The Effects of Mandatory Audit Firm Rotation on Audit Quality

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Abstract
In 2014, the new statutory audit framework proposed by EU was adopted and eventually implemented in Sweden in 2016. The framework included a mandatory audit firm rotation every ten years for public interest entities, with the main objective of enhancing auditor independence. The aim of this study is to examine how mandatory audit firm rotation could affect audit quality. The study is based on a qualitative research method in which auditors were interviewed in order to understand how they perceive the effects of the regulation on the determinants behind audit quality. The study indicates that auditor independence in fact will not be affected by mandatory audit firm rotation, while the perceived independence by the public, i.e. auditor independence in appearance, will be enhanced. The study further suggests that the potential loss of client-specific understanding and knowledge due to shorter audit firm tenures may lead to negative effects on audit quality.

Keywords: Mandatory audit firm rotation, mandatory rotation, auditor competence, auditor independence, audit quality.

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1 Introduction

In this chapter, we present the controversy that surrounds audit quality and the European proposal for mandatory audit firm rotation. We further discuss the international debate that has gathered both opponents and proponents regarding the regulation, which eventually leads to the aim of this study.

1.1 The fall of Enron and Arthur Andersen LLP

The collapse of the U.S. based energy company Enron Corp., together with the fall of its auditing firm Arthur Andersen LLP, is considered one of the biggest audit failures in history (Bratton, 2002). Enron was able to keep massive debts outside the corporate balance sheet for a long period by creating separate entities where the financial details were kept off the corporate balance sheet and was done using generally accepted accounting principles (Brown, 2005). When Enron was finally pressured by its shareholders to include these entities in their corporate balance sheet, it became apparent that the company had huge debts and losses which lead to the sudden plummet of its stock and ultimately its bankruptcy in December 2001 (Ibid). Arthur Andersen LLP was Enron’s auditor (Bratton, 2002), and had been for many years (Brown, 2005). The immediate reaction to the Enron scandal was the questioning of why the auditor had not worked together with the company to rectify the problems or quite simply just withdrawn themselves as their auditor (Ibid). As Brown explains, Andersen pointed out that most of what Enron had been doing, though controversial, was within generally accepted accounting principles. In addition to this, it was found that Andersen had been conducting consulting assignments for Enron, which raised concerns about auditor independence (Ibid). Similar incidents have hit the finance community here in Sweden, most recently the Carnegie Bank scandal in 2007 (Suneson, 2007) and HQ Bank scandal in 2010 (Isacson, 2010). Finansinspektionen, Sweden’s financial supervisory authority, had their bank licenses revoked after discovering that the banks had overvalued their own financial instruments excessively. (Finansinspektionen, 2008; Finansinspektionen, 2010).

1.2 The solution from the European Union

Past events like these, together with the financial crisis, lead to the conclusion that there was a major need to repair the financial system, and development opportunities for the financial
institutions as well as the area of auditing were investigated (EC, 2010). Auditors contribute to the economic stability by ensuring that firms’ financial statements coincide with the reported numbers (IAASB, 2009). The losses of the banks raised concerns not only for the auditors’ executions, but also for the adequacy of the auditing legislations (EC, 2010). The European Commission analysed different ways of changing the role of auditors, the governance of audit firms and their independence. In 2010, a Green Paper was released (Ibid) with ideas and proposed changes for a new regulation - mandatory audit firm rotation - since longer assignments and the risk of developing close relationships were seen as unwanted threats to auditor independence.

The European Commission received several hundred responses, mainly negative, regarding the new possible regulation (EC, 2011a). The summary of responses from the Green Paper showed that well-established audit firms opposed the proposition because they thought it could impair audit quality, and many medium sized audit firms opposed for the same reason as well as for the risk of increased costs. Despite this, a proposal for the new statutory audit framework was submitted in 2011 (EC, 2011b) and eventually adopted in 2014 which meant that a maximum duration of audit firm services for public interest entities\(^1\) was now required (EC, 2014).

### 1.3 Motives for this study

In June 2016, Sweden implemented the new statutory audit framework including mandatory audit firm rotation for public interest entities (Prop 2015/16:162). The proposal states that one of the main objectives with the implementation is to enhance the trust for auditors and their independence because an impaired independence due to strong relationships between auditors and clients can harm the criticalness and thus damage the audit quality. Ultimately, starting January 2017, all public interest entities in Sweden are obligated to follow the new regulation of mandatory audit firm rotation, which requires these entities to change audit firms every ten years (Ibid). Before this, firms could maintain the same audit firm for a longer period of time, an example in Sweden being the tenure between audit firm PwC and their client SCA which lasted over 80 years (Isacson, 2016).

\(^1\) Companies with transferable securities listed on regulated markets, companies operating in the banking and financial sector, companies trading with financial instruments and insurance companies (SFS 2001:883).
The international debate has gathered numerous opponents and proponents regarding mandatory audit firm rotation. Stefaniak et al. (2009) claim that earlier research finds little evidence that mandatory audit firm rotation improves audit quality. Reynolds and Francis (2001) claim that the incentive to protect firm reputation more greatly impacts auditor behaviour and thus auditor independence and audit quality. This could be seen as the audit market itself creating economic incentives to maintain independence, making mandatory audit firm rotation unnecessary. On the other hand, Dopuch et al. (2001) conduct an experiment and conclude that auditors are less willing to issue biased reports under rotation requirements, hence mandatory audit firm rotation enhances auditor independence. The U.S. General Accounting Office (GAO, 2003) conclude that the support for mandatory audit firm rotation generally comes from concerns that auditor independence may be adversely affected by long-term client relationships.

With the proposal, the European Union is striving for harmonisation of international standards on auditing across its member countries. There are known cases from e.g. Italy, which has had the regulation for over forty years, and Spain, that had the regulation for a period of nine years before repealing it (GAO, 2003). The fact that mandatory audit firm rotation was recently implemented in Sweden, together with the lack of observable evidence in the country, makes it interesting to reach a better understanding of the potential effects that mandatory audit firm rotation could have on audit quality.

1.4 Aim of this study

The aim of this study is to gather perceptions from auditors regarding mandatory audit firm rotation requirement in order to examine how this regulation could affect audit quality. By studying opinions about the regulation, along with what auditors think about the underlying factors behind audit quality, we are able to analyse what the regulation could lead to and if it corresponds with its intentions.
2 Theoretical framework

In this chapter, we begin by describing the role of auditors and why audits are conducted. We then define the theoretical topics in our study – audit quality, auditor competence and auditor independence - in which the first topic is dependent on the two latter. We further explain mandatory audit firm rotation, and present arguments for and against it as well as studies made in regard to audit firm tenures and the specific regulation. The chapter ends with a summary of the theoretical framework together with our theoretical model for studying audit quality.

2.1 The role of auditors

Audits are conducted with the purpose of examining the financial statements prepared by management in an organisation and to ensure that they are presented in accordance with applicable financial reporting standards, where the main reason is to enhance the level of trust that the market has on financial reports (IAASB, 2009). When conducting an audit, the main objective of the auditor is to gather reasonable assurance about whether the financial statements give a true and fair view of the entity and to determine if they are free from substantive defects, regardless if they are due to fraud or error (Ibid).

2.2 Audit quality

Audit quality has no fundamental or single definition (FRC, 2007). However, an often-used definition comes from DeAngelo (1981a) where audit quality is divided into two components. By measuring “the ex ante value of an audit”, the definition of audit quality depends on an auditor’s ability to (1) ‘discover errors or breaches in the accounting system’ and (2) ‘withstand client pressures to disclose selectively in the event a breach is discovered’ (DeAngelo, 1981b).

With the definition of audit quality (DeAngelo, 1981b), one can conclude that an auditor’s ability to discover a breach depends on various factors. Differences in knowledge, skills, expertise, experience, etc. will affect the performance of high quality auditing by an auditor or audit team. Also, different audit procedures, time and effort spent will affect the ability to discover a breach. The level of withstanding pressure from the client will show the willingness to report a breach, which is affected by independence, objectivity and scepticism. By this
definition, it is shown that the two subjects are closely related. Lack in auditor independence will reduce the likelihood to report any irregularities, thus harming audit quality.

2.3 Auditor competence

An important and essential part of auditing is auditor competence which is described as the professional knowledge, professional skills, professional values, ethics and attitudes the auditor possesses when performing audit assignments (IFAC, 2005). Auditors need to be provided with a framework for acting in an ethical manner and exercising professional judgement that is in the best interests of both society and the profession (Ibid). A broad understanding of the core business of the entity that the auditor is reviewing is also important for auditor competence (Ibid). Also, a long-term relationship is important for auditor competence since auditors gain confidence in assessing the honesty or dishonesty of the client’s claims since they are able to notice psychological behaviour or changes (IFAC, 2015).

Company-specific knowledge is something that Solomon, Shields and Whittington (1999) examine. They claim that industry-specialist auditors have better non-error knowledge. The specialised auditors have better knowledge than non-specialised auditors because they have greater experience in the industry which allows them to do more accurate assessments in the audit, thus being able to provide better audit quality. Biggs, Selfridge and Krupka (1993) highlight that knowledge and ability to reason about specific client events play an important role for auditor expertise. They conclude that more experienced auditors have better knowledge about their clients’ industry and operations, and that such client knowledge is crucial for audit judgement.

2.4 Auditor independence

Auditor independence can be seen as the most essential factor in ensuring audit quality and reliable financial statements (EC, 2010). Traditionally, auditor independence has been complex to define due to disagreements surrounding its meaning (Antle, 1984). DeAngelo (1981b) defines the level of auditor independence as the probability that an auditor will report a breach in the accounting system, given that it has been discovered. Nowadays, IFAC (2016) requires an auditor to be independent towards its client both in fact and in appearance.
2.4.1 Independence in fact

Independence in fact requires an auditor to act with objectivity, integrity and scepticism and to not get influenced by any interests that would affect the professional judgement (IFAC 2016). It can be difficult to actually measure independence in fact since it contains different factors, e.g. behaviour (Cameran et al. 2005), but regardless of that, several studies have been made in regard to audit tenures and rotation requirements. Summer (1998) looks at different kinds of auditors and whether they obey requests to issue favourable reports for their clients, and concludes that a rotation rule might be negative since there were less independent auditors in short-term relative to long-term engagements. Wang and Tuttle (2009) argue that, with mandatory audit firm rotation, the auditors will much less cooperate in negotiation strategies and thus the outcomes are more favourable for the auditor than the client. However, there are researchers who see the opposite for the independence in fact. As previously mentioned in the introduction, Dopuch et al. (2001) conduct an experiment on whether auditors are more likely to issue favourable reports for management with or without rotation requirements. They show that independence is more often compromised without mandatory rotation, thus favouring rotation rules. Arel, Brody and Pany (2006) also show that audit firms, which are subject to mandatory audit firm rotation, will more likely report its leaving in accordance with accepted accounting principles than if they believe that there is a possibility to continue the relationship with the client. They conclude together with Dopuch et al. (2001) that rotation increases the probability of more accurate reporting.

2.4.2 Independence in appearance

Independence in appearance requires an auditor to be seen and perceived as independent by the public, by avoiding circumstances that could arouse suspicion that the objectivity, integrity and scepticism of the auditor has been compromised (IFAC, 2016). Fearnley and Beattie (2004) argue that the trust in the audit and financial reporting is lost as soon as the independence is perceived as failed. They highlight the importance of the in appearance aspect of independence since the in fact aspect is much less observable. Pearson (1985) also demonstrates the importance of the auditor to not only be independent, but to also be perceived as independent. If an auditor is not perceived as being fully independent of management, their professional audit opinion would lack in value. The faith from financial statement users will exist when they are convinced that the auditor acts in an objective manner. Jennings, Pany and Reckers (2006) show that judges experience enhanced perceived independence due to mandatory audit firm rotation,
and even greater relative to only an audit partner rotation. Gates, Lowe and Reckers (2007) show that master and law students also perceive higher trust in financial statements when rotating audit firms, and also more greatly relative to audit partner rotation or no rotation. Hussey and Lan (2001) gather opinions from hundreds of financial directors where the majority opposed an audit firm rotation requirement. However, regardless of the concerns about audit quality and costs, there is a general agreement that a rotation requirement will enhance the perceived auditor independence.

2.5 Mandatory audit firm rotation

The financial crisis found weaknesses in the audit regulations, especially the statutory audit framework surrounding public interest entities (EC, 2011b), and the European Commission therefore wanted to explore the pros and cons of a mandatory rotation of audit firms (EC, 2010). There was a need to update and strengthen the auditing profession with more strict and robust regulations to restore the trust by the market, where one of the key factors in improving audit quality was to enhance auditor independence (Ibid). To achieve this, the European Union eventually proposed, among other stricter regulations, the implementation of mandatory audit firm rotation (EC, 2011b). This passed to legislation and was adopted in Sweden in April 2014, with the implementation applying to the first financial year starting on or after 17 June 2016, where public interest entities are now obligated to change audit firms after a certain period of time (Prop 2015/16:162). The core requirement in the proposal is a rotation of audit firms after a maximum of ten years, with a cooling-off period of four years after the rotation where the audit firm is refrained from conducting audit services for the audited entity. There are also two specified main exceptions to this core requirement; the first one (1) being that public interest entities are allowed to prolong the engagement to a total of twenty years, provided that a new selection procedure is organised, and the second one (2) being that the audit engagement may be extended to a total of twenty-four years if an additional auditor is engaged when the engagement has lasted for ten years.

Arel, Brody and Pany (2005) present two problematic situations for audit quality that will arise with this regulation; closeness to the client and lack of attention to details. Too close and questionable relationships may be developed when there are longer tenures that affect the scepticism. One U.S. congressman more than thirty years ago even stated: “How can an audit firm remain independent ... when it has established long-term personal and professional
relationships with a company by auditing that company for many years, some 10, 20 or 30 years?” (Ibid, p. 37) However, Arel et al. (2005) argue that there must exist interactions on a daily basis, regardless of the duration of the relationship, since the client must be comfortable with the auditor to share information and discuss problems. A whole new audit firm must start by getting to know the client and therefore doesn’t have the professional relationship that has been built over time, thus the close relationship is important in the audit process. Arel et al. (2005) claim that longer tenures can cause auditors to become tired and only see the audit as a recurring process and repeat old patterns which affects the objectivity. But, it is also argued that the effectiveness may benefit from having done earlier audits for the client. Many companies have complex businesses which can be hard to understand in short periods, and an auditor who is familiar with the business has a better understanding of occurring issues and changes. Arel et al. (2005) also state that an audit failure has been shown to occur more easily in the first year when auditors have not developed the necessary understanding and knowledge for the audit.

2.6 Arguments for and against mandatory audit firm rotation

Catanach and Walker (1999) review different internationally raised opinions regarding the subject. They mention that proponents of mandatory rotation see this as the solution against long-term audit-client relationships that could harm independence and quality, and also reduced audit failures, improved quality in the financial statements and that auditors more easily could resist pressure from management. On the other side, opponents of mandatory rotation generally see this as more costly than beneficial., e.g. start-up costs for auditors and costs of selecting and enlighten new auditors in the client’s organisation. An auditor is prevented from getting the true understanding of its client because of the limitation. They also mention that accountants believe that mandatory rotation is unnecessary since motivators for independence and objectivity comes from the will to protect reputation and client revenues, i.e. from the audit industry itself.

Ewelt-Knauer, Gold and Pott (2013) review different stakeholder perspectives as well as prior research about mandatory audit firm rotation. They believe that a proper collection of arguments, experiences, opinions and evidence for the current debate is missing. They mention that regulators see audit firm tenures mainly as threats to impaired auditor independence and scepticism, and thus audit quality, due to concerns about familiarity between auditors and clients. It is believed that the regulation will increase quality as it alleviates these independence and routine threats, which has strong connections to independence in fact, and also improved
independence in appearance due to positive market reactions. Auditors mainly oppose the regulation because it prevents an effective working relationship, and they fear it will increase the risks of audit failure since there will be less time to build business-specific knowledge. They also mention that the views and opinions from audit clients and shareholders are very varying. For the research review, Ewelt-Knauer et al. (2013) show that archival studies present mixed results, but in general little proof that mandatory rotation provides beneficial effects. The studies support the loss of client expertise in early years, which is gained as tenures increase. Only a few of these studies claim that audit quality decreases with long tenures. For the financial statement users, there is large support for rotation in terms of positive effects for the perceived audit quality, i.e. the independence in appearance. Ewelt-Knauer et al. (2013) conclude that the lack of evidence showing that the regulation would improve audit quality implies careful thinking is needed before an implementation.

2.7 Research on audit firm tenure and audit quality

There have been various studies regarding audit tenures and audit quality, with the use of different measurements for audit quality. Johnson, Khurana and Reynolds (2002) highlight in their study that client-specific knowledge can be crucial for detecting misstatements and that auditors can easier detect audit errors over time when obtaining better understanding of their client’s business. They mention that there is less evidence of the relation between audit firm tenure and the quality of financial reports, i.e. the financial information of a business used by third parties, whereas they study this relationship. Johnson et al. (2002) conclude a lower quality in financial reports for short audit firm tenures, and that the quality in financial reports is not reduced for longer audit firm tenures. This shows the importance of client-knowledge to audit quality, which is also indicated to be greater as the relationship tenure increases (Catanach and Walker, 1999). Jackson, Moldrich and Roebuck (2008) conclude that audit quality is increased by longer audit firm tenure since the audit-client tenure raises the likeliness of an auditor to issue going-concern audit opinions. Bell, Causholli and Knechel (2015) mention that most researchers find a positive relation between audit tenure and quality, while a few other researchers find the opposite. In their own study, Bell et al. (2015) find three main implications regarding audit quality; (1) for first-year audits, audit quality is the lowest, (2) after the first-year audit, audit quality improves, and (3) when the tenure becomes very long, audit quality slightly declines.
2.8 Research on mandatory audit firm rotation

In Italy, mandatory audit firm rotation has been required since 1975 (GAO, 2003), thus allowing the investigation of the regulation where it actually is in place. Cameran, Prencipe and Trombetta (2016) examine mandatory audit firm rotation and audit quality under conditions of possible future re-appointments, i.e. audit firm periods could be renewed every three years up to a maximum of nine years. By studying the three different periods, they could analyse changes in incentives and behaviours from auditors and eventually conclude an improvement in audit quality in the last period, i.e. prior to the rotation. However, Cameran et al. (2015) find a decline in audit quality for the following three years after a mandatory rotation relative to later years, i.e. longer audit tenure improves audit quality. They also find other negative consequences, e.g. that mandatory rotations are costly for clients with higher fees for both outgoing and incoming auditors.

In Spain, mandatory audit firm rotation was required from 1988 through 1995 (GAO, 2003). Ruiz-Barbadillo, Gómez-Aguilar and Carrera (2009) examine mandatory audit firm rotation and auditor independence by analysing its effects on both auditor incentives to maintain the economic dependence from clients and to protect firm reputation during one period (1991-1994) with the rotation requirement and another period (1995-2000) without. They find no evidence that auditors would issue more qualified opinions to maintain the economic dependence during mandatory rotation. However, they find that auditor independence not only fails to enhance under mandatory rotation requirements, but may also be negatively affected. Protecting reputation is an incentive for independence, but such incentives seem to have greater impact on behaviour without the rotation requirement. Incentives from the market itself, e.g. to protect reputation, are more effective and have more influence on independence than the regulation, hence audit firm rotation is unnecessary for auditor independence and audit quality.

2.9 Summary of the theoretical framework

One way to strengthen the auditing profession and to regain the public trust due to earlier audit failures was to adopt more strict regulations, with one being a mandatory audit firm rotation for public interest entities (EC, 2010). Although many of the larger audit firms opposed this proposal because they believed it could impair the audit quality (EC, 2011a), it was still adopted in 2014 (EC, 2014). This also created an extensive debate regarding the regulation. The concept audit quality can be explained as a combination of an auditor’s ability to discover breaches in
the client’s financial statements (auditor competence) and the probability that the discovered breach is reported (auditor independence) (DeAngelo, 1981a & 1981b). Understanding and knowledge about the client as well as their business, resulting from longer relationships, are important for auditor competence (IFAC, 2005 & 2015). More client-specialised auditors are claimed to be able to provide more accurate audit assessments and better audit quality due to better knowledge and experience (Solomon et al. 1999; Biggs et al. 1993). Such client-knowledge is indicated to be greater over time (Catanach and Walker, 1999) where longer audit firm tenures can increase audit quality (Jackson et al. 2008), and shorter audit tenures on the other hand can decrease audit quality (Johnson et al. 2002; Bell et al. 2015; Cameran et al. 2015). Auditor independence is often seen as the most important factor in ensuring audit quality (EC, 2010) which involves the auditor to act objectively (independence in fact) and to be perceived as independent by the public (independence in appearance) (IFAC, 2016). It is hard to measure the independence in fact, which has been shown by studies concluding different results in regard to mandatory audit firm rotation, e.g. less independent auditors due to rotation (Summer, 1998; Wang and Tuttle 2009), more independent auditors due to rotation (Dopuch et al. 2001; Arel et al. 2006) as well as no positive effects on auditor independence due to rotation combined with other greater influences for behaving independently (Barbadillo et al. 2009). Although, when the objectiveness is much harder to observe, it stresses the importance of auditors being perceived as independent (Fearnley and Beattie, 2004), or else the public faith or trust will not exist (Pearson, 1985). Regulators and proponents of mandatory audit firm rotation are concerned that longer relationships and tenures could harm the independence and audit quality (Catanach and Walker, 1999; Ewelt-Knauer et al. 2013). Indeed, mandatory audit firm rotation has shown positive effects on the perceived independence (independence in appearance) by stakeholders (Ewelt-Knauer et al. 2013), judges (Jennings et al. 2006), master and law students (Gates et al. 2007) as well as financial directors (Hussey and Lan, 2001).

2.9.1 Theoretical model

The aim of this study is to examine how mandatory audit firm rotation could affect audit quality. The theoretical model for this study builds on the definition of audit quality from DeAngelo (1981b) and consists of the three most important concepts presented throughout the theoretical review, which are; auditor competence, auditor independence and audit quality. In the model, audit quality is dependent on auditor competence and auditor independence. We will study how mandatory audit firm rotation could affect these relations from an auditor’s perspective.
Auditor competence refers primarily to having the knowledge, skills, experience, expertise, etc. to correctly perform audit tasks (IFAC, 2005). However, we do not study the auditors’ individual knowledge and skills. Since mandatory audit firm rotation will mainly affect firm-client relationship and tenure, we rather focus on these two components which have an underlying impact on the auditor competence and ability to perform high quality audit.

Auditor independence can be explained as the probability that an auditor will report a breach given that it has been discovered (DeAngelo, 1981b). An auditor is required to be (1) independent in fact, i.e. act objectively and avoid being personally influenced, and (2) independent in appearance, i.e. the auditor must be perceived as being independent by the market (IFAC, 2016). Since auditor independence has a strong connection to audit quality, we study the perceived effects that mandatory audit firm rotation could have on the two factors of independence.
3 Method

In this chapter, we begin by explaining the different research approaches and research design as well as our perspective which is connected to the motives for choosing our respondents to collect the primary data. We further describe how we use our primary and secondary data in order to achieve the aim of our study, and end the chapter by discussing the quality of our study.

3.1 Research philosophy

Our study aims to explore how mandatory audit firm rotation could affect audit quality, where we achieve this knowledge by collecting subjective opinions and perceptions regarding the effects of mandatory audit firm rotation on audit quality. This follows an interpretivist approach that explicitly focuses on the understanding and interpretation (Saunders et al. 2016, p. 124), and therefore the subjectivity (Ibid. pp 140-141).

3.2 Research approach to theory

With the interpretivist approach in the study, Jacobsen explains that an inductive reasoning would be most suitable (Jacobsen, 2002, p. 38). We do not find any theory that immediately explains our subject in a significant way. Rather, we collect empirical data from academics and auditors in order to eventually generate or build theory based on generalised conclusions from these observations, which follows the inductive approach (Saunders et al. 2016, p. 145).

3.3 Research design

For this study, we use a qualitative research design that relates to our interpretivist and inductive approaches which, as earlier mentioned, emphasise how people view and understand social issues rather than the issue being studied objectively and also generates theory based on empirical evidence. This is also suitable for our exploratory research since we want to get nuanced data and look deeply into a specific subject (Jacobsen, 2002, p. 56). To get the most appropriate results for our study, we do not think that a quantitative method with questionnaire options would be optimal. By letting the respondents speak freely in an interview, we get a broader understanding of the subject and mitigate the chances of them becoming influenced in any way by any predesigned questions with options. To take a qualitative approach, rather than quantitative, is therefore more suitable for our study. With mandatory audit firm rotation being
in the preliminary stage in Sweden, we want to look further into the subject and get an in-depth understanding and opinions from auditors on how it can affect auditor competence and auditor independence - the underlying factors behind audit quality.

3.4 Perspective

The purpose of the new regulation is to reach a higher level of audit quality, where some of the underlying factors are in some ways already regulated. Also, the regulation is intended to protect stakeholders by making sure that earlier events such as the financial crisis do not happen again, where the auditors play an important role in achieving this. However, as mentioned in Ruiz-Barbadillo et al. (2009) and Reynolds and Francis (2001), regulations may not always be the most effective incentive for auditor behaviour and may therefore be unnecessary. Therefore, we choose to examine the impact of mandatory audit firm rotation on audit quality from an auditor’s perspective in Sweden where the regulation was recently adopted.

3.5 Data collection

3.5.1 Primary data

Primary data is data directly collected for the purpose of the study (Saunders et al. 2016, p. 316), where the researcher goes directly to the primary source and collects data through e.g. interviews, observations or questionnaires (Jacobsen, 2002, p. 152). We have gathered our primary data through seven interviews, with six certified public accountants and one senior auditor, from larger audit firms. The interviews allow us to find out how mandatory audit firm rotation is perceived by the auditors and what they believe are the advantages and disadvantages and how it will possibly affect the factors behind audit quality. The primary data will be used to help us reach an understanding of how mandatory audit firm rotation could affect audit quality.

3.5.1.1 Design of interviews and interview sample

This study uses semi-structured interviews which means we have a set of prepared questions (see Appendix) as well as a list of themes to be covered, giving us the flexibility to omit certain questions in particular interviews and, more importantly, follow up questions are possible throughout the interview (Saunders et al, 2016, p. 388).
Mandatory audit firm rotation has the potential to affect the audit firms to a large extent. We therefore focus on larger audit firms since they most likely have more audit clients and thus would be affected by the regulation the most. By using the Retriever Business database, we are able to select audit firms which perform audit services for public interest entities and thus will be subject to the regulation.

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<tr>
<th>Audit firm</th>
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<tr>
<td>Audit firm 1</td>
<td>Certified public accountant</td>
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<td>Audit firm 1</td>
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<td>Audit firm 4</td>
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</table>

*Table 1. The interviewees*

An exploratory research usually requires a method that allows the gathering of nuanced data and to look deep into the subject (Jacobsen, 2002, p. 56), which is consistent with our choice of a qualitative research method. We also focus on few respondents, since it is considered to be most suitable for an exploratory study and to get nuanced data (Ibid). With interviews, you often collect large amounts of data, where too much data can leave you with the risk of not getting a complete overview of it (Ibid. p. 160).

For our study, we make sure that the majority of our respondents are certified public accountants, or at least perform daily auditing with at least four years of experience. We believe that this is necessary as we feel that they can provide us with the most reliable and valuable information in the area of auditing and for our studied topic, and also to avoid speculations from those less experienced in the profession. Auditor competence and auditor independence are extensive topics, and mandatory audit firm rotation is newly implemented. Therefore, to get the
best understanding of how they may be affected by the new regulation, it comes natural that we would seek those respondents with the most experience.

By interviewing auditors about topics in their own profession, we can never be sure whether they will answer the questions honestly or not answer at all. One way to mitigate this issue is to guarantee anonymity, since the ones who would possibly refuse to answer may do it due to the fear of it being connected to them as persons and to avoid their opinion being publicly known (Jacobsen, 2002, p. 360). For ethical reasons, we therefore ensure our respondents before the interview starts that we keep every one of them completely anonymous, i.e. not mention either personal names or their audit firm relation.

3.5.2 Secondary data

Secondary data is another type of data that is initially collected by others, where the researcher bases its study surrounding this information (Jacobsen, 2002, p. 153). It is favourable to include secondary data together with primary data to complement one another and thus strengthen the empirical results, and also to compare different information against each other which can provide interesting contrast effects (Ibid). Since the regulation was recently implemented in Sweden without the possibility at this time to measure any real effects in the country, we must collect secondary data about the possible consequences regarding the regulation and how it has internationally been studied, and use these as our theoretical framework. We use academic research articles to explain our theoretical topics; auditor competence, auditor independence and audit quality, and also how mandatory audit firm rotation could be related to these topics. This will provide thorough explanations for different aspects in the thesis and also how the studied topics are related to each other, in order to eventually use our primary data to achieve the aim of our study. With mandatory audit firm rotation being in the preliminary stage in Sweden, we collect information from around the world, such as Spain and Italy, where it is or has been implemented in order to get an extensive overview of the different advantages and disadvantages that come with the regulation. We also use the comments in the Green Paper from the European Commission to evaluate the immediate reactions that the affected parties had when mandatory audit firm rotation was being proposed, and also which audit firms felt it would affect them the most in order for us to choose our respondents.
3.6 Quality of study

Validity and reliability are two criteria the data and research should meet, and refers to the empirical results being valid, relevant, reliable and credible (Jacobsen, 2002, p. 21). These two criteria are strongly connected with a quantitative method, although Jacobsen (2002) explains that researchers often include these criteria in a qualitative method since it can be confusing to come up with new concepts that would not say the exact same thing. We therefore use these criteria in the same way as a quantitative study to discuss the quality of our study.

3.6.1 Validity

The validity of a study refers to the empirical data being valid and relevant, that you measure what you want to measure, that what is measured is perceived as relevant and that what is measured for a few can be applied for several (Ibid). Validity can be divided into internal validity, i.e. the credibility of the empirical results (Ibid, p. 256), and external validity, i.e. the transferability of the empirical results and how well it can be generalised (Ibid, p. 266).

To ensure the internal validity of the study, two actions can be taken; (1) to control the results and conclusions against others, and (2) to critically review the results (Ibid, p. 256). Although our informants have a good overview of the reality, they most likely have their own subjective perceptions of it. It is therefore necessary for us to compare their opinions against other studies to test the validity. Whether or not our results coincide with one or more earlier performed studies can tell us about the strength in our validity (Ibid, p. 258). To further increase the validity for qualitative approaches, an advice is to triangulate, i.e. to control the data and conclusions by combining different methods, to see whether the results from an individual researcher can be replicated by another (Ibid, p. 275). We therefore make sure we have a good overview and connection of our primary data from our conducted interviews at audit firms in Sweden, and our secondary data in the form of theoretical references consisting of academic research articles on the subject and the European Commission Green Paper. For the other action of reviewing the results, the most important for us is to critically select our respondents. As mentioned before, we try to gather as correct and valid information as possible by interviewing auditors who we consider would have the most knowledge and experience in the profession.

Regarding the external validity of our study, it is arguable whether our empirical results can be generalised or not. Our results are based around relatively few interviews and exclusively on
the respondent’s individual perceptions. Though, we have noticed that much of the stated opinions regarding our theoretical studied concepts are almost similar, which raises the question of whether our results to some extent could be representative. However, regarding the generalisation for qualitative approaches, the intention is usually not to generalise from the sample to a bigger population (Ibid, p. 266). Rather, the intention is to establish the range and frequency of a phenomenon and to broaden the understanding of it (Ibid).

3.6.2 Reliability

The reliability of the study refers to the study being reliable and credible (Jacobsen, 2002, p. 22). A question regarding this is whether or not the information is trustworthy or if something specific in the study has caused the achieved results, e.g. the study design or how well the data is noted and analysed (Ibid, p. 269).

The immediate aspects we consider in our study are the potential types of interview biases that can arise. One of them is related to the interviewer bias which occurs when comments, tone or non-verbal behaviour from the interviewer creates an inclination in the way the interviewees respond (Saunders et al., 2016, p. 397). The interviewer may attempt to impose their own beliefs through the questions they ask or even in the way they interpret the responses (Ibid). The other one is related to the interviewee bias which occurs when the interviewees participating may be sensitive to the thorough exploration of certain subjects and may choose not to reveal and discuss an aspect of a subject that the interviewer wishes to explore (Ibid). We understand that a complete elimination of interview biases may be hard since some conditions are more complicated to affect than others. For example, things like age, gender or personality are factors that we either can’t affect or can only affect to a small extent. However, we try to eliminate or mitigate as many aspects as possible that might have a negative effect on the interview. To avoid causing the interviewee to feel any types of sensitiveness to the subject, we make sure in the first contact as well as immediately at the interview to present the purpose of our study and what we intend to examine. In regard to the interviews, we also arrive knowledgeably prepared by reading about the meaning of every theoretical topic in the study, what has been internationally studied surrounding these topics and that our prepared interview questions reflect what we intend to get from the interviews. We do this to give the best possible impression, to not negatively affect the interviewee with an unserious presence, and thus being able to discuss the answers in more detail. We have asked the same questions to each
respondent, with most of them being open questions, and thus believe that the answers are not influenced by our own explanations. We also held the interviews at each respondent’s workplace since we feel that it would be most comfortable for them, and also because the context in which the information is being gathered can affect the results (Jacobsen, 2002, p. 271). Finally, to prevent a situation where we would have paid little attention or failed to take notes, we record each interview to be able to transcribe the main points of the conversation. We are, however, aware that it can bring disadvantages in forms of the interviewee responding negatively or feel sensitive since everything they say will be recorded, the recorder causing interruptions during the interview or that the recorder may stop working.
4 Empirical results

In this chapter, we present the data from our conducted interviews. We divide our results into four sections. In the first one, we show the results in regard to auditor competence. In the second one, we show the results in regard to auditor independence and the current regulations surrounding independence. In the third one, we summarise our results. In the last one, we analyse how our empirical results are connected to our main topic; audit quality.

4.1 Auditor competence

The two underlying factors in our theoretical model surrounding auditor competence are firm-client relationship and audit tenure, which are directly affected by the new mandatory rotation. Hence, we begin by asking our respondents about the process in building the initial relationship with a client and subsequently ask both about how they perceive that mandatory audit firm rotation will affect the relationship as well as their opinions on audit tenures.

4.1.1 Audit firm-client relationship

All the respondents share the same opinion regarding the importance of building up a relationship with the client and to understand their core business. Two of the respondents said that the immediate thing to do is to identify who the client is and what they do to ensure you understand their business. One of them states:

“If you don’t understand their business, it is hard to achieve a good relationship and to get the client’s trust.”

One auditor also mentioned that the process of building the relation takes a long time. It can take years before there is even a discussion about providing audit services since you have to prove your expertise and that the relationship in the end must work out. Another respondent pointed out that by not having a good relationship with the client, there are higher risks of misunderstandings.

When asked about how the specific relation between the firm and the client would be affected by a mandatory audit firm rotation, most of the respondents do not see any major impacts. One respondent says:
“I do not think that it will have such a big impact. In most of the relationships there are already clear expectations between us and those we work for. It is a professional partnership that we have and I do not really believe that the relationship will be affected that much.”

Another respondent raised similar opinions. There may be misconceptions surrounding the type of relationship between auditors and clients in that it is often believed to be very warm. On many occasions the audits are very extensive which means that there is trust and professionalism. However, three auditors believe that more time will be spent on both finding new clients and developing new relationships. One concern an auditor has is the risk of auditors not being keen to the clients’ needs to the same extent as without the mandatory rotation requirement.

4.1.2 Audit firm tenure

Regarding longer audit firm tenures, the respondents did point out several advantages and disadvantages. All respondents agree that longer tenures facilitate the development of relationships, understanding of the company and that it also eases the communication. One auditor also states:

“From an economical perspective, there are lower audit risks with longer tenures as well as lower costs for the client. During year one it takes much longer to understand everything that you later bring into the second year.”

One auditor mentioned that with longer tenures you can focus on improving the audit procedures. If you know the business very well, you can strive for new approaches in your auditing. Another auditor thinks that with longer tenures you know the client well and thus can provide better guidance in their services. In addition to this, scheduling and streamlining at the firm increases according to another respondent. One of the respondents understands that there may be a risk in becoming too comfortable with the client, but it is not unusual that clients want to build longer relationships in order to get more open and honest discussions with straightforward answers. It is easier to achieve such interactions when you actually have gotten to know each other for a while. The respondent reckons that many clients want help, support and guidance along the way instead of just getting a signed audit report.
Most of the respondents agree that longer tenures may lead to the risk of becoming too close or comfortable in the relationship. Some consequences stated are that you may develop such a relationship that you might ignore certain regulations or not take actions that would harm your client, you can become too familiar with the business which possibly makes you miss some irregularities and you can get stuck in the same procedures that prevents you from looking at things from new perspectives. One auditor explains that longer tenures in a company will develop a good understanding for the business, the risks and the people running the company. This means that the auditors know what to focus on and what is more or less important to understand. However, this may lead to the auditor repeating the same things and eventually becoming blind to flaws, with the risk of producing an audit of less quality. The company does not get an auditor who is proactive or points out things that they may have missed.

There were mixed opinions of whether the advantages outweigh the disadvantages with longer tenures, or vice versa. Two auditors believe that the market must see the audit work the same way as the auditors do internally, i.e. objectively and professionally, and therefore shorter tenures are the best way to make sure they do. One auditor thinks that it depends on the type of company. For public interest entities, the disadvantages with longer tenures outweigh the advantages because those companies tend to have a more scattered ownership and more individuals that can be affected by less quality audit. For smaller companies, the advantages with longer tenures outweigh the disadvantages because a good relationship is essential. Two of the respondents agree that the advantages with longer tenures outweigh the disadvantages. One of them does not really believe that a situation where you get blind to flaws is that common since auditors work in big teams, often rotating. It is highly likely that at least someone in the team will react to an inaccuracy, hence longer tenures allow you to work more with the client rather than only being the controlling party. The other one thinks that longer tenures are more favourable on bigger audit assignments. As the auditor explains:

“Developing the right understanding for the company takes a long time, with the risk of a more ineffective audit the first years that burdens both the audit firm and the client.”

Usually, with longer assignments there is trust, which allows everyone involved to be more direct with each other. One respondent believes that you gain on serving as an auditor for a longer period of time since the first years is more about getting to understand the company, but a reasonable period is necessary. It is hard to conclude when the relationship actually gets too
long and therefore to say if the advantages outweigh the disadvantages with longer tenures, or vice versa. The last respondent was unsure on whether one of them outweigh the other.

4.2 Auditor independence

We ask our respondents about how they perceive that mandatory audit firm rotation will affect auditor independence, and also more specifically how it will affect independence in fact and independence in appearance. We also ask whether the respondents think that the current regulations are enough in ensuring auditor independence.

4.2.1 Independence in fact

None of the respondents believe that mandatory audit firm rotation will have any effects on auditor independence from an objective perspective. One auditor argues that from their own perspective, auditor independence is the most essential part of auditing and if you jeopardise it, you run the risk of losing your certification or end up in trials. There are other incentives for auditor independence that make sure you never compromise it. Another respondent believes that the majority of auditors already have the objective mind-set and none lack integrity. One auditor also mentions that, while this may differ between audit firms, they have clear internal rules surrounding how you work as objectively as possible.

All of the respondents are of the opinion that the current regulations surrounding auditor independence are good and well-functioning. However, in regard to the external perspective, most of them believe that the new regulation is necessary and/or understand why it is being implemented.

4.2.2 Independence in appearance

All of the respondents agree that mandatory audit firm rotation will have positive effects on auditor independence from a stakeholder perspective. Two auditors argue that the market would see this as positive because if the market perceives that the auditors generally have too long audit tenures with their clients, then actions must be taken regardless of whether it has an effect or not on the actual audit. Two auditors also think that the regulation will give the market a sense of security, and that it will become more apparent and straightforward from a public perspective.
One auditor feels that the current regulations in the field of audit were definitely enough to fulfil their purpose, at least from an internal perspective. If an auditor would miss something, intentionally or unintentionally, there would still be third parties reviewing their work since that is an internal requirement to ensure auditor independence and that nothing goes unnoticed. The same auditor states:

“The work we do internally is not recognised externally, therefore making audit firm rotation good and necessary.”

This statement is also supported by four other respondents. One of them understands that there is a completely different notion of auditing from an external perspective, where it can be seen as management only handing over documentation to their friends and this is the picture that could be changed. Another auditor also felt the need for mandatory audit firm rotation and states:

“As an auditor, you may be independent and have integrity. But if someone else does not perceive that you are, then it all falls apart anyways. The public must be convinced that we are independent.”

As one auditor points out, there are already fundamental and clear regulations on how to perform an independent audit. The essential requirements for how an audit is and should be performed have not changed significantly and are still followed. Also, with additional internal rules for ensuring independence, the respondent thinks these have been working well. However, the public can see longer audit tenures as inconvenient, therefore making mandatory audit firm rotation good and effective from an external perspective.
4.3 Summary of results

<table>
<thead>
<tr>
<th>Audit firm-client relationship</th>
<th>Building a good relationship with the client being audited is important to be able to understand their business and to get their trust. As an auditor, mandatory audit firm rotation would generally not have a big impact on the specific relationship due to already existing regulations and professionalism.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit firm tenure</td>
<td>Longer tenures provide the auditor with a better understanding of the core business. There may be a risk of becoming too comfortable with the client, but longer relationships provide better knowledge, understanding and communication.</td>
</tr>
<tr>
<td>Independence in fact</td>
<td>Auditor independence from an objective perspective will not be affected by mandatory audit firm rotation.</td>
</tr>
<tr>
<td>Independence in appearance</td>
<td>The perceived auditor independence by the public will be enhanced by mandatory audit firm rotation.</td>
</tr>
<tr>
<td>Current regulations for independence</td>
<td>The current regulations are good and well-functioning, but most of the auditors see mandatory audit firm rotation as necessary or understand the implementation.</td>
</tr>
</tbody>
</table>

Table 2. Summary of results

4.4 Audit quality analysis

Mandatory audit firm rotation and audit quality have been subject for many debates and various conducted researches with different approaches for measuring audit quality. The theoretical framework for the topics is extensive, where nearly every common argument that shows the advantages with the regulation can be turned and thus show its disadvantages.

4.4.1 Auditor competence and audit quality

The general consensus from the respondents is that building a relationship with the client is important, and especially in regard to getting to know their business. An early made statement presented in Arel et al. (2005) questions how an audit firm can remain independent when it has developed a personal and professional relationship with a company under a longer period of time. Our results for the audit-firm relationship generally oppose this statement, and rather view the developed professionalism as something good for the relationship. One respondent was
clear about how they have professional relationships and with that comes clear expectations from both parties. Another respondent also stated that there may in some cases be misconceptions from the public about the relationship that the audit firm and client actually have. Arel et al. (2005) argue that many companies have rather complex businesses and that it can be hard to get the full knowledge of it in short periods. The same respondent discusses these aspects in terms of that when the audit actually is extensive, then there is trust and professionalism involved in the audit. One issue for audit quality that Arel et al. (2005) bring up is the closeness to the client. From our interviews, we get the feeling that the area of auditing is already quite regulated and that this closeness to the client is viewed differently from an internal perspective than from an external perspective. To act objectively, professionally, with integrity and to not compromise the professional work are things that are constantly seen as important internally, but they may not always be perceived as equally important from the outside. When regulators and proponents see longer relationships as a threat to familiarity (Ewelt-Knauer et al. 2013; Catanach and Walker 1999) and the professional level is viewed quite differently from the audit firm perspective, the believed effects on the specific audit firm-client relationship will depend on the respondent.

With a broad knowledge and understanding about the client, auditors can more easily find audit errors (Johnson et al. 2002). The knowledge about the specific client will also be greater as the length of the relationship increases (Catanach and Walker, 1999). Also, auditors with longer experience in a specific industry can provide more accurate audit assessments and better audit quality (Solomon et al. 2009). These more experienced auditors have more knowledge on their client’s operations which is crucial for auditor expertise (Biggs et al. 1999). All these claims go hand in hand with the received responses in regard to the advantages with longer audit tenures in terms of facilitations for the relationship and, most importantly, understanding the client. The respondents see the advantages with longer audit tenures in that it can mitigate audit risks and that it allows better guidance when you have gotten to know the client well. Arel et al. (2005) argue that, regardless of the tenure, there must exist daily interactions because the client must be comfortable to share information and problems with the auditor. Such interactions are also claimed by some of our respondents to be more achievable when the relationship has been going on for a period of time. One of these respondents believe that many clients actually want help, guidance and more open discussions from longer relationships instead of just getting a signed audit report. Arel et al. (2005) further states that audit failures run the biggest risk to occur in the beginning of the tenure because the audit firm must start to get to know the client since it
doesn’t have the necessary knowledge yet. This has also been confirmed by Cameran et al. (2015) who claim an audit quality decline for the first three years after rotation, and Bell et al. (2015) who claim that audit quality is lowest for first-year audits. This can be referred to many respondents who point out that the development of the right understanding can take a very long time, and especially one respondent who saw the risks of ineffective auditing in the first years.

Cameran et al. (2015) claim that a mandatory rotation will bring higher fee costs for the client in regard to outgoing and ingoing auditors, and Catanach and Walker (1999) further indicate more start-up costs for the auditors. The cost aspects were especially brought up by two of the respondents. Longer tenures provide lower costs for the client, and also for the auditors since it is time-consuming to understand the business during the first year which eventually is carried forward to the next years. The other auditor saw the potential economic burden from possible ineffective audits that could affect the client due to more frequent rotations.

Arel et al. (2005) mean that longer tenures can lead to too close relationships that could affect the scepticism. This concern is the most consistent one with our responses. Some recurring statements are that the auditors can develop too close of a relationship or familiarity with the business that makes them miss irregularities or get stuck in the same procedures and not looking at the business from new perspectives. This risk of not developing can be referred to the risk described by Arel et al. (2005) that auditors can become too comfortable and only see the audit as a repeatable process. This was also something that one of the respondent stated explicitly when it comes to the risk of repeating the same routines and becoming blind to flaws. The client would lose a proactive auditor and someone who doesn’t point at things which could harm the audit quality.

4.4.2 Auditor independence and audit quality

Auditor independence can be seen as the most important factor for audit quality and reliable financial statements, and the implementation of mandatory audit firm rotation is primarily intended to enhance this key factor (EC, 2010; EC, 2011b). Although there have been studies claiming an enhanced independence in fact due to mandatory rotation (Dopuch et al. 2001; Arel et al. 2006), there are also studies claiming the exact opposite (Summer, 1998; Wang and Tuttle, 2009). What can be interpreted from all our responses is that mandatory audit firm rotation would neither enhance nor have any effects on the auditor independence in fact. One auditor
thinks that there are very clear rules on how to work as objectively as possible, which could be compared to another respondent who believes that most of the auditors already have the objective mind-set and do not lack integrity. Ruiz-Barbadillo et al. (2009) with their study from Spain also give indications that mandatory audit firm rotation can both fail to enhance auditor independence and also have adverse effects. They further argue that other market incentives, rather than regulations, would be more effective for auditor independence. This corresponds with one respondent who argues that independence is so important and essential in the auditing profession and if you jeopardise it you run the risk of losing certifications or face trials. This shows that there are current incentives for auditor independence that make sure you never want to compromise it.

One of the main reasons for the new regulation is to restore the trust in auditors and enhance the perceived independence by the public since auditor independence is viewed as one of the most important aspects in audit procedures (EC, 2010; EC, 2011b). The public having trust for auditors and thus perceiving them as independent has been argued for a long time. Pearson (1985) argues that a professional audit opinion would lack in value if the auditor is not perceived as being independent. Fearnley and Beattie (2004) also states the importance of independence in appearance because the in fact aspect is much more difficult to observe. These claims surrounding the independence in appearance fully correspond with our responses. Our interpretations are that all the respondents believe that mandatory audit firm rotation will have positive effects on the perceived auditor independence. Two respondents think that this will give the market a sense of security and it will become more apparent from the public perspective. Two other respondents think that regardless of the possible effects on the actual audit, you need to adjust to the market if it is believed that too long audit tenures are problematic. Indeed, mandatory audit firm rotation has been shown to be a rather effective regulation for many individuals apart from just our respondents. With this regulation, judges felt an enhanced perceived auditor independence (Jennings et al. 2006), master and law students perceived higher trust in financial statements (Gates et al. 2007) and financial directors believed it would enhance the perceived auditor independence (Hussey and Lan, 2001). Fearnley and Beattie (2004) further claim that the public trust is lost as soon as the independence is perceived as being compromised, which is supported by many of our respondents in regard to the internal work not being recognised externally. One respondent even states that an auditor may be independent, but if the auditor is not perceived as independent, then it all falls apart anyway.
5 Conclusions

In this chapter, we present our conclusions made from the empirical results and analysis with connections to our theoretical model, in order to get an understanding of how mandatory audit firm rotation could affect audit quality. We end by suggesting further research topics on mandatory audit firm rotation.

Mandatory audit firm rotation was recently implemented in Sweden with the intended effects of regaining the audit trust and improving audit quality. The aim of this study has therefore been to gather perceptions and opinions from auditors regarding the regulation in order to understand how mandatory audit firm rotation could affect audit quality and if it corresponds with its intentions. This has been made by establishing a theoretical model for audit quality and further analysing the determinants behind it.

Longer audit firm tenures provide auditors with a broader understanding of the client’s business and is seen as very important for auditor competence, especially when the regulation affects public interest entities which are commonly large and complex. When auditors become more specialised in an industry, they can use that knowledge and experience to do more accurate assessments and provide audits of better quality. However, longer tenures can potentially lead to auditors becoming too close with their clients and only see the audits as repeatable processes. Also, there will be risks of lost perceived auditor independence by the public when the relationship appears to be too long or close. In regard to auditor competence, our study questions an implementation of shorter audit tenures with mandatory rotation to reach a higher level of audit quality. Few studies we have examined have shown that longer tenures negatively affect the audit quality, whereas more studies actually show the opposite for audit quality. Audit quality seems to be low in the first years due to lack of understanding and auditors actually need client-specific knowledge to be able to perform high quality auditing, which fully corresponds with our findings on the important aspects in the auditing. Where the auditors believe that the specific relationship may not be affected due to existing regulations on how to act and that the relationships in most cases are professional, we conclude rather adverse consequences that surround the audit firm-client relation because of the required shorter audit tenures. The risk of becoming too close or comfortable with the client has been a long-term concern regarding the auditing profession. With the decreased trust for financial statements and auditors caused in earlier years, regulators can easily target this by shortening the audit firm tenures in an attempt
to solve this problem. Although, with the loss of understanding, experience and fully developed client-specific knowledge that are crucial for audit expertise, we see the regulation as being more intended to improve auditor independence regardless of the sacrifices of the factors behind the auditor competence and audit quality connection.

Auditor independence is claimed to be one of the most essential factors in the audit profession, which can be divided into independence in fact and in appearance. The auditor is required to act objectively towards its client and not get personally influenced by any means. Also, it is highly important that the public perceives the auditors as being independent. Our study indicates that the auditors do not believe that mandatory audit firm rotation will affect the objectiveness for conducting an audit, i.e. the independence in fact. Reasons being that there are many regulations, internal rules or other incentives that make sure auditors do not compromise the independence and act as objectively as possible. Requirements on how to perform an objective audit have been in place for a long time, which have been well-functioning and enough in many ways to fulfil their purpose from an internal perspective. Our study further indicates that the auditors believe that mandatory audit firm rotation will have positive effects for the perceived auditor independence by the public, i.e. the independence in appearance. Situations where auditors can become too comfortable in the audit process are viewed as negative, and the public will therefore feel more secure with a regulation that directly deals with these issues. Independence in appearance seems to be equally important as the objective aspect because of different internal and external notions of independence and because auditors must always be perceived as being independent from an external viewpoint. Even though already existing regulations may be seen as enough to act independently, this shows why many of our respondents generally do not oppose mandatory audit firm rotation and see it as either necessary or understand why it is being implemented.

In our theoretical model, audit quality is dependent on auditor competence and auditor independence. Our study indicates that auditor independence in fact will neither be enhanced nor affected by mandatory audit firm rotation since it is not viewed as an occurring issue. The perceived independence, i.e. auditor independence in appearance, could however be enhanced by mandatory audit firm rotation since it deals with the concerns about longer audit tenures. Our study further indicates that auditor competence will be negatively affected due to the loss of client-specific understanding and knowledge that is essential for auditor expertise and audit quality. Overall, our study suggests that mandatory audit firm rotation results in audit firms
being perceived as more independent, but at the expense of auditor competence which may lead to lower audit quality.

We are aware of the fact that mandatory audit firm rotation is in its starting phase in Sweden. Our study is therefore limited to examine the perceived effects that this regulation might have. The most appropriate research in the following years would therefore be to examine the actual effects that this regulation has caused. It will take some years before this regulation starts to really affect audit firms, and it further requires a rotation of audit firms to most accurately test the effects. It would also be interesting in this starting phase to examine how stakeholders see the regulation, and whether they also believe that the perceived auditor independence will be enhanced. Auditor perceptions could also be included for this matter to make a comparative study and examine whether their opinions correspond with each other.
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Appendix

*Interview questions*

1. Are you comfortable with us recording the interview?

2. How long have you worked at the audit firm and as an auditor?

3. What is your position in the audit firm?

4. With the new regulation requiring firm rotation generally every ten years, there will be more client changes. How do you work to build an initial relationship with the client?

5. How do you think mandatory audit firm rotation will affect the relationship between audit firm and client?

6. How do you think mandatory audit firm rotation will affect your audit firm, as well as the clients?
   - What are the advantages?
   - What are the disadvantages?

7. What does auditor independence mean to you and how important is it?

8. How do you think mandatory audit firm rotation will affect auditor independence? Positive and/or negative?

9. How do you think the requirement to change audit firm will affect;
   - Your ability to do an objective analysis?
   - Auditor independence viewed from the stakeholder/market perspective?

10. What risks and disadvantages do you see with longer tenures between audit firms and clients?

11. What advantages do you see with longer tenures between audit firms and clients?
   - Do you believe that the advantages outweigh the disadvantages, or vice versa?
12. Do you believe that the current requirement to rotate audit partners and the analysis model for auditor independence was enough to ensure auditor independence and audit quality? Do you also have internal rules that you follow?

13. The five most common threats for auditor independence are *Self-interest threat, self-review threat, the advocacy threat, the familiarity threat* and *the intimidation threat*. Do you think that mandatory audit firm rotation will have a positive and/or negative affect on any of these threats?

14. Finally, what suggestion or way do you think is the most effective in ensuring auditor independence and audit quality?