess client acceptance and client retention decisions. The procedures vary from form-based questionnaires (Firm A, Firm B, and Firm C) to software that calculates risk ratings for potential and existing clients (Firm D and Firm E). Notably, Firm B is currently examining risk ratings and is considering a change to a risk-weighted system for client acceptance and retention decisions.

All five firms have implemented some form of tiered approval for both client acceptance and retention. Outside of having tiered systems, the approval processes vary considerably. Three firms have Risk Committees that evaluate what each respective firm considers a higher risk and/or publicly traded client.

5.1.2 Summary of Client Acceptance Findings

For client acceptance, the local office partners focus on broadly similar considerations, such as risks, management integrity and background information, industry concerns, and the audit firm's capabilities and expertise. The specific considerations within each of these groupings varied significantly within the firms, especially Firm A and Firm C. The focal factors at Firm B, Firm D, and Firm E are relatively consistent among the partners.

Although there was some agreement among the local partners on the key focuses for client acceptance, there was disparity between the local office partners and the Risk Management partners about which factors are most important in the acceptance decision. At Firm D, the local office partners consistently identified general risk as a key factor, but the Risk Management partner at Firm D felt specific business risks were most important. On the other hand, the local partners at Firm E felt policymakers focus mainly on a few specific risk areas, but Firm E's Risk Management partner said the firm is more concerned with broader risks. At Firm A, Firm B, and Firm C, the local office partner opinions of focal areas differed and were not consistent with those the Risk Management partners said were most important. Interestingly, the various partners identified differing roles and responsibilities for local office partners and Risk Management partners as the basis for differences in risk perception.

5.1.3 Summary of Client Retention Findings

During client retention, local office partners focus on the two major factors: risk and changes at the client. Local office partners generally viewed client retention as an analysis of the changes that have occurred at a client from the prior year and whether these changes related to new risks. The local office partners also acknowledged client difficulties as a major reason for terminating a client relationship. These difficulties included management integrity concerns, issues during the prior year audit, and internal controls problems.

While the local office partners were relatively consistent in the matters they felt were most important in client retention decisions, there was significant variability in these partners' opinions about the policymakers' areas of focus. The local partners identified a variety of different matters they see as Risk Management emphases. However, the primary focal areas raised by the Risk Management partners suggested that the engagement partners should be

considering broader aspects of the continuing engagement, not assessing specific risk areas more diligently. Risk Management partners were more concerned about the adequacy and thoroughness of the assessments than specific aspects of retention.

Unlike client acceptance, the two partner groups did not agree on the reasons for the contrasting views of significant retention concerns. While several local office partners thought the main driver of the difference between the partner groups related to risk tolerance and/or the difference in roles and responsibilities of each partner group, Risk Management partners thought the local office partners are often unable to understand the depth or complexities of the potential risks for a continuing client. This issue raised by Risk Management can be due in part to the auditor-client relationship, but it arises when the engagement partners fail to consider the root cause of what could be causing these risks and the impact of that underlying dynamic on the audit.

5.1.4 Overall Variances

The variations summarized in Sections 5.1.1, 5.1.2, and 5.1.3 show that each firm had differences in local office partner responses and Risk Management partner responses both within and among the firms. However, there were also instances where the partners within and across each firm provided consistent responses. The areas of emphasis for client acceptance for local office partners were highly similar for Firm E. The local office partners at Firm B and Firm D provided some similar focal areas for client acceptance. However, Firm A and Firm C partners had very different aspects that they consider most important for client acceptance. When asked about areas of focus for policymakers, partners from Firm D provided highly similar responses. Firm E partners also gave somewhat similar answers. Firm C's partners had minimal overlap in responses, as the partners provided individually distinct answers. Firm A and Firm B partners

had highly dissimilar replies. Lastly, partners' views about the differences in client acceptance risk perception were highly consistent among the partners at Firm B, Firm D, and Firm E with minimal similarities at Firm A and Firm C.

With client retention, local office partners focus on highly similar factors at Firm B, while Firm A, Firm C, Firm D, and Firm E local office partners have slightly different areas of focus. The partners within all five firms had differing views of the factors are most important to policymakers when evaluating going concern, although the greatest differences were found with the partners at Firm A and Firm C. Finally, when asked about reasons why perception of risk related to client retention may differ between local office and Risk Management partners, Firm D's partners provided highly consistent responses and Firm B, Firm C, and Firm E partners provided moderately similar responses. However, the partners at Firm A were highly dissimilar in their opinions of these differences.

For both client acceptance and client retention, partners at all five firms fluctuated between responses that were both consistent and inconsistent across the partner group. Thus, the variations in the responses are not solely attributable to differences in the individual firms. The following sections (Section 5.1.5, 5.1.6, and 5.1.8) discuss three primary themes that help explain the variances identified. These themes include the impact of acquisitions by accounting firms, differences in areas of specialization among the partners, and differences between the roles of local office partners and Risk Management partners.

5.1.5 Impact of Accounting Firm Acquisitions

As discussed above (see Section 5.1.4), partners from each of the firms provided both consistent and inconsistent responses across the various topical areas of client acceptance and client retention considerations. However, the partners at Firm A consistently provided markedly

different responses for each aspect of client acceptance and retention. Only the responses related to client acceptance risk perception had relatively similar responses among the partners.

One notable difference for Firm A from the other firms is that all three of these local office partners previously worked at other firms that had recently merged with Firm A. The variation in the responses among these partners could be explained by the impact of the merger and the subsequent changes in processes and procedures around client acceptance and client retention. Although all three of the local office partners at Firm A had extensive audit experience (an average of 26.3 years), the short tenure at this firm could result in uncertainty or limited experience with the client acceptance and retention processes.

Similarly, partner LOP-3B had approximately three years of experience at Firm B, as this partner was with a different firm that merged into Firm B. Although this partner did provide somewhat consistent responses with other partners from Firm B, there were certain areas where this partner seemed to provide limited responses to questions, either because of inexperience in certain aspects of client acceptance and retention with Firm B or because of uncertainty about the relevant details. For example, LOP-3B did not perform any client acceptance or retention procedures outside of the formal processes. This partner also discussed only general aspects of risk as those areas most important to policymakers for client acceptance and retention. Lastly, LOP-3B described the differences in risk perception for both client acceptance and client retention as a difference in the level of conservatism across the two partner groups. When describing an example of pushback received during client acceptance, this partner described a situation where a person at a higher level of review had asked for additional information (see Section 4.8). When I asked what the primary concern was surrounding this prospective client, LOP-3B responded, “I never really understood it. ...I just got the information they told me to

get.” Thus, it appears that LOP-3B could view Firm B’s processes and procedures as a formality because these procedures are different from those performed at LOP-3B’s prior firm.

Extant research has performed limited examinations of the impact of mergers on the audit firm, especially in the realm of auditor decision-making processes (Jenkins et al. 2008). Research has examined the effect of an accounting firm merger, noting that when accounting firms merge, the employees have to “de-identify” with the previous firm and “re-identify” with the new merged entity, but that this process is slow (Empson 2004, 764). However, Empson’s (2004) study interviews accountants from both audit and tax, as well as a range of experience levels within a merged firm. It is possible that this impact differs across experience levels and across specialty areas. Over time, as the organizational identity and professional identity of the prior firm became the partner’s own identities, it may be difficult for the partner to separate from the old firm and adapt to the policies and procedures of the surviving firm. This issue is especially salient for partners with a lengthy tenure at the prior firm. Shedding the prior firm’s culture would likely take additional time and effort if a partner had been with the prior firm for an extended period. The significant variance in responses for Firm A suggests that audit partners who enter a firm as the result of a merger might require additional time to remove the affiliation with the prior firm and accept the policies and procedures of the new firm as their own.

This consideration seems to apply not only in the case of Firm A, where the local partners have limited experience and may not have adhered to the full organizational identification at the new firm, but is also exemplified by the alternate example from Firm D. Firm A’s partners provided a broad range of responses that were relatively inconsistent within firm guidance articulated by the Risk Management partner. Partners from Firm D, on the other hand, provided responses that were consistently similar. The similarity in responses comports with the idea that

the partners have formed an organizational identification with Firm D. Based on the completed demographic questionnaires, the partners at Firm D have been with the firm for most, if not all, of their respective careers. The shortest tenure at Firm D for any of the partners interviewed in this study is 16 years. None of the other firms interviewed had the same level of firm tenure as Firm D. Thus, the results of this study indicate that both the level of variability and the level of consistency in participant responses could be the result of organizational identification by the partners.

5.1.6 Differences in Specializations

Although the acculturation of the partners within the audit firm is one factor that could affect the partners' views of client acceptance and retention, differences in the client bases and specializations for the individual partners also seem to play a part in the differences across the partner participants in this study. Six of the local office partners in this study indicated they specialize within specific industries or particular client bases. These partners either mentioned their specializations during the interview or indicated their area of focus in the demographic questionnaire. Several of these focuses are industry-based, but some are broad areas of specialization (e.g., start-up companies). Hsieh and Lin (2015) find that partners with industry specializations are less likely to accept higher risk audit clients than firm-level industry specialists, most likely due to reputational concerns. Low (2004) conducts an experiment that finds audit partners have higher quality risk assessments when they have industry-specific knowledge. Therefore, there is evidence that industry experience affects the partner's overall view of risk.

The results of my study further support the findings of these prior studies in industry specializations with direct evidence from the profession. Low (2004) finds audit partners with

relevant knowledge related to the client's industry perform better risk assessments but also have improved planning decisions related to those industry considerations. Auditors with domain-specific experience (i.e., inventory) also perform higher quality audit planning assessments (Bedard and Wright 1994). These studies, when considered together, suggest that auditors with prior industry experience have specific knowledge that translates into higher quality considerations about the audits of clients within the same industry.

In the current study, participants were asked a variety of questions about client acceptance and client retention considerations. While several participants provided a broad range of discussion points and examples during the interview, those participants who indicated they specialized in a particular area generally responded with comments focused on particular industry-related considerations.

Partner LOP-1A's considerations during client acceptance and client retention decisions primarily include economic and going concern considerations. Additionally, this partner believes that policymakers are primarily concerned with economics, risk, and proper utilization of staff on more profitable engagements. The pushback examples provided by LOP-1A indicate this partner's potential and continuing jobs are generally questioned about fees, going concern issues, and realization. This partner focuses primarily on audits of healthcare clients and benefit plans. Anecdotal evidence indicates these audits tend to have lower realization rates than other audits, especially benefit plan audits that are historically performed during non-peak times of the year.

Partner LOP-1B also focuses on healthcare audits. LOP-1B's considerations for client acceptance focus on understanding the prospective client and the company's needs. Additionally, this partner focuses on the history of the company and management, the plans and forecasts for the company, and the ability of the entity to pay the audit fees. For client retention, the main

focus is difficulties with the client (“pain and suffering aspect” (LOP-1B)). However, LOP-1B stated that most pushback on client retention relates to fees and the level of risk assumed on the engagement. So similar to LOP-1A, LOP-1B’s responses appear to be concentrated around issues specific to healthcare audits and auditors with lower realization.

Two partners at Firm C indicated they specialized in particular industries. LOP-1C serves audit clients in higher education. Thus, this partner’s focuses during client acceptance and retention mainly address issues with financial viability (particularly around accreditation issues), trade industry concerns, and management integrity matters. LOP-1C indicated that the concerns for higher education clients differ from other for-profit entities:

[T]here's very few private colleges that we wouldn't accept, I don't think... even one that had accreditation issues. ... I think that's kind of different from the commercial side. I mean, we just don't have, there's not many clients that we would not accept. Whereas it probably, I wouldn't say it happens frequently on the commercial side, but, but it probably happens more than it does with my client base. (LOP-1C)

LOP-2C primarily audits non-profit entities. Similar to LOP-1C, this partner is concerned with management integrity issues during client acceptance and client retention. However, this partner also see economic concerns as one of the primary factors, noting that the firm often avoids (prospective) clients who are simply looking for the lowest fee. LOP-1C also mentioned that when the higher-level reviewers push back on these non-profit clients, “[I]t’s almost always economics.” This concern with economics is consistent with non-profit audit concerns, as non-profit clients would not generate large fees for the audit firm. So with these two partners at Firm C, the areas of discussion around client acceptance and retention processes and procedures appear to be skewed by the individual partners’ industry groups and specific industry-related concerns.

Two partners at Firm D also mentioned specializations. LOP-1D focuses primarily on start-up companies. LOP-1D's main concerns for both client acceptance and client retention related to economics, going concern, and potential funding issues. These matters are highly sensitive factors for start-up entities. Additionally, LOP-1D noted that the most common forms of pushback received from higher levels of approval in the client acceptance and retention processes related to fees and economics, including the risk assumed by the audit firm. Although these issues are likely concerns for any (prospective) client, the risk of business failure and risk of non-payment would be higher for start-up companies, placing greater significance on these factors for client acceptance and retention decisions for this type of entity.

LOP-3D concentrates in the hospitality industry. This partner outlined three primary areas of focus for client acceptance: management integrity, the business model and viability of the company, and the sophistication of the entity's financial reporting platform. For client retention, LOP-3D is most concerned about going concern and significant changes within the entity. Although these matters could apply to any type of for-profit industry, LOP-3D's explanations of these matters, the examples provided, and the emphases of various discussion points throughout the interview related specifically to the hospitality industry. More importantly, this partner emphasized the fact that risk considerations in the client acceptance and retention processes differ within industries:

[Y]ou'd be dangerous if you took our best [UNIQUE INDUSTRY] partner and told him go out and risk assess one of [LOP-3D]'s clients. Likewise, don't get me near, you know, a, a big [UNIQUE INDUSTRY] company. I mean, I could manage my way around, but you don't want me being the one making the risk call. (LOP-3D)

As evidenced by this quote from LOP-3D, local office partners are aware of the potentially unique considerations required for client acceptance, client retention, and overall risk assessments across different types of industry groups.

Considering the areas of specialization for the six partners noted above, the issues discussed by these partners within client acceptance and client retention were consistent with the concerns that are relatively specific to their particular industries or specialty areas. The remaining partner interviews generally did not provide the same narrow focus as these six partners. Thus, it appears that specializations within industry or specific concentration areas contribute to the variation or responses both within and between firms.

5.1.7 Consultations

The impact of industry-specific concerns is also important as it relates directly to consultations between local office partners and those higher up in the client acceptance and retention review process. As discussed in Section 4.15.1, local office partners consult frequently on client acceptance and retention decisions, generally to discuss potential issues in advance and avoid wasting time pursuing a (prospective) client that those at higher approval levels will reject during the process. Partner consultations in advance of the formal process indicates an evolution of audit firms in the consultation process. Salterio and Denham (1997) classify this consultation structure as “discovering organizations,” noting that only two of the five firms they interviewed about consultation processes fall into this category. These organizations exhibited formal consultation departments and encouraged consultation in advance of transactions occurring, while “conditioned viewing organizations” (two of the five firms interviewed) provided approvals of whether a particular accounting treatment is correct or incorrect (Salterio and Denham 1997). Based on the results of my interviews, it appears that all five firms interviewed have a blended model of consultation for client acceptance and retention. All five recommend consultation in advance and consider multiple factors (discovering organization). All five also appear to have an interactive review process where the final approvers ask questions and gather

additional information that may extend beyond the scope of specific acceptance and retention conditions (discovering organization). But in the end, the formal approval or disapproval of the transaction is given or parameters are set around specific features of the audit (concurring partner assignments, etc.) as a condition of acceptance (conditioned viewing organization).

This assistance might include pre-clearance for client-related concerns (eight partners), to ask questions about some matter (eight partners), to identify and/or address risks related to the engagement (seven partners), to save time during the formal process (seven partners), to discuss matters related to job economics (four partners), or to discuss industry-related matters (three partners). Partners from Firm B, Firm C, and Firm E (two partners from each firm) indicated they would speak with a regional partner for these matters. These issues can range from known issues to unknown issues where the partner is trying to stay ahead of problems.

I think, you know, it's sort of ... asking for permission prior to, uh, heading into something, rather than the other way around, um, asking for forgiveness later. I, I just think our profession, ...you have to be on ...the vetting of, of any issues on the front end, rather than trying to deal with it on the back end. (LOP-3C)

The consultations were also compared to discussions with a “subject matter expert” (LOP-1E) or simply a partner with specific expertise (LOP-2A).

[W]e have a very collaborative culture in our firm. And that encourages, promotes, you know, fosters, um, that type of dialogue. ...[Y]ou know, there's seven degrees of separation, right, with Kevin Bacon? ...[T]here's no more than two degrees of separation in our firm. So you either know somebody or you know somebody who knows somebody. ...I think it's also because within our culture it's one where these, our subject matter experts, whether they be risk oriented or technical oriented, are viewed as resources, as opposed to the wizard behind the curtain. ...So it, it's not that I need to go convince somebody. ...[A]t the end of the day I need to convince myself first, and they're a resource at helping me convince myself. (LOP-1E)

This quote summarizes the tone from each of the partners interviewed during this study. The regional and/or technical partners who make acceptance decisions at a higher level than the local office partner are in that position because of their level of expertise. So local partners do not

appear to have any reservations discussing matters with these individuals in advance in order to get assistance on matters that could potentially be problematic for the acceptance or retention process.

5.1.8 Defined Partner Roles

This delineation between the partner groups and the reasons why partners consult with others within their firm also suggests that the partners within the local offices view their knowledge and expertise differently from those at the Risk Management level. During the interviews, I noted that many of the participants seemed to view the local office partners and the Risk Management partners as two distinct groups of partners. As noted in Sections 4.7.1 and 4.8, the local office partners do not necessarily view the Risk Management group or the client acceptance/retention approval process as adversarial. Nevertheless, the interview discussions frequently took on a tone whereby the policymakers were viewed as a separate and distinct group, generally classified as “they” or “them.”

This distinction indicates the two partner groups might be viewed separately as a classification of the necessary roles each partner group assumes. As LOP-1B noted, the Risk Management partners are generally the “gatekeepers” in the client acceptance and retention processes. “And that’s the difference between the local partner having more of the business side of the house... than [RISK MANAGEMENT], which is all about risk management” (LOP-1E). Thus, the differences in the responses between the local office partners and the Risk Management partners throughout this study could be indicative of the functional role assumed by the two partner groups in the client acceptance and client retention processes.

Both partner groups consistently identified the impact of partner roles as a major contributor to the differences between local office and Risk Management partners’ views of risk

in the client acceptance and retention processes. For client acceptance, the majority of the local office partners at Firm A, Firm B, Firm D, and Firm E believe the differences in the local office partners' and Risk Management partners' views of risk are a function of their roles and job duties. The Risk Management partners from Firm B and Firm E share the same view. The majority of the local office partners at each of the five firms stated differences in risk perception for client retention is due to differences in roles and responsibilities between the two partner levels. The Risk Management partners from Firm B, Firm C, and Firm D agreed with this assessment. Therefore, it appears that both local office partners and Risk Management partners see a clear distinction between the functions of the two partner groups.

Both the local office partners and the Risk Management partners acknowledge that the local office partner has many different duties and job responsibilities and the firm evaluates these partners based on their book of business and revenue contributions to the firm. Similarly, both groups see the role of the Risk Management partner as minimizing risk to the firm as a whole. As discussed in Section 5.1.7, the local office partners in this study generally equate this role of Risk Management with subject matter expertise.

Audit research has found that general audit experience (i.e., years of service) does not equate to expertise; task-specific knowledge is a better indicator of expertise (Bédard et al. 1993; Bonner and Lewis 1990). Additionally, expertise in one aspect of auditing does not automatically indicate expertise in all areas of auditing (Bédard et al. 1993). Thus, it is possible that the local office partners' view of Risk Management expertise is specific to the domain of risk. The results of this study indicate this view occurs within the five firms studied. The local office partners' views of Risk Management as a separate partner group ("them") and the consistent opinion that the Risk Management partners focus primarily on risk indicate the local partners view Risk

Management as risk experts. Following this same logic, the local office partners may perform their own client acceptance and retention assessments from the standpoint of their own areas of expertise (e.g., industry-related or client relationship “expertise”) and leave the more detailed risk focus to the risk experts in Risk Management. Under this view, the client acceptance and retention assessments are classified into role-related assessments. Local office partners focus on office-wide considerations such as economics, capabilities, and industry expertise and leave the firm-level risk assessment to the Risk Management partners.

This role-specific view is further supported by responses from Risk Management partners when asked about the areas local office partners should focus on within client acceptance and client retention. When discussing client acceptance focuses for local office partners, the Risk Management partners consistently stated that the analyses of prospective clients should be more in-depth (RM-A, RM-B, and RM-D) and should focus more on particular risk-related aspects of the prospective client (RM-A, RM-C, RM-D, and RM-E). Similarly, Risk Management partners felt local office partners should spend more time assessing risk factors for client retention (RM-A and RM-D). “[Engagement partners] just quickly click a few buttons, don't really think about it, and just continue an engagement” (RM-A). This comment from RM-A, combined with the overall views from Risk Management about the local office partners, indicate the local office partners may simply defer the in-depth risk assessment to the risk experts in the client acceptance and retention processes.

5.1.9 Cannabis

During the interviews, five local office partners and one Risk Management partner brought up the subject of cannabis without prompting as part of the discussion on client acceptance. These responses represented all of the firms except Firm C. I mention it as a final

theme identified in this study, as I believe the conversations with partners about the cannabis industry illuminate how modifications based on current economic or industry trends occur within the client acceptance and retention processes for the firms in this study. The accounting and audit profession has taken note of the opportunities for accounting and audit firms related to the cannabis industry. The AICPA has even created a website for CPAs to use when considering if they should take on a client in this industry (AICPA, n.d.), although this website does not provide any specific guidance for audit client acceptance or retention considerations.

Firm A and Firm B explicitly disallow services with any clients in the cannabis industry. “Yeah, they’ve flat out said no cannabis, no, no services period” (LOP-1A). Firm B noted a similar sentiment. “If it’s somebody in the marijuana industry we can’t do any business with them” (LOP-3B). LOP-2E mentioned cannabis during our interview, but could not recall the specifics of the firm’s cannabis policy. I followed up on our conversation subsequent to the interview to inquire about Firm E’s official policy. LOP-2E said that the firm will not perform any services with companies that are directly involved in the marijuana industry (i.e., production or distribution) but that the firm will consider work with businesses that might perform ancillary services (i.e., transportation services) or that are involved in the cannabidiol (CBD) or hemp industries. “The issue involved is that although it is legal in some states, it is still a federally controlled substance” (LOP-2E). I asked the other partners who mentioned cannabis during the interview to elaborate on whether the firm has provided any reason for the policy and/or its position on cannabis. A partner from Firm B expressed a similar insight on the issue of legality, but added that it is likely a factor related to reputational risk that drives Firm B’s cannabis policy:

[I]t's really because it's ... a federal crime. ...[O]n a state level, state by state level, it may be legal, but from a federal standpoint it's still a crime. And I think that's really, we don't want to be affiliated with anything related to federal crimes. (LOP-1B)

LOP-1A noted that Firm A's policy also was generally related to reputational risks associated with the industry.

This consideration of reputational risk is not limited only to the marijuana industry, but cannabis seems to be a hot area for firms to consider. At Firm E, the reputational concerns over cannabis are considered in a similar manner as reputational considerations for management, the company, or other industries.

[W]hat's the reputation of management, what's the reputation of the company or the industry, is there some amount of reputational risk to the prospective client that we would, uh, not want to be associated with. And, you know, the, the obvious example that's hot today is, uh, medical marijuana and some of the legal, legalized marijuana operations that are ongoing. And, you know, as a profession we have to think very hard about while these are legal businesses, do we want to be associated with them, uh, is the potential for our name to be in the news too high, that sort of thing. (LOP-2E)

Prior research has examined the “sin industries,” those that fall under the categories such as gambling, alcohol, firearms, and tobacco. Callen and Fang (2018) find that audit fees are higher for companies headquartered in areas where local gambling norms are more liberal (i.e., the religious view of the local community is more tolerant towards gambling). Leventis et al. (2013) look beyond just gambling and find that firms in six industries classified as “sin industries” pay approximately 20% higher audit fees than non-sin companies and approximately 22% higher fees for consulting services, and that these premiums escalate based on the level of sinfulness.

However, there is limited research related to the new cannabis industry. Azzaro (2019) conducts a qualitative analysis about considerations made by CPAs when deciding whether to perform accounting services for clients in the cannabis industry. The CPAs interviewed stated

reasons not to serve the cannabis industry focused more on the number of cash transactions and potential client integrity issues while those who do provide services to cannabis clients consider the accounting firm itself and whether the firm provides the right corporate tone, expertise, and due diligence procedures to appropriately service the cannabis clients (Azzaro 2019). Thus, the introduction of legalized cannabis in the U.S. has potentially paved the way for audit research to consider whether concerns around this industry are similar to these other accounting services. Similarly, audit research could examine the link between cannabis and the predecessor sin industries, or if, perhaps, the earlier sin industries have helped pave the way to make cannabis less of a concern for some firms. Entities that fall within the industries of casinos, distilleries/breweries, and pornography are currently audited by various firms, and these firms have deemed the upside of the audit engagement offsets any potential reputational effect. It is possible that this same outcome could result for cannabis.

Firm D was the only firm in this study that stated the firm would consider accepting clients (or engagements) in the cannabis industry. I did not ask the partners directly involved in the study about the cannabis matter, but two of the local office partners mentioned that the client acceptance checklist/questionnaire in the firm's acceptance database included a checkbox for audits in the cannabis industry. I followed up on this matter with a partner who was not involved in the study, but currently serves as a partner in Firm D's Risk Management group. This partner explained that the cannabis checkbox is for all service lines offered by the firm, not just audit, and is included in a question about other industries that could be classified as "sin industries." Identifying that the company is part of the cannabis industry does not automatically trigger rejection. However, it must now be analyzed and approved (for both acceptance and retention) by the two highest approval levels at the firm: the head of Risk Management (focusing on the

risk profile) and the head of the firm's technical partner group (focusing on the industry and required skillset needed).

As an example, this Risk Management partner at Firm D noted that tobacco companies will surely enter into (or at least explore) the cannabis arena. The firms that currently audit those companies, especially the large ones like Philip Morris, will likely not want to walk away from the highly profitable audit services over legalized cannabis. Similarly, RM-B stated that the Risk Management group at Firm B does consider emerging industries and revisits these areas regularly to determine whether the firm's policies should change.

These are all kind of emerging businesses and, you know, right now cannabis is illegal federally so we don't touch it. But it's growing up everywhere around, right? It's opportunities for, for people serving. So we focus on those industries, if you will. (RM-B)

Considering these examples, as well as current economic trends that indicate potential expansion of legalized cannabis (additional states, products, etc.), future research should consider the impacts of this emerging industry, including new avenues of research into sin industries as well as the reputational effects to the audit firm related to taking on these cannabis companies as audit clients.

5.2 Contributions

The recruitment of highly experienced professionals with policy-setting responsibilities as well as local office partners responsible for executing firm policies and procedures around client acceptance and retention was a significant undertaking. I obtained participants from five international, national, and regional audit firms operating within the U.S., which is a significant number of participants for a field study. Previous field studies in client acceptance and/or retention have utilized a single firm (Bedard and Johnstone 2004; Johnstone and Bedard 2003, 2001) and three firms (Gendron 2002, 2001) to obtain in-depth information relevant to the

specific firms studied. The level of expertise of the participants included in this study provides a deeper understanding of how audit firms manage audit risk across the firm by hearing from those directly involved in each firm's risk management process and the implementation of established policies and procedures. Beyond the number of firms and the experience level of planned participants, there is significant diversity in the type of participating firms including international, national, and regional firms. The diversity of these firms increased the amount and quality of information gathered in the study.

The results of the study, as summarized above, show that the firms interviewed have very individualized client acceptance and retention procedures. I believe this study only begins to uncover the variation that exists in practice. However, the firms that I used for this study represent a broad spectrum of the size and types of firms that exist across the U.S. Additionally, the topics covered and questions asked in the semi-structured interviews provide an expansive foundation for future research. Additional research can build upon the information provided by this study and examine additional firms or further details about specific aspects of the client acceptance and/or retention processes.

This study is also beneficial to auditors in practice. The results of this study expand upon the results of prior studies on client acceptance and client retention. The number of firms used in this study provide the opportunity for audit firms to consider the variety of procedures that are currently in use when making client acceptance and retention policy decisions. The results of this study could also be used to establish best practices for audit firm client acceptance and retention practices. Although each firm in this study followed at least the minimum requirements under the current auditing standards, the participating firms could also use the considerations in this study to determine whether modifications to their existing client acceptance and retention procedures

might allow the firms to be more effective and/or more efficient in their acceptance and retention decisions.

During the interviews, several partners noted that this study was of interest to them and/or to the firm.

I think [the questions asked during the interview were] spot on in terms of, you know, the things we're obviously sensitive to and... the whole acceptance and continuation process. ... The key is... making sure that, you know, a quality judgment's being rendered by the engagement team first and foremost, because they're the ones that are closest to the facts. ... And, you know, from team to team, I'm sure there's going to be varying degrees of quality of how that assessment's done, but it is all predicated on that. I think all the firms are very serious about it. ... [So] I think you asked the right questions in terms of that topical area. (LOP-3D)

Most participants were interested in the types of procedures other firms were performing in comparison to their own procedures. The Risk Management participants also felt they could potentially use the results of this study to evaluate their own processes and procedures.

[W]e're always concerned about can we be doing things better or more efficiently or, you know, just whatever. So... your study is intriguing in terms of the results. And I'm sure as you talk to different sized firms, you're getting very remarkable different structures and processes and things like that. Even though we're all trying to follow the same standards basically. Right? ... But how you get there can be remarkably different. Um, and it's not a one size fits all kind of scenario. So that's why when we go to these, you know, we hear what these other firms are doing, it's different from ours and you're intrigued about it, but that doesn't necessarily mean that I'm like, well, we're not doing something right. And so when, you know, I, I look at the results of kind of what you come up with. There's going to be some themes and there, there might be some things that are, that our takeaway is and say, hey, we ought to consider doing this, this, or this. But it doesn't necessarily mean any firm's doing it wrong. (RM-C)

These comments further support the importance of this research and its applicability to practitioners. “I'm excited to... learn where this [study] goes” (RM-E).

5.3 Limitations

Although there are significant benefits to this study, this dissertation also has limitations.

The first limitation relates to the participants. I interviewed partners who participate in

developing their firm's policies and procedures as well as partners who carry out those requirements, represented by Risk Management partners and local office partners, respectively. My study does not include other individuals who might also be involved in the client acceptance and retention processes (i.e., office managing partners, regional partners, and other partners who are part of the approval processes), nor do I use any auditors who may assist in the acceptance and/or retention processes, such as managers. Although these individuals potentially could provide additional insight into the processes, I believe it is important to first understand how the policies and procedures are developed by Risk Management and how the local office partners interpret and implement them. Future research should consider how others within audit firms influence the client acceptance and retention decision-making processes.

Second, it is possible that the proposed models for the client acceptance and client retention processes are either incorrect or incomplete. Although some risk of error is possible, the proposed models are built upon the AICPA and PCAOB requirements set forth by the respective auditing standards that indicate firms either must perform or should consider performing certain procedures. Therefore, the models represent the minimum considerations firms should include as part of their client acceptance and retention procedures. The discussions with the participating firms in this study show that the different firms have chosen to implement additional policies and procedures that are not required by the standards. The models loosely include these procedures under the "recommended" headings. But at this time, there is not enough consistency noted among the firms to indicate that the models should be significantly modified. Further research might find that the models need to change to include policies and procedures commonly used across a wide variety of audit firms.

Third, while the firms in this study represent a cross-section of international, national, and regional firms operating in the U.S., the use of only five firms and confidentiality concerns prohibit me from performing analyses of these firms based upon size. Some of the variances in this study both between and within firms could potentially be explained by differences in firm size, location, expertise, or other similar factors. However, any analyses based upon size would likely allow an individual firm to be identified within a particular grouping (i.e., Big 4) or possibly even by name. During the interviews, I promised participants their responses would remain confidential and neither the individual nor the firm would be identifiable in my dissertation. Therefore, I am unable to perform any analyses based on specific firm benchmarks at the risk of violating my assurances to study participants. Future research should consider interviews with a broader sample of firms to enable firm size-specific comparisons across and within the participating firms.

Fourth, this study also only considers the processes and procedures used by audit firms to make client acceptance and retention decisions. The study does not include any considerations of the quality of companies that each firm assesses regularly. In other words, it is possible that the international and national firms are able to be more selective with factors such as management integrity due to the ability of those firms to attract a greater number of potential audit opportunities. It is also possible that the companies themselves perform regular assessments to determine whether they might be an attractive company for an auditor. For example, audit committees frequently consider which firms their companies are attractive to as clients (Jenkins et al. 2019). This question was raised by one of the participants in the study.

[A]nd I think about, you know, the risks around client acceptance and what companies like to ... build those same risks, but if it's a risk to me, it's a risk to the Board, as well. Right? It's a risk to those charged with governance. ...[W]hat are companies doing, you know, to manage those same risks and, and how might the profession potentially leverage

that? ...[I]f I think about developing an audit approach ...it takes into consideration the control environment... And, you know, would the client acceptance process or approach do the same thing? Is there a way to leverage off of, or better incorporate what management might already been doing, or what the Board or those charged with governance, might be doing on the same topic? (LOP-1E)

Future research could address this avenue of client acceptance considerations.

A final limitation arises from the use of a field study as the basis for this dissertation.

This study uses only interviews and does not include a review of each firm's documented policies and procedures. Although these documents could provide a great deal of information about participating firms' client acceptance and retention policies and procedures, the documents are proprietary and were not made available to me. This limitation is addressed somewhat by the nature of the questions asked of all participants related to specific attributes of each firm's policies and procedures, but the responses were contingent upon the candor of the participants.

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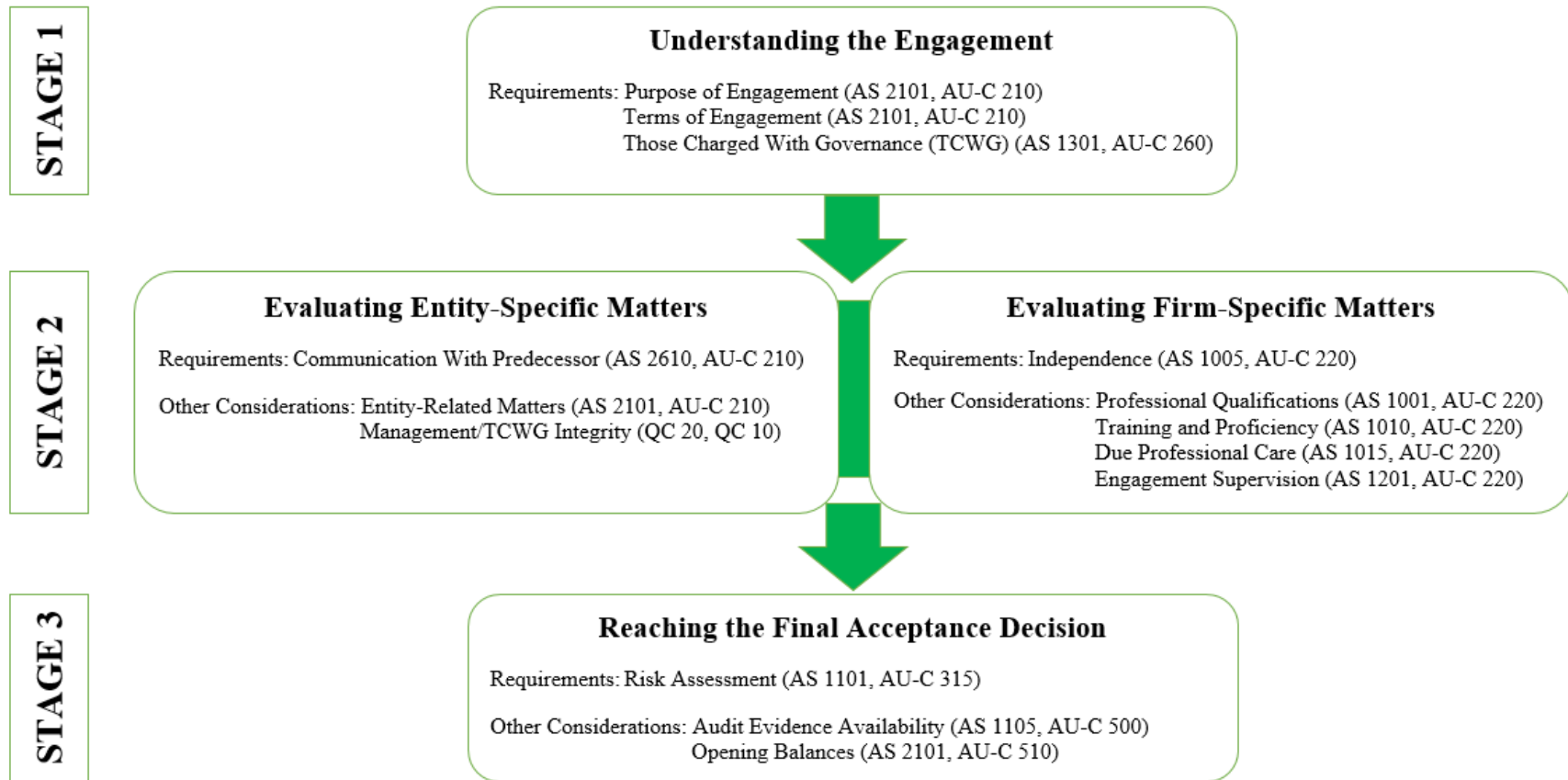
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**FIGURE 1
MODEL OF THE CLIENT ACCEPTANCE PROCESS**

Figure 1: Model of the Client Acceptance Process



**FIGURE 2
MODEL OF THE CLIENT RETENTION PROCESS**

Figure 2: Model of the Client Retention Process

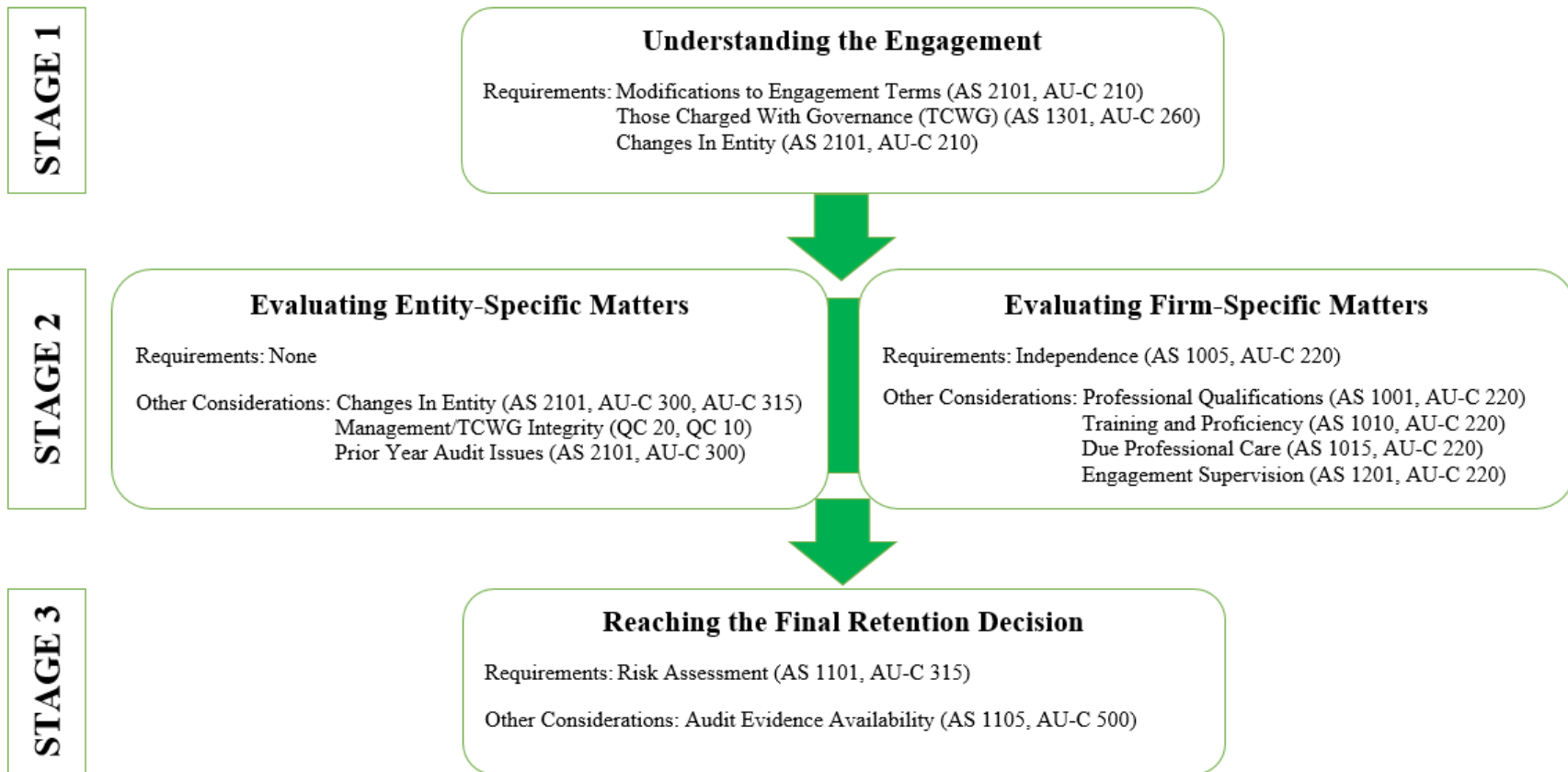


TABLE 1
LOCAL OFFICE PARTNER DEMOGRAPHIC INFORMATION

LOP Demographics

Average Interview Length	60.73
Minimum	36
Maximum	125
 Total Participants	 15
Male	11
Female	4
 Average Years of Service	 26.62
Minimum	14
Maximum	39
 Average Years With Current Firm	 20.08
Minimum	10
Maximum	39
 % With Big 4 Experience	 53.3%
 Average Years of Partner Experience	 13.42
Minimum	2.5
Maximum	30
 Average Experience In Other Offices	 26.7%
 % Involvement in Policy Making	 20.0%

TABLE 2
RISK MANAGEMENT PARTNER DEMOGRAPHIC INFORMATION

RM Demographics

Average Interview Length	90.80
Minimum	75
Maximum	105
Total Participants	5
Male	3
Female	2
Average Years of Service	28.50
Minimum	22
Maximum	33
Average Years With Current Firm	16.88
Minimum	8
Maximum	30
% With Big 4 Experience	80.0%
Average Years of Partner Experience	11.38
Minimum	7
Maximum	18
Average Experience In Other Offices	0.0%
% Involvement in Policy Making	100.0%

**TABLE 3
COMBINED PARTNER DEMOGRAPHIC INFORMATION**

<u>Combined Demographics</u>	
Average Interview Length	68.25
Minimum	36
Maximum	125
Total Participants	20
Male	14
Female	6
Average Years of Service	27.06
Minimum	14
Maximum	39
Average Years With Current Firm	19.32
Minimum	8
Maximum	39
% With Big 4 Experience	60.0%
Average Years of Partner Experience	12.94
Minimum	2.5
Maximum	30
Average Experience In Other Offices	20.0%
% Involvement in Policy Making	40.0%

**TABLE 4
CLIENT ACCEPTANCE AND CLIENT RETENTION PROCESS SUMMARY**

CLIENT ACCEPTANCE AND CLIENT RETENTION PROCESSES					
	Firm A	Firm B	Firm C	Firm D	Firm E
General Process	System-automated questionnaire, charge code generated after process complete	Form-based questionnaire	Form-based; use practice aid checklist for engagement and additional form to consider all engagements for client	Software tool guides process and determines risk ratings (for both general risk and income tax risk); forms (questionnaires) within database drive sequential steps; charge code set up after process complete	Questionnaire within database application; determines risk ratings for client
Management Integrity	Background searches, conflict checks, discussions with predecessor	Background searches, discussions with bankers and attorneys, discussions with predecessor, review financial statements, inquiries within firm for people who can speak to management's integrity (previous relationship)	Form includes questions about management integrity; discussions with predecessor, industry referrals, background checks may be performed	Background searches, discussions with bankers and attorneys, discussions with predecessor, review financial statements, inquiries within firm for people who can speak to management's integrity (previous relationship)	Database includes questions on owners and investors, predecessor auditor inquiries, background checks; background searches coded such that higher levels are things that bear on judgment or ethics of management
Background Checks	Required only for public companies, optional for private; includes officers, key Board members, and Audit Committee chair	Required for all clients; includes individuals with influence over reporting, C-level employees, in-house counsel, Board chair, Audit Committee chair; head of risk management and legal have to review and approve if any issues noted	Required only for public companies; only performed on private companies if there is reason to believe there are risk issues; includes key members of management	Required for all new clients; performed on executives (CEO, CFO, Board chair, Audit Committee chair)	Required for all new clients for those in financial reporting or oversight roles, certain Board members, key owners; results classified by level to identify further procedures necessary for acceptance/retention
Independence Checks	Conflict checks sent to all partners for public companies	Database used to confirm independence, internal checks performed on entities with international operations	Form completed that covers team and local office; annual independence checks performed for all clients; conflict checks sent for non-routine services	Database/software used to confirm independence; searches for conflicts of interest, direct investments by firm employees, prohibited services during lookback period	Conflict checks (survey) within firm and across global organization; searches performed on various client and independence databases maintained by firm

**TABLE 4
CLIENT ACCEPTANCE AND CLIENT RETENTION PROCESS SUMMARY**

CLIENT ACCEPTANCE AND CLIENT RETENTION PROCESSES

	Firm A	Firm B	Firm C	Firm D	Firm E
Approval Process	Tiered by prescribed criteria such as public/private, fee level, industry, regulatory environment; higher risk requires higher level of review	Tiered based on prescribed criteria such as public/private, engagement size (fee)	Tiered based on quality/risk criteria; separate approval for fees (regional audit partner)	Signoff required by engagement partner, regional partner, technical partner; additional (tiered) approvals based on fee level	Tiered based on risk ratings; criteria includes public/private, capital market transactions, complexity, financial factors, industry; public and higher risk companies must all be approved by Risk Committee
Retention Process	Questions more abridged, focused on changes from prior year; lower levels of approval required versus acceptance, approved only by engagement partner if no changes	Checklist with similar questions, focuses on changes from prior year; background checks performed with changes in management	Checklist similar to acceptance, focuses mostly on changes, less info about client risk factors; fees also reassessed annually; process less about acceptance and more about second level of review needed	Forms similar to acceptance, risk rating generated by system; all partners required to review and approve all continuing clients in system; background checks performed on any new key members of management	Similar to acceptance but more abbreviated process considering mostly changes in risk factors and economics; background checks performed with changes in management
Retention Timing	Performed at end of engagement for next year	Performed as part of planning for new audit	Annual process	Annual process	Annual process
Levels of Approval for Acceptance	Managing partner, regional liaison from National office (industry lead), Risk Committee	Office managing partner, regional managing partner, regional technical partner required for all new clients, risk level may require head regional managing partner and national risk partner approval	Partner approves, sends to regional technical partner; at next risk level, goes to Risk Committee for group decision	Signoff required by engagement partner, regional partner, technical partner	Regional approval at lowest level (managing partner and technical partner); two levels of National approval, with Risk Committee required for highest risk clients
Levels of Approval for Retention	Engagement partner (no changes), regional liaison from National office (industry lead), Risk Committee	Engagement partner (no changes); if there are changes, same level of approvals as acceptance	Regional technical partner; Risk Committee if public or meets risk threshold (same as acceptance)	Approvals more regionalized for continuing clients; regional audit and regional technical partners required to approve all continuing clients; some large clients may be considered at National level of review	Same as acceptance with regional approval at lowest level and two levels of National approval; Risk Committee required for highest risk clients

**TABLE 4
CLIENT ACCEPTANCE AND CLIENT RETENTION PROCESS SUMMARY**

CLIENT ACCEPTANCE AND CLIENT RETENTION PROCESSES

	Firm A	Firm B	Firm C	Firm D	Firm E
Risk Ratings	No	No	No	Yes, calculated for both acceptance and retention; general risk rating and income tax risk rating	Yes, calculated for both acceptance and retention
Risk Committee	5-6 people, most of which are in National, including head of Assurance and head of Risk; primarily for public company clients; approval required prior to entering normal acceptance or retention process	No	Yes, approves SEC and higher risk or more complex clients; four partners including regional service partners and assurance director for firm	No	Yes, approves public and higher risk clients; 3-4 partners including National technical partners and Risk Management partners; includes line partner representation
Differences for Public Clients	More questions, but generally same processes; approval required for Risk Committee for all public clients; conflict checks sent to partner group; background searches performed	Highest level of approval (risk management) required for all public companies	Generally the same process, just different questions; all public clients must be approved annually by Risk Committee	Process similar but forms include additional questions for public companies	Similar process but procedures may be more onerous; approval required by Risk Committee

**TABLE 5
LOCAL OFFICE PARTNER CLIENT ACCEPTANCE BETWEEN FIRM SUMMARY**

CLIENT ACCEPTANCE

	Firm A	Firm B	Firm C	Firm D	Firm E
Other Client Acceptance Procedures	<ul style="list-style-type: none"> - Discussions with others in firm - Book of business considerations - Due diligence to gather info about the company - Initial gut check 	<ul style="list-style-type: none"> - Memo summarizing thoughts on management integrity 	<ul style="list-style-type: none"> - Discussions with individuals in industry and trade associations - Understanding needs of company and if fit - Feel for management integrity - Discussions within firm to ensure no barriers to acceptance 	<ul style="list-style-type: none"> - Feedback from local community and others in industry - Examining fit for firm and risk-reward payoff - Understanding management integrity - Peer analysis with existing clients 	<ul style="list-style-type: none"> - Relationship building - Assessing management integrity - Discussions with others in industry - Vet out factors that might cause issues - Understanding fit with firm
Primary LOP Focuses	<ul style="list-style-type: none"> - Economics - Industry - Risks or issues with management 	<ul style="list-style-type: none"> - Potential relationship with prospect - Understanding business and service needs - Looking for potential issues - Background info of company and management 	<ul style="list-style-type: none"> - Adequate resources available - Industry experience - Reputation and integrity of company and management 	<ul style="list-style-type: none"> - Management integrity - Expertise and experience of management - Business model - Going concern 	<ul style="list-style-type: none"> - Management integrity - Financial viability of client - Potential industry or company issues
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Firm wide risk - Overall process itself 	<ul style="list-style-type: none"> - Management integrity - Everything together to make informed decision - General risk related to company 	<ul style="list-style-type: none"> - Experience necessary - Resources needed - Major risk factors 	<ul style="list-style-type: none"> - Management integrity - Risk characteristics 	<ul style="list-style-type: none"> - Management integrity - Financial viability and going concern - Complex issues and firm capabilities
Differences in Risk Perception	<ul style="list-style-type: none"> - Level of acceptable risk - Appreciation of entire risk profile 	<ul style="list-style-type: none"> - Different exposure and experience - Risk focuses on one area while engagement partners wear lots of different hats 	<ul style="list-style-type: none"> - Risk partners more aware of where risk might be for firm on more global basis 	<ul style="list-style-type: none"> - Local partners more motivated by economics and growth - Risk partners focused on risk management and reputational risks 	<ul style="list-style-type: none"> - Local partner focuses on revenue and economics while risk partners focus on potential risks and costs of engagement
Pushback	<ul style="list-style-type: none"> - Fee vs risk - Partner experience and expertise 	<ul style="list-style-type: none"> - Background checks - Going concern 	<ul style="list-style-type: none"> - Economics - Exposure to increased risk 	<ul style="list-style-type: none"> - Background checks - Industry issues 	<ul style="list-style-type: none"> - Management integrity - Background checks - Additional information regarding issues noted

**TABLE 6
RISK MANAGEMENT PARTNER CLIENT ACCEPTANCE BETWEEN FIRM SUMMARY**

CLIENT ACCEPTANCE

	Firm A	Firm B	Firm C	Firm D	Firm E
Primary Focuses	<ul style="list-style-type: none"> - Management integrity - Really looking at client situation, industry, complexity - Consider people (expertise), resources, and time required 	<ul style="list-style-type: none"> - Know your clients - Reputation - Industry - Expertise and capacity - More in-depth analysis of prospective client 	<ul style="list-style-type: none"> - Identification of areas that engagement partner might view as low risk but experienced partner would think needs to be addressed 	<ul style="list-style-type: none"> - Understanding the company well enough - Having dialogues with regional leadership before acceptance process begins 	<ul style="list-style-type: none"> - Thinking about the broader risk to the firm (Risk Management lens)
Differences in Risk Perception	<ul style="list-style-type: none"> - Local office partners focus on risk in terms of potential litigation claims - Should look at it in terms of risk of material misstatement 	<ul style="list-style-type: none"> - Engagement partner probably has a degree of optimism about corrections of issues - Risk management usually wants to see actions in place 	<ul style="list-style-type: none"> - Risk Management more risk averse - Want people making risk decisions to be more conservative 	<ul style="list-style-type: none"> - Local partners may be bringing in companies that aren't the right fit for the firm in terms of viability, continuing opportunity, risk, etc. 	<ul style="list-style-type: none"> - Ability to perform the work versus understanding the true issues
Majority of Rejections	<ul style="list-style-type: none"> - Management integrity - Competence and/or expertise 	<ul style="list-style-type: none"> - Cannabis - Digital asset offerings - Significant international operations 	<ul style="list-style-type: none"> - Transactional-based risk situations - Lack of expertise 	<ul style="list-style-type: none"> - Not common, as should have been discussed before formal process started 	<ul style="list-style-type: none"> - Results of background checks - Timing - Governance infrastructure issues
Pushback	<ul style="list-style-type: none"> - Usually when we learn something new later on in the process - Size of client and resources required 	<ul style="list-style-type: none"> - High risk business - Had seen other examples of similar situation that didn't work out 	<ul style="list-style-type: none"> - Unique transactions or accounting issues 	<ul style="list-style-type: none"> - Independence issues may arise during the formal process 	<ul style="list-style-type: none"> - Capacity/resources - Expertise - Results of background checks

**TABLE 7
CLIENT ACCEPTANCE WITHIN FIRM SUMMARY: FIRM A**

CLIENT ACCEPTANCE - FIRM A

	LOP-1A	LOP-2A	LOP-3A	RM-A
Primary LOP Focuses	<ul style="list-style-type: none"> - Economics - Level of risk - Current consulting work (possibly higher fees) - Going concern - Fees (revenue and risk) 	<ul style="list-style-type: none"> - Economic viability - Industry expertise required - Timing/delivery of work (economics and resources) - Issues that arise in background checks or discussions with predecessor 	<ul style="list-style-type: none"> - Strong management team (namely for public clients) - Past issues that have not improved - More latitude with private, more about economics 	-N/A
Other Client Acceptance Procedures	<ul style="list-style-type: none"> - Collaboration with peers for budget help - Does it make sense for book of business 	<ul style="list-style-type: none"> - Due diligence including Google searches (company and key individuals), review website, background info, initial gut check - Get feel for goals and objectives 	<ul style="list-style-type: none"> - None 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Firm-wide - More strategic plan - Fee vs risk - Industry - If highly leveraged - Financial 	<ul style="list-style-type: none"> - Process itself is key component - Things weighed more heavily on case by case basis 	<ul style="list-style-type: none"> - How much risk firm going to take on - Firm very clear about risk being important 	<ul style="list-style-type: none"> - Management integrity - Really looking at client situation, industry, complexity - Consider people (expertise), resources, and time required
Differences in Risk Perception	<ul style="list-style-type: none"> - Level of acceptable risk - Book of business (LOP) vs firm-wide (RM) 	<ul style="list-style-type: none"> - No differences, local partners still have to protect the firm 	<ul style="list-style-type: none"> - National has better appreciation for entire risk profile 	<ul style="list-style-type: none"> - Local office partners focus on risk in terms of potential litigation claims - Should look at it in terms of risk of material misstatement
Pushback	<ul style="list-style-type: none"> - Fee vs risk 	<ul style="list-style-type: none"> - Whether priced correctly vs amount of risk assumed - Whether have right people on the engagement 	<ul style="list-style-type: none"> - Partner (industry, experience, workload, etc.) - Firm will accept work if have right partner servicing account 	<ul style="list-style-type: none"> - Usually when we learn something new later on in the process - Size of client and resources required

**TABLE 8
CLIENT ACCEPTANCE WITHIN FIRM SUMMARY: FIRM B**

CLIENT ACCEPTANCE - FIRM B

	LOP-1B	LOP-2B	LOP-3B	RM-B
Primary LOP Focuses	<ul style="list-style-type: none"> - Potential relationship with prospect and needs, fit - Ability to pay, business history, members of management, plans/forecasts 	<ul style="list-style-type: none"> - First impressions - Looking for potential issues 	<ul style="list-style-type: none"> - Initial qualification of prospect to ensure type of client looking for - Understanding business and service needs - Background info of company and management 	- N/A
Other Client Acceptance Procedures	<ul style="list-style-type: none"> - Adding memos into file summarizing thoughts on management integrity 	<ul style="list-style-type: none"> - Nothing outside of required procedures, as it's a detailed list 	<ul style="list-style-type: none"> - No additional procedures, as they cover everything 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Management integrity 	<ul style="list-style-type: none"> - Everything goes together; need all the info to make informed decision 	<ul style="list-style-type: none"> - General risk of company - Litigation risk - Risk of going out of business - Risk dealing with criminals 	<ul style="list-style-type: none"> - Know your clients - Reputation - Industry - Expertise and capacity - More in-depth analysis of prospective client
Differences in Risk Perception	<ul style="list-style-type: none"> - National doesn't see details of what client went through to get to current point - National tends to just look at negative factors - They are gatekeepers 	<ul style="list-style-type: none"> - They have much more exposure over whole firm that local partner may not have - They have experience local partners may not have had that can be leveraged 	<ul style="list-style-type: none"> - They are ultra conservative - They dive deeper into getting more information - Risk partners have risk focus while local partners wear lots of different hats - Engagement partners get evaluated on economics 	<ul style="list-style-type: none"> - Engagement partner probably has a degree of optimism about corrections of issues - Risk management usually wants to see actions in place
Pushback	<ul style="list-style-type: none"> - Cannabis - SEC sanctions with PE group - Previously dropped by another auditor due to lawsuit 	<ul style="list-style-type: none"> - Background checks - Going concern 	<ul style="list-style-type: none"> - Going concern - Shareholder disputes (fighting over control) 	<ul style="list-style-type: none"> - High risk business - Had seen other examples of similar situation that didn't work out

**TABLE 9
CLIENT ACCEPTANCE WITHIN FIRM SUMMARY: FIRM C**

CLIENT ACCEPTANCE - FIRM C

	LOP-1C	LOP-2C	LOP-3C	RM-C
Primary LOP Focuses	<ul style="list-style-type: none"> - Commitment from management to do right thing - Issues with financial viability, including management's plan to fix 	<ul style="list-style-type: none"> - Have agreed to engage (proposal process complete) - Economics - Reputation of business and owner 	<ul style="list-style-type: none"> - Industry expertise - Have resources necessary (including expected timing) - Risks that internal resources can't overcome - Independence 	-N/A
Other Client Acceptance Procedures	<ul style="list-style-type: none"> - Talking to others in industry - Inquiring about involvement in industry associations and understanding of current industry issues 	<ul style="list-style-type: none"> - Understanding needs, processes, procedures - Getting feel for integrity - Determine if good fit - Examine past financials and tax returns for issues 	<ul style="list-style-type: none"> - Discussing prospect with regional technical partner and office managing partner to ensure no barriers to acceptance (adequate resources and expertise) 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Management integrity - Having right people with industry experience to serve client 	<ul style="list-style-type: none"> - Economics - Experience and resource needs - Industry or accounting risks - Users of financials - If highly leveraged 	<ul style="list-style-type: none"> - Additional risk factors above and beyond those spelled out in practice aid checklist 	<ul style="list-style-type: none"> - Identification of areas that engagement partner might view as low risk but experienced partner would think needs to be addressed
Differences in Risk Perception	<ul style="list-style-type: none"> - Pretty rare 	<ul style="list-style-type: none"> - Risk highest when accepting client, so local partners okay that someone else has to approve 	<ul style="list-style-type: none"> - Risk partners more aware of where risk might be for firm on more global basis 	<ul style="list-style-type: none"> - Risk Management more risk averse - Want people making risk decisions to be more conservative
Pushback	<ul style="list-style-type: none"> - None 	<ul style="list-style-type: none"> - Always economics - Larger, more complex clients with more exposure to risk with outside investors 	<ul style="list-style-type: none"> - Issues in background checks - Independence in appearance 	<ul style="list-style-type: none"> - Unique transactions or accounting issues

**TABLE 10
CLIENT ACCEPTANCE WITHIN FIRM SUMMARY: FIRM D**

CLIENT ACCEPTANCE - FIRM D

	LOP-1D	LOP-2D	LOP-3D	RM-D
Primary LOP Focuses	<ul style="list-style-type: none"> - Right management people in place - Going concern issues - Investors and funding mechanisms - Too many problems - Doing other work where it may be more profitable and less risky 	<ul style="list-style-type: none"> - Anything integrity or reputation risk related - Reason for prior firm leaving 	<ul style="list-style-type: none"> - Independence - Integrity of management and Board - Business model and viability - Financial reporting platform (expertise and sophistication) 	-N/A
Other Client Acceptance Procedures	<ul style="list-style-type: none"> - Reach out to people in local community for feedback 	<ul style="list-style-type: none"> - Business decisions and risk-reward payoff 	<ul style="list-style-type: none"> - Preliminary qualification of client - Networking in industry and community - Understand integrity - Peer analysis with existing clients - Get reads from relationships in the market 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Risk of material misstatement - Greater weight to risk than economics - More conservative with risk than economics 	<ul style="list-style-type: none"> - Integrity of management including reputation, skillset, and background - Risk characteristics such as industry, income tax risk, exposure from GAAP and auditing standards 	<ul style="list-style-type: none"> - Risk - Management integrity 	<ul style="list-style-type: none"> - Understanding the company well enough - Having dialogues with regional leadership before acceptance process begins
Differences in Risk Perception	<ul style="list-style-type: none"> - Local partners more inclined to win work and grow practice - Local partners more focused on business side while risk partners more focused on risk management than economics 	<ul style="list-style-type: none"> - Local partner looking more at economic returns while risk looking more at reputational risks - Local partner incented if they can manage risk, risk partner focused on risk rather than fees 	<ul style="list-style-type: none"> - Should be a healthy back and forth where all parties are challenging each other 	<ul style="list-style-type: none"> - Local partners may be bringing in companies that aren't the right fit for the firm in terms of viability, continuing opportunity, risk, etc.
Pushback	<ul style="list-style-type: none"> - Resources needed - Internal control issues - Fees 	<ul style="list-style-type: none"> - DOJ investigations - Risky, volatile industry - Issues in background searches 	<ul style="list-style-type: none"> - Issues in background searches - Sensitive to integrity issues - Challenges to understand issues since not experts in every industry 	<ul style="list-style-type: none"> - Independence issues may arise during the formal process

**TABLE 11
CLIENT ACCEPTANCE WITHIN FIRM SUMMARY: FIRM E**

CLIENT ACCEPTANCE - FIRM E

	LOP-1E	LOP-2E	LOP-3E	RM-E
Primary LOP Focuses	<ul style="list-style-type: none"> - Management integrity - Financial viability of client - Industry 	<ul style="list-style-type: none"> - Requisite skills needed (talent and experience) - Whether management expectations are reasonable and manageable - Good strategic fit - Reputation of management, company, industry - Reputational risk 	<ul style="list-style-type: none"> - Background of company including reason for bid, management changes, internal control issues - Management integrity (and Audit Committee) - Viability of company - Potential for restatements - Going concern - Prior issues not addressed - Historical relationships with management - Issues in news 	-N/A
Other Client Acceptance Procedures	<ul style="list-style-type: none"> - Playing golf (relationship building but also risk rating) - Talk with others in industry or advisors to company 	<ul style="list-style-type: none"> - Spend time with prospect to get good understanding - Put in enough effort to make informed and educated decision - Weigh if prohibited services are more profitable than audit work 	<ul style="list-style-type: none"> - Vet out factors that might cause issues - Don't want to spend time on something that's not a good fit 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Integrity of management, TCWG - Financial viability of company - Industry - Capabilities and expertise related to entity, industry, and geographic reach 	<ul style="list-style-type: none"> - Good fit economically (profitability and growth) - Risk level that can be managed (audit, reputational, legal risk) - Handful of factors, not one specifically 	<ul style="list-style-type: none"> - Integrity of management and Audit Committee - Financial status of company - Going concern issues - Complex or judgmental accounting issues - Past issues - Engagement economics 	<ul style="list-style-type: none"> - Thinking about the broader risk to the firm (Risk Management lens)
Differences in Risk Perception	<ul style="list-style-type: none"> - Audit partner measured on generating revenue, so bias - People who aren't measured on revenue helping with risk assessment to ensure objectivity 	<ul style="list-style-type: none"> - Different points of view - Risk management considers risks and costs of potential engagement - Risk partners spend more time thinking about big picture of risk - Focused on different aspects by virtue of role 	<ul style="list-style-type: none"> - Differences over economics and understanding market factors behind economics (competition) 	<ul style="list-style-type: none"> - Ability to perform the work versus understanding the true issues
Pushback	<ul style="list-style-type: none"> - Prior negative experience with management - Additional information about industry 	<ul style="list-style-type: none"> - Management experience and qualifications - IPOs including underwriter and reputation - Management integrity concerns from predecessor auditor 	<ul style="list-style-type: none"> - Material weakness remediation - Additional information needed to understand issue - Results of background checks or conflict checks - Economics 	<ul style="list-style-type: none"> - Capacity/resources - Expertise - Results of background checks

**TABLE 12
LOCAL OFFICE PARTNER CLIENT RETENTION BETWEEN FIRM SUMMARY**

CLIENT RETENTION

	Firm A	Firm B	Firm C	Firm D	Firm E
Other Client Retention Procedures	<ul style="list-style-type: none"> - Managing economics - Understanding client's plans and goals 	<ul style="list-style-type: none"> - Focus on going concern 	<ul style="list-style-type: none"> - Keeping up with client throughout the year - Discussions with audit team about issues and possible improvements - Discussions with client about issues and possible improvements 	<ul style="list-style-type: none"> - Managing account and economics - Due diligence around problem areas - Performing formal procedures throughout the year 	<ul style="list-style-type: none"> - Memo summarizing all retention considerations - Review communications with management - Consider audit environment for staff - Understanding client's future plans - Annual meetings with regional leadership
Primary LOP Focuses	<ul style="list-style-type: none"> - Economics - Client difficulties 	<ul style="list-style-type: none"> - Pain and suffering, prior year issues - Treatment of audit team (respect) 	<ul style="list-style-type: none"> - Management integrity - Changes (financial condition, organization, management, etc.) 	<ul style="list-style-type: none"> - Management integrity and tone at the top issues - Going concern - Significant changes and risks 	<ul style="list-style-type: none"> - Relationship with management - Financial viability - Right fit for firm - Management integrity
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Fee/economics 	<ul style="list-style-type: none"> - Management integrity - Risk factors related to company 	<ul style="list-style-type: none"> - Risk (higher risk issues) - Economics - Changes from prior year 	<ul style="list-style-type: none"> - Overall risk factors - Management integrity - Concerns over control environment 	<ul style="list-style-type: none"> - Going concern - Economics - New or significant risk factors
Differences in Risk Perception	<ul style="list-style-type: none"> - Risk - Partner capabilities 	<ul style="list-style-type: none"> - Risk tolerance (conservatism) - Local partners want to retain client and revenue - Prior experience 	<ul style="list-style-type: none"> - Level of conservatism - Differences in goals (risk vs economic growth) - Severity of risk 	<ul style="list-style-type: none"> - Level of risk aversion and risk sensitivity - Familiarity and relationship with client 	<ul style="list-style-type: none"> - Engagement partner has closer relationship with client while risk management takes more detached view - Big picture of risk
Pushback	<ul style="list-style-type: none"> - Risk profile of client - Client difficulties 	<ul style="list-style-type: none"> - Client risks/issues - Going concern 	<ul style="list-style-type: none"> - New risk areas - Complex areas 	<ul style="list-style-type: none"> - Economics - Heightened risk areas 	<ul style="list-style-type: none"> - Industry issues - Past issues with internal controls

**TABLE 13
RISK MANAGEMENT PARTNER CLIENT RETENTION BETWEEN FIRM SUMMARY**

CLIENT RETENTION

	Firm A	Firm B	Firm C	Firm D	Firm E
Primary Focuses	<ul style="list-style-type: none"> - Focusing on changes - Issues if partners just quickly click through buttons and don't think about client trends - Partners are in a hurry and just assume they are continuing all clients 	<ul style="list-style-type: none"> - Do it sooner 	<ul style="list-style-type: none"> - Management integrity - Capabilities 	<ul style="list-style-type: none"> - Adequately identifying and assessing risk 	<ul style="list-style-type: none"> - Added factors to consider if client is bad to people, challenging to deal with, not timely
Differences in Risk Perception	<ul style="list-style-type: none"> - Pretty well aligned 	<ul style="list-style-type: none"> - Challenge for engagement partner to step outside of scenario 	<ul style="list-style-type: none"> - Assessment of quality of management 	<ul style="list-style-type: none"> - Have to guard against complacency - Taking objective lens to client 	<ul style="list-style-type: none"> - Ability to perform the work versus understanding the true issues
Majority of Rejections	<ul style="list-style-type: none"> - Management integrity - Complexity - Competence - Resources - Uses of financials 	<ul style="list-style-type: none"> - Company had something they were pursuing or developing that didn't work out - Issues in the company (investigations, etc.) 	<ul style="list-style-type: none"> - They outgrow our abilities or reach - Management capabilities (too many audit adjustments) - Fraud 	<ul style="list-style-type: none"> - Concerns about management or audit committee - Internal controls - Inadequate finance support and personnel - Firm resources 	<ul style="list-style-type: none"> - Fraud - Capabilities of clients - Going concern - Turnover (accounting) - Hard on audit staff
Pushback	<ul style="list-style-type: none"> - Not aware of any situations 	<ul style="list-style-type: none"> - Engagement team comes in trying to find ways to keep the client that's a bad fit 	<ul style="list-style-type: none"> - Firm capabilities 	<ul style="list-style-type: none"> - Tends to be related to risk designations 	<ul style="list-style-type: none"> - Significant financial difficulties - New arenas that are risky - Integrity issues - Fraud

**TABLE 14
CLIENT RETENTION WITHIN FIRM SUMMARY: FIRM A**

CLIENT RETENTION - FIRM A

	LOP-1A	LOP-2A	LOP-3A	RM-A
Primary LOP Focuses	<ul style="list-style-type: none"> - Economics - Difficulty of client - Issues with info provided by client (scope limitations) 	<ul style="list-style-type: none"> - Considerations about people doing work if client is difficult and demanding - Aggravation factor - Contentious issues requiring several consultations - Staff don't like working on them - Not paying timely 	<ul style="list-style-type: none"> - Pay bills - Financial results don't create unnecessary risk for firm - Fraud allegations 	- N/A
Other Client Retention Procedures	<ul style="list-style-type: none"> - Managing economics and issues - Budget assessments with and without fees of certain clients 	<ul style="list-style-type: none"> - Talk to client about goals and aspirations - Plans for company, retirement, exit strategies 	<ul style="list-style-type: none"> - None, partner generally aligned with firm's views on risk profile 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Staffing concerns - Economics - Utilization of staff 	<ul style="list-style-type: none"> - No one thing more than another - Maybe fees since it's a bright line 	<ul style="list-style-type: none"> - National focuses more on policy and QC standards - Local partners know auditing standards but not necessarily QC standards 	<ul style="list-style-type: none"> - Focusing on changes - Issues if partners just quickly click through buttons and don't think about client trends - Partners are in a hurry and just assume they are continuing all clients
Differences in Risk Perception	<ul style="list-style-type: none"> - Risk - Utilization 	<ul style="list-style-type: none"> - None because mostly done at local offices and reviewed by industry or QC expert 	<ul style="list-style-type: none"> - Engagement partners might view themselves differently than National office does (skillset) 	- Pretty well aligned
Pushback	<ul style="list-style-type: none"> - Going concern - Economics - Realization 	<ul style="list-style-type: none"> - Difficult clients where people don't enjoy working on them 	<ul style="list-style-type: none"> - Risk profile of client, even if profitable - Skillset 	- Not aware of any situations

**TABLE 15
CLIENT RETENTION WITHIN FIRM SUMMARY: FIRM B**

CLIENT RETENTION - FIRM B

	LOP-1B	LOP-2B	LOP-3B	RM-B
Primary LOP Focuses	<ul style="list-style-type: none"> - Pain and suffering aspect and management's commitment to changing that - Don't usually drop for financial reasons 	<ul style="list-style-type: none"> - Issues that arose in prior year audit (concerns) - Issues with "bullies" 	<ul style="list-style-type: none"> - If client was raided by FBI - Have to be treated with respect - If client's treating staff with disrespect and not changing 	- N/A
Other Client Retention Procedures	<ul style="list-style-type: none"> - None, all considered in checklist 	<ul style="list-style-type: none"> - Increased focus on going concern 	<ul style="list-style-type: none"> - None 	- N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Integrity - Right fit for firm 	<ul style="list-style-type: none"> - Going concern - Issues in background checks - Material weaknesses and significant deficiencies 	<ul style="list-style-type: none"> - Risk factors 	- Do it sooner
Differences in Risk Perception	<ul style="list-style-type: none"> - Lower level of risk tolerance 	<ul style="list-style-type: none"> - Experience of seeing more scenarios than line partners - More push on future cash flow issues 	<ul style="list-style-type: none"> - Risk folks more conservative and focused on risk - Engagement partners want to retain client and keep revenue 	<ul style="list-style-type: none"> - Challenge for engagement partner to step outside of scenario
Pushback	<ul style="list-style-type: none"> - Fees - Management cooperation - Risk related to client 	<ul style="list-style-type: none"> - Going concern - Issues paying fees 	<ul style="list-style-type: none"> - None 	<ul style="list-style-type: none"> - Engagement team comes in trying to find ways to keep the client that's a bad fit

**TABLE 16
CLIENT RETENTION WITHIN FIRM SUMMARY: FIRM C**

CLIENT RETENTION - FIRM C

	LOP-1C	LOP-2C	LOP-3C	RM-C
Primary LOP Focuses	<ul style="list-style-type: none"> - Has management done anything to create distrust - Changes in financial condition - Economics - Management fraud 	<ul style="list-style-type: none"> - Difficulties in past audits that can't be overcome - Integrity of management - Comfort with relationship 	<ul style="list-style-type: none"> - Changes in organization or management - Consistency - Issues with internal controls - Reasons for management departure - Fraud allegations - Litigation 	-N/A
Other Client Retention Procedures	<ul style="list-style-type: none"> - None 	<ul style="list-style-type: none"> - Should do more wrap-up meeting with audit staff to discuss problem areas and ways to make it better - Discussion with client about ways to improve 	<ul style="list-style-type: none"> - Keeping up with clients during the year 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Management integrity - Having proper resources to serve client - Are fees commensurate with risk 	<ul style="list-style-type: none"> - Economics - Higher risk accounting issues - Financial condition of client - Risk trumps economics 	<ul style="list-style-type: none"> - New issues - Changes from prior year 	<ul style="list-style-type: none"> - Management integrity - Capabilities
Differences in Risk Perception	<ul style="list-style-type: none"> - On questions of financial viability, local partners more willing than firm to give client benefit of the doubt 	<ul style="list-style-type: none"> - Local partners desire lower threshold where no additional approvals required (especially retention) - RM views risk more severely - Local partners driven by book of business - Local partners have growth goals while RM goal is to protect firm 	<ul style="list-style-type: none"> - Engagement partner sees no changes as not risky while leaders more conservative and look to protect firm and maintain quality control - Local partners want more flexibility to approve continuance if no changes but leadership group wants formalized process for every client 	<ul style="list-style-type: none"> - Assessment of quality of management
Pushback	<ul style="list-style-type: none"> - Probably didn't do good enough job documenting - Not really changing their minds, just providing more information 	<ul style="list-style-type: none"> - Accounting risks - Complex areas - Aggressive accounting practices by management - Management integrity - Economics 	<ul style="list-style-type: none"> - Going concern and risk of non-payment - New risks identified 	<ul style="list-style-type: none"> - Firm capabilities

**TABLE 17
CLIENT RETENTION WITHIN FIRM SUMMARY: FIRM D**

CLIENT RETENTION - FIRM D

	LOP-1D	LOP-2D	LOP-3D	RM-D
Primary LOP Focuses	<ul style="list-style-type: none"> - Internal control risks and problems - Risk of material misstatement - Going concern problems - Tone at the top issues 	<ul style="list-style-type: none"> - If it's worth it personally and for people in the office - What toll it's taking on the office (morale, ability to serve other clients) - Economics - Reputation risk - Pain it's causing staff 	<ul style="list-style-type: none"> - Significant changes - Deterioration of management behavior - Turnover - Going concern - What drives dramatically different risk management procedures for the coming year 	-N/A
Other Client Retention Procedures	<ul style="list-style-type: none"> - Additional due diligence if there are concerns about specific areas (e.g., funding) 	<ul style="list-style-type: none"> - Manage account throughout the year - Review economics throughout the year 	<ul style="list-style-type: none"> - Doing formal procedures all the time so that formal process is just documentation 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Risk factors - Skills and tone of management, AC, internal audit - Pressure to meet earnings targets - Lack of understanding internal controls - Slow to implement improvements 	<ul style="list-style-type: none"> - Economics for business line - Management integrity - Overall risk factors 	<ul style="list-style-type: none"> - Client's sensitivity on the control environment 	- Adequately identifying and assessing risk
Differences in Risk Perception	<ul style="list-style-type: none"> - Risk partners focus on risk of material misstatement - Local partners may think risk is minimal due to limited exposure (low business risk) 	<ul style="list-style-type: none"> - Risk management usually more risk averse - Line partners more defensive due to client relationships, higher risk tolerance - Sometimes flips where higher ups see good economics but local partner knows there are issues 	<ul style="list-style-type: none"> - Qualitative aspects where engagement team is closer to facts because of direct client relationship - Risk partners more conservative and burden of proof is on engagement team - National has more risk averse fact assessment and heightened risk sensitivity 	<ul style="list-style-type: none"> - Have to guard against complacency - Taking objective lens to client
Pushback	<ul style="list-style-type: none"> - Economics - Economics don't match risk 	<ul style="list-style-type: none"> - Resource limitations 	<ul style="list-style-type: none"> - Risks associated with debt and going concern issues - Concerns about private companies going public 	- Tends to be related to risk designations

**TABLE 18
CLIENT RETENTION WITHIN FIRM SUMMARY: FIRM E**

CLIENT RETENTION - FIRM E

	LOP-1E	LOP-2E	LOP-3E	RM-E
Primary LOP Focuses	<ul style="list-style-type: none"> - PITA Factor (Pain In The Ass) - How client treats auditors - Financial health and viability 	<ul style="list-style-type: none"> - Strategic fit for firm - Profitability - Strength of management - Management response to prior engagements and findings - Working relationship with management - Firm's ability to continue serving - Significant disagreements with management 	<ul style="list-style-type: none"> - Past issues with internal controls - Management integrity - Financial viability - Right fit for firm - Relationship (whether difficult to work with) - Economics 	-N/A
Other Client Retention Procedures	<ul style="list-style-type: none"> - Team prepares memo that walks through all the different considerations of retaining client, including industry, fees, risk, staff opportunities, skillset of audit staff vs audit needs, financial viability 	<ul style="list-style-type: none"> - Review communications with management to assess responses - Discussions with management about future plans - If it's a healthy environment for audit staff 	<ul style="list-style-type: none"> - Annual meetings with regional leadership to review risk, economic, and other factors 	-N/A
Primary Policymaker Focuses	<ul style="list-style-type: none"> - Going through formal process rather than assuming still meets criteria from prior assessment 	<ul style="list-style-type: none"> - Addressed ability to execute quality audit - Good fit economically - Going concern - No new risk factors 	<ul style="list-style-type: none"> - Mix of key risk factors and economics - Integrity issues - Independence issues - Going concern or accounting issues - Economics 	<ul style="list-style-type: none"> - Added factors to consider if client is bad to people, challenging to deal with, not timely
Differences in Risk Perception	<ul style="list-style-type: none"> - Engagement partner has pressure of retaining business and maintaining book of business - More challenging to be objective longer in relationship - Risk management needed to look at risk profile of all clients 	<ul style="list-style-type: none"> - Line partners more involved in day to day - National and risk partners take more detached and dispassionate view - Necessary to get beyond personal relationships and look at big picture of risk 	<ul style="list-style-type: none"> - Idea of acceptable economics 	<ul style="list-style-type: none"> - Ability to perform the work versus understanding the true issues
Pushback	<ul style="list-style-type: none"> - Financial viability - Asking if engagement partner both overly or under critical - More vocal approach of firm to say it's okay to walk away 	<ul style="list-style-type: none"> - Issues with material weaknesses and significant deficiencies - Issues with specialized industry knowledge 	<ul style="list-style-type: none"> - Economics and understanding local market - Issues with industry or strange nature of client 	<ul style="list-style-type: none"> - Significant financial difficulties - New arenas that are risky - Integrity issues - Fraud

**TABLE 19
LOCAL OFFICE PARTNER OTHER MATTERS BETWEEN FIRM SUMMARY**

OTHER MATTERS

	Firm A	Firm B	Firm C	Firm D	Firm E
Consultations	<ul style="list-style-type: none"> - Discuss with others to make sure there are not bigger issues than LOP thinks (might get rejected) 	<ul style="list-style-type: none"> - Get help or different perspective on new or unusual items - Discuss if think there might be issues 	<ul style="list-style-type: none"> - Atypical or complex issues - Preliminary clearance that engagement will be accepted and supported 	<ul style="list-style-type: none"> - Primarily around acceptance matters - Conversations around risk and economics, address questions related to prospect - Way to get pre-approval before investing in acceptance process 	<ul style="list-style-type: none"> - Discuss big picture concerns or known issues up front - Get thoughts on issues to address them ahead of time - Risk management is subject matter expert, used as resource
Appeals Process	<ul style="list-style-type: none"> - Risk Committee has final say - Can appeal but would get advocates 	<ul style="list-style-type: none"> - Can push it up to higher levels at the firm - Get help from senior partners - Group discussion as there are different views of risk 	<ul style="list-style-type: none"> - Could consult up to Risk Committee, but they likely have final say - Might bring in head of audit practice 	<ul style="list-style-type: none"> - Can appeal to higher technical people if issue needs to be discussed further 	<ul style="list-style-type: none"> - Can appeal up to head of audit practice - Not likely to get overturned unless new information available - Only push if economic decision, not risk
Mismatch vs Risk	<ul style="list-style-type: none"> - Annual survey sent to clients - Would come up in acceptance process 	<ul style="list-style-type: none"> - Individual partner would likely have to identify - Annual evaluations sent to clients 	<ul style="list-style-type: none"> - Generally identified in retention process - Technical partner or engagement partner would have to identify issue - Client could request 	<ul style="list-style-type: none"> - Interviews of significant clients performed every few years and job given client service rating - Partner experience match considered in acceptance process 	<ul style="list-style-type: none"> - Client satisfaction interview process between certain clients and leadership would identify mismatch - Changes made annually based on workload, capacity, possibly risk
Cannabis	Firm will not accept any services with clients in cannabis industry	Firm will not accept any services with clients in cannabis industry	Not mentioned during interviews	Included in acceptance/retention questionnaire as checkbox requiring additional scrutiny	Firm will not accept any services with clients directly involved in cannabis industry

TABLE 20
RISK MANAGEMENT PARTNER OTHER MATTERS BETWEEN FIRM SUMMARY

OTHER MATTERS

	Firm A	Firm B	Firm C	Firm D	Firm E
Consultations	- Not discussed	- Encouraged, especially in the acceptance process to help navigate	- Occurs for both acceptance and continuance when there are unique transactions	- Encouraged early in the process before formal procedures begin	- Discussions prior to formal process to vet potential issues
Appeals Process	- Informally, partner can appeal up the line to Chief Risk Officer - CRO would make ultimate decision	- People try to go to senior leadership and plead case	- Goes up the chain of approvers, possibly to Board	- Would go up the chain of command, up to the head of the audit service line	- Can be escalated up to the Board, if needed

**TABLE 21
OTHER MATTERS WITHIN FIRM SUMMARY: FIRM A**

OTHER MATTERS - FIRM A

	LOP-1A	LOP-2A	LOP-3A	RM-A
Consultations	- If risk might be rejected - To avoid wasting time	- Those with expertise to determine if issues might be a bigger deal	- To document conversations about certain issues	- Not discussed
Appeals Process	- Get advocates (region) - Risk Committee pretty much has final say	- Maybe just if neither approver is sure and wants to elevate it to another person	- Risk Committee is pretty much final say, but can go back to them	- Informally, partner can appeal up the line to Chief Risk Officer - CRO would make ultimate decision
Mismatch vs Risk	- Annual (optional) survey sent to all clients, firm might decide to switch partners	- Would have to come from partner on engagement	- Identified in acceptance, probably most frequent challenge in acceptance	-N/A
Cannabis	Firm will not accept any services with clients in cannabis industry	Not mentioned during interview	Not mentioned during interview	Not mentioned during interview

**TABLE 22
OTHER MATTERS WITHIN FIRM SUMMARY: FIRM B**

OTHER MATTERS - FIRM B

	LOP-1B	LOP-2B	LOP-3B	RM-B
Consultations	<ul style="list-style-type: none"> - Something new or unusual - Uncertain as to how to handle it - Save time 	<ul style="list-style-type: none"> - Sanity check to make sure not missing something - Get different perspective 	<ul style="list-style-type: none"> - If think there will be issues - If something happens during the year 	<ul style="list-style-type: none"> - Encouraged, especially in the acceptance process to help navigate
Appeals Process	<ul style="list-style-type: none"> - Get help from senior partner - Get everyone on the phone to discuss - Group decision, different views of risk 	<ul style="list-style-type: none"> - Can push it up to head of audit and head of risk management 	<ul style="list-style-type: none"> - Can go to lead managing partner, head of risk, head of audit 	<ul style="list-style-type: none"> - People try to go to senior leadership and plead case
Mismatch vs Risk	<ul style="list-style-type: none"> - Annual client evaluations mailed out - Client could call anyone at firm - Reassignments usually based on workload 	<ul style="list-style-type: none"> - Up to individual partner to identify - Might be a relationship partner on account who could identify 	<ul style="list-style-type: none"> - Partner would be the one to identify it 	<ul style="list-style-type: none"> -N/A
Cannabis	<ul style="list-style-type: none"> Firm will not accept any services with clients in cannabis industry 	<ul style="list-style-type: none"> Not mentioned during interview 	<ul style="list-style-type: none"> Firm policy that firm won't do business in marijuana industry 	<ul style="list-style-type: none"> Cannabis is illegal federally so firm will not accept clients in the industry

**TABLE 23
OTHER MATTERS WITHIN FIRM SUMMARY: FIRM C**

OTHER MATTERS - FIRM C

	LOP-1C	LOP-2C	LOP-3C	RM-C
Consultations	<ul style="list-style-type: none"> - Interest in client - Whether firm will support win with resources - Sign-off prior to entering formal process 	<ul style="list-style-type: none"> - Complex client or complex accounting issues - Generally at engagement team level 	<ul style="list-style-type: none"> - Large engagements to ensure it can/will be accepted - When requests for services are not typical or have new risk areas - Avoiding surprises - Asking permission rather than forgiveness later 	<ul style="list-style-type: none"> - Occurs for both acceptance and continuance when there are unique transactions
Appeals Process	<ul style="list-style-type: none"> - Risk Committee might bring in head of audit practice to consult 	<ul style="list-style-type: none"> - Bring in head of audit practice 	<ul style="list-style-type: none"> - Could consult up to Risk Committee, but there are final authority 	<ul style="list-style-type: none"> - Goes up the chain of approvers, possibly to Board
Mismatch vs Risk	<ul style="list-style-type: none"> - Switch personnel to better serve client from time to time - Evaluated with annual retention decisions 	<ul style="list-style-type: none"> - Would usually be based on technical skills - Technical partner would be the one to identify it 	<ul style="list-style-type: none"> - Industry issues would be part of the retention approval bundle - Have seen both client requests and partner requests for switch based on personality issues 	<ul style="list-style-type: none"> -N/A
Cannabis	Not mentioned during interview	Not mentioned during interview	Not mentioned during interview	Not mentioned during interview

**TABLE 24
OTHER MATTERS WITHIN FIRM SUMMARY: FIRM D**

OTHER MATTERS - FIRM D

	LOP-1D	LOP-2D	LOP-3D	RM-D
Consultations	<ul style="list-style-type: none"> - Upfront acceptance conversations around risk and economics - Economics and high risk concerns for continuing clients - Don't want to waste time 	<ul style="list-style-type: none"> - Will have client fully vetted before submitted for acceptance approval - Not much discussion about retention 	<ul style="list-style-type: none"> - Preliminary conversations on acceptance to give advance notice and address questions - Want to get buy-in before spending time and money on acceptance 	<ul style="list-style-type: none"> - Encouraged early in the process before formal procedures begin
Appeals Process	<ul style="list-style-type: none"> - Partners have opportunity to revisit risk ratings - Might appeal to regional managing partner or even at National level 	<ul style="list-style-type: none"> - Can bring in higher ups to appeal - Usually just a matter of making sure the right people are making the decision 	<ul style="list-style-type: none"> - Higher up opinions can't really be shopped around - Might pull other technical people into the discussion 	<ul style="list-style-type: none"> - Would go up the chain of command, up to the head of the audit service line
Mismatch vs Risk	<ul style="list-style-type: none"> - Partner not connected with engagement goes to client and interviews key people - Engagement gets client service rating from client 	<ul style="list-style-type: none"> - Partner not connected with engagement goes to client and interviews key people - Includes CEO, CFO, controller, Audit Committee chair - Done for sizeable engagements every few years 	<ul style="list-style-type: none"> - Any decision about engagement team rests with firm leadership - Partner experience match considered in acceptance process - Firm also looks at workload metrics 	-N/A
Cannabis	Included in acceptance questionnaire as checkbox to indicate additional approvals	Included in acceptance questionnaire as checkbox to indicate additional approvals	Not mentioned during interview	Not mentioned during interview

**TABLE 25
OTHER MATTERS WITHIN FIRM SUMMARY: FIRM E**

OTHER MATTERS - FIRM E

	LOP-1E	LOP-2E	LOP-3E	RM-E
Consultations	<ul style="list-style-type: none"> - Financial viability - Background checks - Potential independence issues and possible resolutions - Risk management viewed as subject matter expert resource 	<ul style="list-style-type: none"> - Robust dialogue outside formal processes - Due diligence and research ahead of time on big picture concerns and specific questions 	<ul style="list-style-type: none"> - If requires higher levels of approval or there are known issues - Discuss up front for advance notice and to get thoughts on issues 	<ul style="list-style-type: none"> - Discussions prior to formal process to vet potential issues
Appeals Process	<ul style="list-style-type: none"> - Would go to head of audit practice - Probably wouldn't be overturned unless new information is available 	<ul style="list-style-type: none"> - National committees or partners could be brought in - Occasionally push harder only if economic decision (not risk) 	<ul style="list-style-type: none"> - Could possibly work with regional partners to make sure all things were considered - Ultimately up to Risk Committee 	<ul style="list-style-type: none"> - Can be escalated up to the Board, if needed
Mismatch vs Risk	<ul style="list-style-type: none"> - Client satisfaction interview process between client and leadership team (for certain accounts) - Professional mismatch would be identified 	<ul style="list-style-type: none"> - Stylistic differences arise naturally and partners will be reassigned - Changes might be made annually depending on workload, industry, risk, etc. 	<ul style="list-style-type: none"> - Expertise and skillset of team addressed in acceptance and retention decisions - Also review partner workloads and capacity 	-N/A
Cannabis	Not mentioned during interview	Firm will not accept any services with clients directly involved in marijuana industry	Not mentioned during interview	Not mentioned during interview

APPENDIX A
RISK MANAGEMENT PARTNER INTERVIEW PROTOCOL

PART I – CONSENT, INSTRUCTIONS & DEMOGRAPHICS

Thank you for agreeing to be part of my research about audit firm client acceptance and retention procedures. You have been selected as a participant in this study because you are a Risk Management partner. The information you provide to me will be used in completing my dissertation. Your responses will remain completely anonymous, so I ask that you be as candid as possible. This interview should last approximately an hour and will be audio recorded for accuracy. All recordings and transcripts will be kept confidential within my dissertation committee, and the recordings will be destroyed at the end of the study. All analyses performed will be collective in nature and your responses will not be personally identifiable in any reports.

Please complete this document prior to your scheduled interview and respond to the following questions regarding your background. You can submit the completed document to jparlier@vt.edu prior to the interview. By filling out this information below you are giving consent to be interviewed.

Please answer the following questions about yourself:

1. How long have you been in the audit profession?
2. How long have you been with [*your current firm*]?
3. [*If applicable*] What other firms have you worked with prior to [*your current firm*]?
4. How long have you been a partner at [*the current firm*]?
5. What is your current role with [*the firm*]?
6. How long have you been in your current role with [*the firm*]?
7. Have you worked in any other offices within [*the firm*]?

Please answer the following questions about the firm based on your experience:

8. Is your firm part of a network, association, or other similar type of group?
9. If so, are the client acceptance or [*retention or reacceptance or continuance*] policies and procedures used by your firm the same as the policies and procedures used by the other members of your firm's network, association, or other group members?

PART II – BACKGROUND INFORMATION ABOUT THIS STUDY

This research project is focused on client acceptance and [*retention or reacceptance or continuance*]¹⁷ procedures. After focusing on the broader concepts of client acceptance and [*retention or reacceptance or continuance*], we will discuss more specific questions related to your individual duties/responsibilities within the client acceptance and [*retention or reacceptance or continuance*] processes as well as some specific examples of these processes. I am interested in your views, based on your personal experiences, of how the client acceptance and [*retention or reacceptance or continuance*] policies and procedures are implemented within your office and what factors affect the decision-making process for both client acceptance and [*retention or reacceptance or continuance*].

PART III – RESEARCHER BIOS

Following is information on the backgrounds of the research team. Please note that only one of the researchers below will be present at your interview.

Jenny Parlier, CPA (NC), is currently pursuing her PhD in Accounting at Virginia Polytechnic Institute and State University (Virginia Tech). She was an audit senior manager with BDO (2004-2013) and was employed by a local accounting firm prior to her time at BDO (2000-2004). This series of interviews constitutes one part of her dissertation.

Greg Jenkins, CPA, is the John E. Peterson, Jr. Professor of Accounting and Information Systems at Virginia Tech. Dr. Jenkins has published research on a variety of topics related to auditing, using both behavioral and field study methodologies. He has served on two research task forces of the Auditing Section of the American Accounting Association charged with providing research assistance to the Public Company Accounting Oversight Board related to quality control standards and auditor independence. Professor Jenkins previously worked as an auditor with Ernst & Young, LLP and McGladrey & Pullen, LLP. Dr. Jenkins serves as the chairperson of Jenny’s dissertation committee.

PART IV – INTERVIEW

PREFACE: Thank you for agreeing to be part of my research about audit firm client acceptance and retention procedures. You have been selected as a participant in this study because you are a Risk Management partner. The information you provide to me will be used in completing my dissertation. Your responses will remain completely anonymous, so I ask that you be as candid as possible. This interview should last approximately an hour and will be audio recorded for accuracy. All recordings and transcripts will be kept confidential within my dissertation committee, and the recordings will be destroyed at the end of the study. All analyses performed will be collective in nature and your responses will not be personally identifiable in any reports.

Can you please verbally confirm that you understand and agree to participate in this study?

¹⁷ Although I use the term “retention” throughout the paper, the interview protocol will be adapted for the specific term used by the respective audit firm.

To begin, I would like to focus on a particular aspect of Risk Management, client acceptance and [*retention or reacceptance or continuance*]. I would like to discuss procedures followed by Risk Management in order to manage the policies and procedures that must be followed in the local, regional, and national offices.

1. Can you walk me through how the client acceptance and [*retention or reacceptance or continuance*] requirements are developed and reviewed for the firm? Specifically, I would like for you to consider how your firm addresses the following aspects of these processes:
 - a. Purpose of the engagement
 - b. Terms of the engagement, including modifications to these terms in subsequent audits
 - c. Identification of and communication with Those Charged With Governance (TCWG)
 - d. Communications with the predecessor auditor
 - e. Understanding the entity and/or changes in the entity
 - f. Integrity of management and TCWG
 - g. Independence
 - h. Audit team's professional qualifications, training, due professional care, and engagement supervision
 - i. Expected availability and reliability of audit evidence, including opening balances for prospective clients
 - j. Prior year audit issues
 - k. Are there any other factors that have not been previously discussed that you believe are important in the client acceptance and [*retention or reacceptance or continuance*] procedures required by the firm?

2. How does the Risk Management group determine specific criteria within the required client acceptance and [*retention or reacceptance or continuance*] processes? For example, how are levels determined for the weight of individual factors within client risk ratings, the approval levels based on risk ratings, and/or dollar values used when monetary thresholds? When considering how these various factors should be considered, are there any guidelines RM follows or and specific considerations made by RM in these assessments?

Now I would like to discuss some more specific aspects of the client acceptance and [*retention or reacceptance or continuance*] processes.

3. What do you, as a member of the Risk Management group, believe are the key factors or circumstances that local office partners should consider during the client acceptance process? Why do you believe these factors are important in this decision?

4. What do you, as a member of the Risk Management group, believe are the key factors or circumstances that local office partners should consider during the client [*retention or reacceptance or continuance*] process? Why do you believe these factors are important in this process?
5. Are there any areas where you believe differences exist between Risk Management and local office partners in the perceptions of risk related to the client acceptance process? What are some examples of these differences?
6. Are there any areas where you believe differences exist between Risk Management and local office partners in the perceptions of risk related to the client [*retention or reacceptance or continuance*] process? What are some examples of these differences?

For the next two questions please respond to the questions as thoroughly as possible without providing any details about the specific client or prospective client.

7. I would like for you to think about a situation you were a part of where a prospective client was rejected during the client acceptance process, at a level of approval above that of the prospective engagement partner. To the best of your knowledge, what were the primary factors in that decision? Why do you believe these factors were important in that decision?
8. I would like for you to think about a situation you were a part of where an existing client relationship was terminated during the client [*retention or reacceptance or continuance*] process, at a level of approval above that of the prospective engagement partner. To the best of your knowledge, what were the primary factors in that decision? Why do you believe these factors were important in that decision?

Lastly, I would like to ask you some broad questions about the client acceptance and [*retention or reacceptance or continuance*] processes.

9. Are there any specific factors or considerations within the firm's formal client acceptance process where you see the majority of rejections occur? Why do you think these factors play such a large role in the client acceptance process?
10. Are there any specific factors or considerations within the firm's formal client acceptance process where you never see rejections occur? Why do you think these factors play such a small role in the client acceptance process?
11. Similarly, are there any specific factors or considerations within the firm's formal client [*retention or reacceptance or continuance*] process where you see the majority of rejections occur? Why do you think these factors play such a large role in the client [*retention or reacceptance or continuance*] process?

12. Are there any specific factors or considerations within the firm's formal client [*retention or reacceptance or continuance*] process where you never see rejections occur? Why do you think these factors play such a small role in the client [*retention or reacceptance or continuance*] process?

13. What happens if the engagement partner disagrees with the client acceptance or [*retention or reacceptance or continuance*] decisions made by individuals at higher levels of approval? Is there an appeal or dispute process available to the local office partners? If so, please describe the process.

Thank you, again, for your insights into the client acceptance and [*retention or reacceptance or continuance*] processes. Your responses will be used, along with responses from other firms, to help me analyze the client acceptance and [*retention or reacceptance or continuance*] procedures followed by firms and to examine similarities and differences across firms. May I follow up with you if I need additional information at a later date? I also will provide an executive summary of the findings of my research study so that you can review your firm's policies and procedures and how they compare, in general, with other anonymous firms.

APPENDIX B LOCAL OFFICE PARTNER INTERVIEW PROTOCOL

PART I – CONSENT, INSTRUCTIONS & DEMOGRAPHICS

Thank you for agreeing to be part of my research about client acceptance and retention procedures. You have been selected as a participant in this study because you are an audit partner. The information you provide to me will be used in completing my dissertation. Your responses will remain completely anonymous, so I ask that you be as candid as possible. This interview should last approximately one hour and will be audio recorded for accuracy. All recordings and transcripts will be kept confidential within my dissertation committee, and the recordings will be destroyed at the end of the study. All analyses performed will be collective in nature and your responses will not be personally identifiable in any reports.

Please complete this document prior to your scheduled interview and respond to the following questions regarding your background. You can submit the completed document to jparlier@vt.edu prior to the interview. By filling out this information below you are giving consent to be interviewed.

Please answer the following questions about yourself:

1. How long have you been in the audit profession?
2. How long have you been with [*your current firm*]?
3. [*If applicable*] What other firms have you worked with prior to [*your current firm*]?
4. How long have you been a partner at [*the current firm*]?
5. What is your current role with [*the firm*]?
6. How long have you been in your current role with [*the firm*]?
7. Have you worked in any other offices within [*the firm*]?

Please answer the following questions about the firm based on your experience:

1. What is your understanding of how the firm develops the policies and procedures surrounding client acceptance and [*retention or reacceptance or continuance*]?
2. Are you involved in any way in the policy-making processes for client acceptance or [*retention or reacceptance or continuance*]? If so, what is your role? Do you think local office partners should be involved in these policy-making decisions? Why or why not?

PART II – BACKGROUND INFORMATION ABOUT THIS STUDY

This research project is focused on client acceptance and [*retention or reacceptance or continuance*] procedures. After focusing on the broader concepts of client acceptance and [*retention or reacceptance or continuance*], we will discuss more specific questions related to your individual duties/responsibilities within the client acceptance and [*retention or reacceptance or continuance*] processes as well as some specific examples of these processes. I am interested in your views, based on your personal experiences, of how the client acceptance and [*retention or reacceptance or continuance*] policies and procedures are implemented within your office and what factors affect the decision-making process for both client acceptance and [*retention or reacceptance or continuance*].

Part III – RESEARCHER BIOS

Following is information on the backgrounds of the research team. Please note that only one of the researchers below will be present at your interview.

Jenny Parlier, CPA (NC), is currently pursuing her PhD in Accounting at Virginia Polytechnic Institute and State University (Virginia Tech). She was an audit senior manager with BDO (2004-2013) and was employed by a local accounting firm prior to her time at BDO (2000-2004). This series of interviews constitutes one part of her dissertation.

Greg Jenkins, CPA, is the John E. Peterson, Jr. Professor of Accounting and Information Systems at Virginia Tech. Dr. Jenkins has published research on a variety of topics related to auditing, using both behavioral and field study methodologies. He has served on two research task forces of the Auditing Section of the American Accounting Association charged with providing research assistance to the Public Company Accounting Oversight Board related to quality control standards and auditor independence. Professor Jenkins previously worked as an auditor with Ernst & Young, LLP and McGladrey & Pullen, LLP. Dr. Jenkins serves as the chairperson of Jenny's dissertation committee.

PART IV – INTERVIEW

PREFACE: Thank you for agreeing to be part of my research about client acceptance and retention procedures. You have been selected as a participant in this study because you are an audit partner. The information you provide to me will be used in completing my dissertation. Your responses will remain completely anonymous, so I ask that you be as candid as possible. This interview should last approximately one hour and will be audio recorded for accuracy. All recordings and transcripts will be kept confidential within my dissertation committee, and the recordings will be destroyed at the end of the study. All analyses performed will be collective in nature and your responses will not be personally identifiable in any reports.

Can you please verbally confirm that you understand and agree to participate in this study?

I would like to begin by discussing the general client acceptance and [*retention or reacceptance or continuance*] processes for your firm.

1. I would like to start by asking you for a high-level description of the type of processes your firm uses as the basis for client acceptance and [*retention or reacceptance or continuance*] decisions. For each of the following aspects of the client acceptance and [*retention or reacceptance or continuance*] processes, please discuss the policies and procedures your firm has developed to address each component:
 - a. Purpose of the engagement
 - b. Terms of the engagement, including modifications to these terms in subsequent audits
 - c. Identification of and communication with Those Charged With Governance (TCWG)
 - d. Communications with the predecessor auditor
 - e. Understanding the entity and/or changes in the entity
 - f. Integrity of management and TCWG
 - g. Independence
 - h. Audit team's professional qualifications, training, due professional care, and engagement supervision
 - i. Expected availability and reliability of audit evidence, including opening balances for prospective clients
 - j. Prior year audit issues
 - k. Are there any other factors that have not been previously discussed that you believe are important in the client acceptance and [*retention or reacceptance or continuance*] procedures required by the firm?
2. Are the client acceptance and [*retention or reacceptance or continuance*] processes based on thresholds, questionnaires, risk rating profiles that are calculated by a system developed by your firm, or is it a different process? Are there multiple levels of approval required as part of these processes?

Now I would like to discuss some more specific client acceptance questions pertaining to your individual duties and/or responsibilities in the client acceptance process.

3. What conditions must exist before you will recommend acceptance of a prospective client (i.e., begin the firm's formal process of client acceptance)? Why are these conditions important to your decision-making process?
4. What factors or circumstances will prevent you from recommending a prospective client for acceptance? Why do these factors play an important role in your decision?
5. In your opinion, and based on your experience, are there any procedures you perform prior to the formal acceptance procedures that you view as key and/or significant but that are not required by your firm's formal acceptance process? Why do you believe these procedures are important to complete, even if they are not required?

6. In your opinion, and based on your experience, what factors do you believe the firm's policy makers view as most critical in the client acceptance process?
7. Are there any areas where you believe differences exist between Risk Management and local office partners in the perceptions of risk related to the client acceptance process? What are some examples of these differences?

Next, I would like to discuss some specific examples based on your experience within the client acceptance process. Please respond to the questions as thoroughly as possible without providing any details about the specific client or prospective client.

8. I would like for you to think of an example of a time when you decided to recommend a client for acceptance and that client eventually was accepted, but someone at a higher level in the client acceptance process "pushed back" on whether the client should be accepted. What factors or circumstances were raised as potentially problematic? Based on your experience, and in your opinion, why do you believe these factors were identified as problematic?
9. Now I would like to talk about an example of a prospective client that you proposed the firm accept but the acceptance of that client was declined as part of the formal acceptance process (i.e., the prospect was rejected at a higher level). To the best of your knowledge, what were the factors or circumstances that went into that decision? Based on your experience, and in your opinion, why do you believe these factors were identified as problematic?

I would now like to change the direction of the discussion and talk about the client [*retention or reacceptance or continuance*] process. Similar to the client acceptance discussion, I would like to start with questions pertaining to your individual duties and/or responsibilities.

10. What are the primary factors or circumstances you consider when evaluating whether or not to continue an existing client relationship? Why are these important to your decision-making process?
11. What are some of the specific factors or circumstances that will prevent you from continuing with an existing client? Why are these factors important in your decision?
12. Are there any procedures that you perform prior to the formal [*retention or reacceptance or continuance*] procedures that you view as key and/or significant but that are not required as part of the formal [*retention or reacceptance or continuance*] process? Why do these factors play an important role in your process?

13. In your opinion, and based on your experience, what factors do you believe the firm's policy makers view as most critical in the client [*retention or reacceptance or continuance*] process?

14. Are there any areas where you believe differences exist between Risk Management and local office partners in the perceptions of risk related to the client [*retention or reacceptance or continuance*] process? What are some examples of these differences?

Similar to our prior discussion, I would like to discuss some specific examples based on your experience within the client [*retention or reacceptance or continuance*] process. Again, please respond to the questions as thoroughly as possible without providing any details about the specific client.

15. I would like for you to think of an example of a time when you decided to retain a client and that client eventually was reaccepted, but someone at a higher level within your firm "pushed back" on whether the client should be retained. What factors or circumstances were raised as potentially problematic? Based on your experience, and in your opinion, why do you believe these factors were identified as problematic?

16. Now I would like for you to think about an example of a time when a client relationship was terminated as part of the formal [*retention or reacceptance or continuance*] process. What was your understanding of the factors or circumstances that went into that decision? Based on your experience, and in your opinion, why do you believe these factors were key in this decision?

Lastly, I would like to ask you some broad questions about the client acceptance and [*retention or reacceptance or continuance*] process.

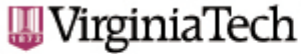
17. Does the upper-level review of either a prospective or continuing client typically occur only as part of the formal process, or do you have discussions or consultations with individuals at higher approval levels before going into the formal acceptance or [*retention or reacceptance or continuance*] process?

18. [*If above answer is "discussions," ask the following:*] What is the typical nature of those discussions or consultations? What parties do you typically hold these discussions with (i.e., national, regional, local partners or others)? What are some of the issues that are discussed prior to the formal acceptance or [*retention or reacceptance or continuance*] process? Why do you believe these discussions are necessary?

19. What happens if you disagree with the client acceptance or [*retention or reacceptance or continuance*] decisions made by individuals at higher levels of approval? Is there an appeals process? If so, please describe the appeals process and the individuals involved.

Thank you, again, for your insights into the client acceptance and [*retention or reacceptance or continuance*] processes. Your responses will be used, along with responses from other firms, to help me analyze the client acceptance and [*retention or reacceptance or continuance*] procedures followed by firms and to examine similarities and differences across firms. May I follow up with you if I need additional information at a later date? I also will provide an executive summary of the findings of my research study so that you can review your firm's policies and procedures and how they compare, in general, with other anonymous firms.

**APPENDIX C
INSTITUTIONAL REVIEW BOARD APPROVAL LETTER**



Office of Research Compliance
Institutional Review Board
North End Center, Suite 4120, Virginia Tech
300 Turner Street NW
Blacksburg, Virginia 24061
540/231-4606 Fax 540/231-0959
email irb@vt.edu
website <http://www.irb.vt.edu>

MEMORANDUM

DATE: January 28, 2018
TO: Greg Jenkins, Jennifer Ashley Parlier
FROM: Virginia Tech Institutional Review Board (FWA00000572, expires January 29, 2021)
PROTOCOL TITLE: The Client Acceptance and Retention Process: How Policies and Procedures Are Developed and Implemented Within Audit Firms
IRB NUMBER: 17-1179

Effective January 26, 2018, the Virginia Tech Institutional Review Board (IRB) approved the New Application request for the above-mentioned research protocol.

This approval provides permission to begin the human subject activities outlined in the IRB-approved protocol and supporting documents.

Plans to deviate from the approved protocol and/or supporting documents must be submitted to the IRB as an amendment request and approved by the IRB prior to the implementation of any changes, regardless of how minor, except where necessary to eliminate apparent immediate hazards to the subjects. Report within 5 business days to the IRB any injuries or other unanticipated or adverse events involving risks or harms to human research subjects or others.

All investigators (listed above) are required to comply with the researcher requirements outlined at <http://www.irb.vt.edu/pages/responsibilities.htm>

(Please review responsibilities before the commencement of your research.)

PROTOCOL INFORMATION:

Approved As: Expedited, under 45 CFR 46.110 category(ies) 6,7
Protocol Approval Date: January 26, 2018
Protocol Expiration Date: January 25, 2019
Continuing Review Due Date*: January 11, 2019

*Date a Continuing Review application is due to the IRB office if human subject activities covered under this protocol, including data analysis, are to continue beyond the Protocol Expiration Date.

FEDERALLY FUNDED RESEARCH REQUIREMENTS:

Per federal regulations, 45 CFR 46.103(f), the IRB is required to compare all federally funded grant proposals/work statements to the IRB protocol(s) which cover the human research activities included in the proposal / work statement before funds are released. Note that this requirement does not apply to Exempt and Interim IRB protocols, or grants for which VT is not the primary awardee.

The table on the following page indicates whether grant proposals are related to this IRB protocol, and which of the listed proposals, if any, have been compared to this IRB protocol, if required.

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APPENDIX D
INSTITUTIONAL REVIEW BOARD AMENDMENT APPROVAL LETTER



Office of Research Compliance
Institutional Review Board
North End Center, Suite 4120
300 Turner Street NW
Blacksburg, Virginia 24061
540/231-3732 Fax 540/231-0959
email irb@vt.edu
website <http://www.irb.vt.edu>

MEMORANDUM

DATE: December 4, 2018
TO: Sudip Bhattacharjee, Jennifer Ashley Parlier
FROM: Virginia Tech Institutional Review Board (FWA00000572, expires January 29, 2021)
PROTOCOL TITLE: The Client Acceptance and Retention Process: How Policies and Procedures Are Developed and Implemented Within Audit Firms
IRB NUMBER: 17-1179

Effective December 4, 2018, the Virginia Tech Institution Review Board (IRB) approved the Amendment request for the above-mentioned research protocol.

This approval provides permission to begin the human subject activities outlined in the IRB-approved protocol and supporting documents.

Plans to deviate from the approved protocol and/or supporting documents must be submitted to the IRB as an amendment request and approved by the IRB prior to the implementation of any changes, regardless of how minor, except where necessary to eliminate apparent immediate hazards to the subjects. Report within 5 business days to the IRB any injuries or other unanticipated or adverse events involving risks or harms to human research subjects or others.

All investigators (listed above) are required to comply with the researcher requirements outlined at: <https://secure.research.vt.edu/external/irb/responsibilities.htm>

(Please review responsibilities before the commencement of your research.)

PROTOCOL INFORMATION:

Approved As: Expedited, under 45 CFR 46.110 category(ies) 6,7
Protocol Approval Date: January 26, 2018
Protocol Expiration Date: January 25, 2019
Continuing Review Due Date*: January 11, 2019

*Date a Continuing Review application is due to the IRB office if human subject activities covered under this protocol, including data analysis, are to continue beyond the Protocol Expiration Date.

FEDERALLY FUNDED RESEARCH REQUIREMENTS:

Per federal regulations, 45 CFR 46.103(f), the IRB is required to compare all federally funded grant proposals/work statements to the IRB protocol(s) which cover the human research activities included in the proposal / work statement before funds are released. Note that this requirement does not apply to Exempt and Interim IRB protocols, or grants for which VT is not the primary awardee.

The table on the following page indicates whether grant proposals are related to this IRB protocol, and which of the listed proposals, if any, have been compared to this IRB protocol, if required.

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APPENDIX E
INSTITUTIONAL REVIEW BOARD CONTINUING REVIEW APPROVAL LETTER



Office of Research Compliance
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300 Turner Street NW
Blacksburg, Virginia 24061
540/231-3732 Fax 540/231-0959
email irb@vt.edu
website <http://www.irb.vt.edu>

MEMORANDUM

DATE: January 9, 2019
TO: Sudip Bhattacharjee, Jennifer Ashley Parlier
FROM: Virginia Tech Institutional Review Board (FWA00000572, expires January 29, 2021)
PROTOCOL TITLE: The Client Acceptance and Retention Process: How Policies and Procedures Are Developed and Implemented Within Audit Firms
IRB NUMBER: 17-1179

Effective January 9, 2019, the Virginia Tech Institutional Review Board (IRB) approved the Continuing Review request for the above-mentioned research protocol.

This approval provides permission to begin the human subject activities outlined in the IRB-approved protocol and supporting documents.

Plans to deviate from the approved protocol and/or supporting documents must be submitted to the IRB as an amendment request and approved by the IRB prior to the implementation of any changes, regardless of how minor, except where necessary to eliminate apparent immediate hazards to the subjects. Report within 5 business days to the IRB any injuries or other unanticipated or adverse events involving risks or harms to human research subjects or others.

All investigators (listed above) are required to comply with the researcher requirements outlined at: <https://secure.research.vt.edu/external/irb/responsibilities.htm>

(Please review responsibilities before the commencement of your research.)

PROTOCOL INFORMATION:

Approved As: Expedited, under 45 CFR 46.110 category(ies) 6,7
Protocol Approval Date: January 26, 2019
Protocol Expiration Date: January 25, 2020
Continuing Review Due Date*: January 11, 2020

*Date a Continuing Review application is due to the IRB office if human subject activities covered under this protocol, including data analysis, are to continue beyond the Protocol Expiration Date.

FEDERALLY FUNDED RESEARCH REQUIREMENTS:

Per federal regulations, 45 CFR 46.103(f), the IRB is required to compare all federally funded grant proposals/work statements to the IRB protocol(s) which cover the human research activities included in the proposal / work statement before funds are released. Note that this requirement does not apply to Exempt and Interim IRB protocols, or grants for which VT is not the primary awardee.

The table on the following page indicates whether grant proposals are related to this IRB protocol, and which of the listed proposals, if any, have been compared to this IRB protocol, if required.

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