

Mandatory Audit Firm Rotation in a Big 4 audit firm

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Abstract

Mandatory Audit Firm Rotation (MAFR) has recently been given prominence in the Netherlands, when it took effect January 2016, to improve audit quality directly and to enhance auditor independence which subsequently leads to better audit quality. Previous studies show that evidence on the impact of MAFR on audit quality and auditor independence is inconclusive. On top of this, the measures used in these researches are often only proxies of these real constructs. Through a case study in a Big 4 audit firm located in the Netherlands, this thesis therefore examines how and why MAFR affects audit quality and how independence 'in fact' plays a role in this. The results of the case study deepens our understanding into the actual relationship between MAFR and the constructs: audit quality and auditor independence 'in fact'. The outcomes of research demonstrate that MAFR affects four key themes which are related to these constructs: fresh perspective, altering your opinion and audit approach, work attitude in the year before rotating, and behavior in the interpersonal relationship. Additionally, four factors are identified that impact the extent to which MAFR influences these key themes: internal Partner and Senior Manager rotation, awareness of MAFR by lower level auditors, number of public interest entities, and natural rotation. The results of this research provide input for the ongoing discussion related to MAFR and should be of interest to policy makers and regulators in other countries who are considering to implement this policy.

Keywords: (mandatory) audit firm rotation, audit quality, auditor independence (in fact), Big 4 audit firm

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1. Introduction

There has been a wave of corporate scandals, such as Enron, Royal Ahold and WorldCom. Trust in the many parties involved in the financial reporting process is harmed by these scandals and auditors have an important role in this process (Bruynseels and Cardinaels, 2014). Auditors together with accounting are often seen as factors that could prevent these problems (Ball, 2009; Imhoff, 2003). This raised concerns about the auditor-client relationship on which many countries have legislated limitations (Corbella et al., 2015). Mandatory Audit Firm Rotation (MAFR) is one of these limitations and has recently been given prominence in the Netherlands when it took effect 1 January 2016 (Accountant.nl, 2015). MAFR shortens for audit firms the consecutive period of having the same client.

From the perspective of the European Commission, audit quality might be harmed by having a client for many years (European Commission, 2011). Therefore, the European Commission (2011), states that the rationale for implementing MAFR is to better audit quality directly and to enhance auditor independence which subsequently leads to also more audit quality (European Commission, 2011).

Independence is an important element of audit quality since it is the foundation of the public accounting profession and based on this rests strength of the profession itself (Carey, 1970). “User trust in financial reporting requires perceived as well as actual audit independence” (Ball, 2009). It is fundamental to have an independent auditor in order to have reliable auditor reports (Ramsay, 2001).

There has not been a consistent approach by legislators on whether audit firm rotation should occur on a mandatory or voluntary basis. Most studies on audit firm rotation use data from a regulatory regime in which changing auditors is voluntary (Casterella and Johnston, 2013). For example, there are empirical studies in non-mandatory regimes, which studies auditor independence by looking at the relationship between earnings quality and auditor tenure (Johnson et al., 2002; Myers et al., 2003). More specifically, all studies in the US context that have examined the area of audit firm rotation, have conducted this in a regime where the audit firm change is voluntary (Carcello and Nagy, 2004). As a result, it is unclear that whether these results would extend to a regulatory regime where audit firm rotation is mandatory (Carcello and Nagy, 2004). Similarly, as stated by Casterella and Johnston (2013), the samples used for these researches are not representative for a regime in which there is MAFR and therefore it is unsure whether these contribute to the debate on MAFR. As stated by Carcello and Nagy (2004), “further research is clearly needed on the relation between

auditor tenure and financial reporting quality where auditor changes are mandated or are driven by the audit committee rather than by management” (2004, p.67). Similarly, Ewelt-Knauer et al. (2012) states that “regulators, professional bodies and academics should continue to learn from countries which have implemented mandatory rotation in the past” (2012, p. 37).

In the Netherlands a MAFR with a ten-year audit firm rotation period for Public Interest Entities¹ (PIEs) took effect 1 January 2016 (Accountant.nl, 2015). By introducing this mandatory audit firm rotation it means that this type of entity cannot be audited by the same audit firm for more than ten consecutive years. This means that auditors need to switch these specific clients before 2016 if they already passed this period.

MAFR has never been adopted before in the Netherlands and for this reason it is unsure what would be the real impact of this policy in the Netherlands (Ernst & Young, 2014). There are only speculations on “the impact of the new Dutch law on the audit profession and market, including fees, professional recruiting, firm concentration and ultimately, audit quality” (Ernst & Young, 2014). A change could have significant implications for the cost and quality of auditing services and it is therefore critical that public policies regarding MAFR are shaped by research and not by anecdote. On top of this, the Netherlands is one of the very few countries in the world to mandate audit firm rotation and is, therefore, a unique setting to examine this topic. In this way the real preliminary impact can be examined of MAFR on audit quality and auditor independence which is an important element from which audit quality is derived. This can be realized for instance from the viewpoint of auditors themselves by looking into how MAFR affects their audit quality and independence.

Two types of auditor independence exist: independence ‘in fact’ and ‘in appearance’. Both have to be studied to understand auditor independence (Daniels and Booker, 2011). Independence ‘in fact’ “reflects the auditor’s state of mind that permits the audit to be performed with an unbiased attitude” (Campa & Donnelly, 2016, p. 423). Independence ‘in appearance’ “refers to the avoidance of facts and circumstances that would lead a reasonable investor to conclude that the auditor would not be capable of acting without bias” (Campa & Donnelly, 2016, p. 423). However, to study the effect of MAFR on the auditors independence ‘in fact’, information is required that is not publicly available (Daniels and Booker, 2011). Therefore, this causes for a limited amount of research in this area.

¹ For the Netherlands: listed entities, credit institutions, central credit institutions, reinsurers, life insurers or non-life insurers (FEE, 2014).

Research outcomes on the impact of MAFR on audit quality and auditor independence is inconclusive (Ewelt-Knauer et al., 2013; Corbella et al., 2015). As stated by Ewelt-Knauer et al. (2013), “there is some evidence that rotation may have a positive impact on ‘independence in appearance’, most research fails to generalize these findings to measures of audit quality associated with ‘independence in fact’ and there is even evidence of potentially adverse effects of rotation” (2013, p. 27). On top of this, according to Casterella and Johnston (2013), “it appears that the conclusions reached about the possible effectiveness of MAFR appear to depend on the type of data (voluntary vs. mandatory) used” (2013, p. 112). Furthermore, as discussed previously, most research is not performed in a regime where audit firm rotation is mandated (Carcello and Nagy, 2004; Ewelt-Knauer et al., 2012). Therefore, more research is required, in a regime where audit firm rotation is mandatory, on the effect of MAFR on audit quality and auditor independence ‘in fact’ which is an important element for an auditor from which audit quality is derived. The following central research question aroused:

How and why does mandatory rotation of the external audit firm affects audit quality and how does independence ‘in fact’ play a role in this, from the viewpoint of Dutch auditors?

The outcome of this research deepens our understanding into the impact of MAFR and for this reason contributes to the auditing literature and policy makers/regulators. For research, this study captures the role of a corporate governance mechanism, audit firm rotation, in a mandatory audit firm rotation regime, the Netherlands. For policy makers and regulators, this research provides useful insights in the impact one may expect from MAFR as they could use this ex ante evidence to consider the need to implement MAFR in other countries, such as the US. Lastly, the study is timely in view of recent amendments to Dutch audit firms.

Audit quality and auditor independence are difficult to measure and “the measures used in research are only proxies of the real constructs, hence, provide limited insight into actual relationships” (Ewelt-Knauer et al., 2013, p. 35). A case study in this area of research could provide a deeper understanding into the actual relationship between MAFR and audit quality. In this way the underlying reasons of how and why MAFR affects audit quality and how auditor independence ‘in fact’ plays a role in this can be discovered. For this reason, a case study is performed at a regional office of a Big 4² audit firm, located in the Netherlands,

² Big 4: PWC, EY, Deloitte and KPMG.

where audit firm rotation is mandatory. Semi-structured interviews are conducted with auditors working at this firm and data is collected through observations.

The remainder of this paper is organized as follows. In chapter two the outcomes of the literature review are described. The research methodology is discussed in chapter three, followed by the results of the case study that can be found in chapter four. Finally, the paper is concluded with a discussion and by answering the research question.

2. Literature Review

2.1. Audit quality and demand for MAFR

There is for public companies a separation between ownership (stakeholders) and control (management). According to agency theory the different interest between the principal and the agent may lead to a moral hazard problem (Jensen and Meckling, 1976). Shareholders want management to act in a certain way by representing their interests, while management pursues their own self-interest at the expense of the principal. Corporate governance can be used to reduce the opportunistic behavior of management by for example having accounting standards and auditors who audit if the financial statements are in accordance with the applicable accounting standards. The previously mentioned agency problem has led to a demand for auditors (Imhoff, 2003). Stakeholders rely on the opinion of auditors, thus the performed audit, and it is therefore of importance that the audit quality is as good as possible.

As discussed in the introduction, Corporate scandals also raised questions about audit quality and the auditor-client relationship. In other words, the agency problem and corporate scandals led to a demand of better audit quality and raised concerns about the auditor-client relationship. MAFR might provide a solution for this by possibly resulting in higher audit quality and because it mandates a limitation on the auditor-client relationship.

2.2. MAFR and the Dutch Audit Profession Act

The Dutch Audit Profession Act imposes an audit firm rotation period and restricts non-audit services. The legislation applies to Public Interest Entities (PIEs) incorporated in the Netherlands and listed in the European Union. MAFR took effect 1 January 2016 and the restrictions on non-audit services already took effect 1 January 2013. This research only covers the policy on MAFR which has recently been given prominence in the Netherlands.

PIEs have to rotate their auditor after a ten-year period of being audited by the same audit firm. After a cooling-off period of four years, PIEs can be audited again by the audit firm. Companies had to be in accordance with the legislation before it took effect. This means that it is not allowed having a longer audit firm-client relationship than ten years after the 1st of January 2016.

2.3. Mandatory and voluntary audit firm rotation

There are a limited number of countries who adopted MAFR rules, such as: Italy, South Korea, Brazil and The Netherlands (Ewelt-Knauer et al., 2013; Harris, 2012). According to Harris (2012), the countries that require MAFR have reported several reasons for this, such as enhancing audit quality, strengthening the independence of the auditor, or increasing competitiveness in audit markets.

Other countries only have MAFR for specific clients, such as certain industries (e.g. Singapore, Poland, Serbia and Slovenia) (Ewelt-Knauer et al., 2013; Harris, 2012). For example, Singapore has mandatory audit rotation rules for domestic banks (Harris, 2012).

There are even several countries that actually put an end to having a regime in which audit firm rotation is mandatory after it has been adopted for some time, partly due to increased audit costs (e.g. Canada, Austria, South Korea, Greece, Spain, Latvia, Czech Republic and Turkey) (Corbella et al., 2015; Ewelt-Knauer et al., 2013).

As can be concluded, there is not a consistent approach by legislators on whether audit firm rotation should occur on a mandatory or voluntary basis. Until now, only a few countries have mandated audit firm rotation (Corbella et al., 2015). On top of this, the rotation periods that are mandated differ among the countries. According to Ewelt-Knauer et al. (2013), there is internationally a wide variety of approaches and experiences with MAFR. The reasons for this variety are discussed in the next sections.

2.4. Debate on MAFR

There are very opposing views on MAFR and there seems to be little consensus (Casterella and Johnston, 2013). Several debates have been taken place on the effectiveness of MAFR as one means of improving audit quality in which there are proponents and opponents of MAFR. For example, “whether auditor rotation should be made mandatory is an issue that has been debated for more than 40 years in the U.S.” (Myers et al, 2003). The arguments for and against MAFR are discussed in this chapter by dividing these in two groups: proponents and opponents of MAFR. In chapter 5 these arguments are linked to the outcomes of this research.

Cameran et al. (2005) states that of the 24 empirical studies they reviewed, 19 are against audit firm rotation being mandatory. Cameran et al. (2005) also considered 26 reports by different regulators and other relevant bodies representing auditees’ stakeholder of which

22 are against the adoption of MAFR. It can be concluded, that the position of regulators and evidence of academic literature towards MAFR is negative.

Several parties also mention that the effectiveness of MAFR may differ among companies and also depends on how this policy is applied. For example, speculations that MAFR would benefit some companies while harming others, the expectation that the amount of time people are required to rotate off influences the effectiveness, and suggestions that it should only be applied to the largest publicly traded companies (Casterella and Johnston, 2013).

2.4.1. Proponents of MAFR

“The nature of auditing requires that auditors interact extensively with their clients” (Arel et al., 2005). Proponents of MAFR argue that when an auditor has a client relationship for a longer period of time this increases the level of familiarity with the client together with a pressure to retain the client (Arel et al., 2005). This causes that the auditor has an eagerness to please the client more and a lack of attention to detail due to staleness and redundancy (Arel et al., 2005). Similarly, a long-tenure relationship could potentially decrease auditor independence and lower audit quality (Ewelt-Knauer et al., 2013; Casterella and Johnston, 2013). Also routine is seen as a threat of a longer auditor-client relationship (Ewelt-Knauer et al., 2013).

MAFR would prevent long term auditor-client relationships and for this reason entails the avoidance of a decrease in auditor independence in fact and routine threats (Ewelt-Knauer et al., 2013). The concern over losing the client is also reduced by rotating audit firms, as stated by Imhoff (2003). Proponents of MAFR believe that this enhancement in auditor independence in fact leads to higher audit quality and therefore a lower number of audit failures (Casterella and Johnston, 2013). Furthermore, successor auditors may offer a fresh look on the audit (Corbella et al., 2015). Next to these benefits, “regulators also expect positive financial market reactions due to increased audit quality and improved independence in appearance” (Ewelt-Knauer et al., 2013).

Corbella et al. (2015) expects that MAFR has two advantages over Partner rotation, which requires that internally within the audit firm Partners have to be replaced at their clients after a certain period. They presume that a Partner of a new audit firm is more likely to object the judgments made by partners from predecessor audit firms. Additionally they expect Partners to be aware of the fact that their judgments are being reviewed in future by another audit firm. Similarly, the European Commission (2011) states that internal rotation is not

sufficient enough, because it would be unlikely that a new Partner on an engagement criticizes the work of the previous colleague.

2.4.2. *Opponents of MAFR*

Opponents of MAFR are more concerned with the knowledge about clients that audit firms gain over a longer period of time. MAFR leads to a short(er) auditor-client relationship in which less specific knowledge about the client is gained by the auditor. Opponents expect that this lack of specific client knowledge leads to being more vulnerable to audit failures due to a decline in audit quality (Casterella and Johnston, 2013). Similarly, opponents argue that an increase in the audit-client relationship leads to more client-specific knowledge and for this reason auditors have to rely less on management which enhances more independency (Solomon et al., 1999).

According to Arel et al. (2005) there will be always close interactions no matter the length of the relationship, because clients have to feel comfortable with the auditors in order to share more information and discuss problems. In order to feel comfortable around the auditor, trust needs to be built with the client and this does not happen in a short manner of time (Arel et al., 2005).

There is also a cost aspect when applying MAFR. Regulators refer to set-up costs when auditors have a new client and have to understand their business (European Commission, 2011). Also the costs of client's management to facilitate in this start up process are taken into consideration (European Commission, 2011).

2.4.3. *Auditors point of view on MAFR*

For this research auditors are interviewed and therefore it is of importance to understand their point of view on MAFR. In this way a potential bias on the new policy can be taken into account when drawing conclusions based on the results.

In general, auditors in both Big 4 and non-Big 4 oppose MAFR (Ewelt-Knauer et al., 2013). For instance, auditors are afraid that MAFR unnecessarily increases the risk of audit failures before being able to build company specific knowledge and this will harm audit quality (PwC, 2012, 2013; Grant Thornton, 2009). PwC (2013) states that there is lack of evidence which supports that MAFR would enhance auditor independence, hence audit quality, and even expects it to have an adverse effect. Another fear of auditors is when rotations are used for negotiating on lower prices of audit work. This price competition could cause a downward pressure on audit fees (Ernst and Young, 2011).

2.5. *Empirical research on MAFR*

The empirical literature on audit firm rotation can be separated into two categories. The first one studies the effects of auditor tenure on audit quality, and also auditor independence, in regimes where audit firm rotation is a voluntary action. The second category researches the same effects, however these are performed in regimes where audit firm rotation is mandatory or try to represent this type of regime by using voluntary short-tenure audits.

Research on audit firm rotation is mainly examined in regimes where audit firm rotation is voluntary instead of mandatory. As an example, all studies in the US that have examined the area of audit firm rotation, have performed this in a regime where the audit firm change is voluntary (Carcello and Nagy, 2004). As discussed before, it is unclear whether these results would extend to a regulatory regime where audit firm rotation is mandatory and if the results actually contribute to the debate on MAFR (Casterella and Johnston, 2013; Carcello and Nagy, 2004). Therefore, in this literature review the focus is more on the limited amount of relevant empirical research realized in regimes where audit firm rotation is mandatory. On top of this, the focus in this research is on audit quality, which includes auditor independence ‘in fact’. Furthermore, empirical evidence is grouped by the type of research, because this provides an understanding of which research is really conducted in a regime where audit firm rotation is mandatory or whether the research tries to simulate this regime with the aid of an experiment. Research in a regime where rotation is mandatory is more valuable for this research than experiments in which this regime is simulated.

2.5.1. *Archival research*

For this type of research, data from databases or public information is collected and analyzed by using statistical methods.

Empirical research in a regime where MAFR was applied is for example performed in Spain by Ruiz-Barbadillo et al. (2009) of which the results show that MAFR is not associated with an audit quality improvement. In this specific study the situation in Spain when audit firm rotation was mandatory is compared with the situation after the audit firm rotation was abolished. In the period of MAFR, auditors did not issue as much going concern issues then when the mandatory regime was abolished. Thus shows an undesirable result than the intention of the policy makers.

Cameran et al. (2015) conclude that in Italy the quality of audited earnings decrease the first three years after rotating compared to the year before rotating when the audit was

performed by the previous audit firm. Based on their analysis the authors also conclude that this quality improves each consecutive year when an audit firm keeps performing an audit at the same client. This outcome suggests that MAFR would lead to a lower quality of audited earnings. A conclusion of another research that is in line with these results, performed by the AICPA (1992), is that the chance is higher of audit failures in the first two years audit years at a client. These authors argue that MAFR would therefore increase this risk, because auditors would not have enough client-specific knowledge.

In the research of Ruiz-Barbadillo and Gómez-Aguilar (2002), which is also performed in Spain, a logistic regression is performed and shows that auditors are more dependent in the first year of the auditing engagement and are acting more dependent the shorter the audit-firm client relationship. It can be concluded that in Spain MAFR was not a good solution to improve auditor independence.

The mentioned archival studies provide insights in the relation between audit firm tenure and both audit quality and auditor independence in fact. However, “archival studies are limited in their ability to assess perceptual measures such as independence” (Kaplan and Mauldin, 2008).

2.5.2. *Experimental research*

In experimental researches, regimes in which there is mandatory audit firm rotation are simulated by the researcher. This is done in order to look at the effects of MAFR, while this legislation is not mandated yet. These types of researches for instance look at the effects of audit firm rotation on independence ‘in appearance’ and ‘in fact’ of auditors. The limitation of this type of research is that the results cannot be extended to a regime where audit firm rotation is mandatory (Carcello and Nagy, 2004; Casterella and Johnston, 2013).

Dopuch et al. (2001) find that auditor independence ‘in fact’ is higher in regimes that require audit firm rotation. For this experiment 72 managers and 72 auditors have participated in examining this relation.

Kaplan and Mauldin (2008) show in their experiment that audit firm rotation does not significantly strengthen the perceptions of non-professional investors on the independence of auditors. This study provides ex ante experimental evidence of what impact might be expected in a regime of MAFR, by simulating this regime in an experiment. The non-professional investors are represented by 125 MBA students who were given a case.

Jennings et al. (2006) examine the effects of strong corporate governance and audit firm rotation on the perceptions of 49 U.S. professional judges on the independence of auditors.

The results show that the perceptions of judges on auditor independence are improved in a regime where audit firm rotation is mandatory compared to a regime that rotates audit partners (Jennings et al., 2006). Their experiment is manipulating auditor rotation at two levels, which is audit firm rotation and partner rotation.

Daniels and Booker (2011) used experimental scenarios to show that, based on the perception of 207 bank loan officers, audit firm rotation enhances auditor independence in appearance, however does not improve perceptions of audit quality. The perceptions of the loan officers are not significantly changed by the length of the auditor tenure within the audit firm rotation (Daniels and Booker, 2011). Furthermore, this study is in an environment where a board of directors mandates to change auditors every seven years. Therefore, the audit firm rotation policy and the length of the tenure were manipulated.

2.5.3. Interview and survey based research

A few conclusions in the research of Ebimobowei and Keretu (2011) is that mandatory rotation of auditors in Nigeria improves the independence of auditors, allow for a fresh approach and improves the audit quality. 172 auditors and users, who have considerable knowledge of accounting and auditing, have participated in a questionnaire in which they had to rate the relationship between MAFR and audit quality, independence and costs.

Hussey and Lan (2001) results of a questionnaire with finance directors show that mandatory rotation can enhance the perceived independence of auditors even if concerns about audit quality and costs are very high and when the viewpoints on MAFR are negative.

The results of a research for which data is collected through questionnaires and interviews in Italy, where audit firm rotation is mandatory, shows that MAFR improves independence in appearance, while the impact on independence 'in fact' is negative (SDA Bocconi School of Management, 2002).

2.6. Exposition of theoretical framework

This chapter ends with a brief summary of the main points that follow from the literature review and the expectations based on this.

MAFR has took effect 1 January 2016 in the Netherlands, which is one of the very few countries in the world to mandate audit firm rotation. This means there is not a consistent approach by legislators on whether audit firm rotation should occur on a mandatory or voluntary basis. Further, there are different rotation periods among countries where audit firm

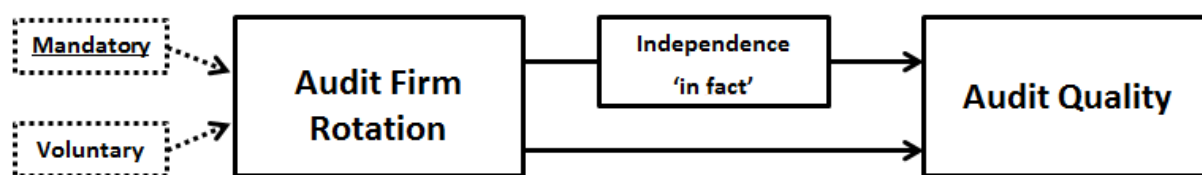
rotation is mandatory. These differences may also influence the effectiveness of MAFR. Outcomes of research could therefore differ between regimes where audit firm rotation is mandatory.

There are very opposing perspectives on MAFR and there seems to be little consensus. The impact audit firm rotation may have on audit quality and auditor independence can be interpreted in different ways. This possible impact, which is the scope of this research, is displayed in Figure 1. Only which interpretation is closest to reality and is perceived by auditors to be the correct one? These theoretical viewpoints are both for and against MAFR and thus very contradicting. The viewpoint of auditors on MAFR is negative and therefore might create a bias towards the results in this research. Similar, the position of academic literature and regulators is overall negative towards MAFR. The Dutch auditors in the case study could also share these thoughts and it could affect their experience with the new legislation.

Evidence based on empirical studies that examine the impact of MAFR on audit quality and auditor independence is also inconclusive. Further, empirical research actually performed in regimes where audit firm rotation is mandatory is very limited. This means there is a demand for research on audit firm rotation in regimes where audit firm rotation is mandated.

The impact on independence ‘in appearance’ is overall positive in both experimental, and interview/survey based research. However, research is not able to generalize the association between MAFR and audit quality or auditor independence ‘in fact’. For both constructs, audit quality and auditor independence ‘in fact’, research even shows a potential negative effect when having a regime in which audit firm rotation is mandatory. It is unclear why there is no consensus among researchers about the impact of MAFR on these constructs. For these reasons it is examined how and why MAFR affects audit quality and how auditor independence ‘in fact’ plays a role in this, from the viewpoint of Dutch auditors. This can create more sense of this specific area of research, while taking into account that the effectiveness of MAFR can differ among countries which have mandated audit firm rotation and that auditors in general have a negative point of view on this policy.

Figure 1: *Scope of research*



3. Research Methodology

3.1. Method of research

Audit quality and auditor independence are difficult to measure and “the measures used in research are only proxies of the real constructs, hence, provide limited insight into actual relationships” (Ewelt-Knauer et al., 2013, p. 35). On top of this, research outcomes on the impact of MAFR on auditor independence and audit quality are inconclusive (Ewelt-Knauer et al., 2013). Qualitative research is realized for this research, because it provides more insight into the actual relationship between MAFR and audit quality or auditor independence. In this way the real constructs audit quality and auditor independence can be analyzed and the outcomes of research are not limited to only proxies of this construct.

According to Yin (2009), the choice for a method of research depends largely on the type of research question, if it is required to control behavioral events and whether there is a focus on contemporary events. This is displayed in table 1.

Table 1: *Relevant Situations for Different Research Methods (Yin, 2009)*

Method	Form of Research Question	Requires Control of Behavioral Events?	Focuses on Contemporary Events?
Experiment	how, why?	yes	yes
Survey	who, what, where, how many, how much?	no	yes
Archival Analysis	who, what, where, how many, how much?	no	yes/no
History	how, why?	no	no
Case Study	how, why?	no	yes

The research question in this research focuses on how and why a certain economic phenomenon works. It examines a contemporary event and the relevant behaviors cannot be controlled. Based upon the previous, a case study is most relevant for this research. Also as stated by Yin (2009), “the case study method is most likely to be appropriate form how and why questions” (2009, p. 27).

This research aims to provide a deeper understanding into the actual cause-effect relationship between MAFR and audit quality. According to Yin (2003), the most suitable type of case study for this research is an explanatory one, because a causal relationship is

researched. Explanatory theories are discussed in chapter two and these are most suitable for the realization and design of causal case studies, because “the case study analysis can then take advantage of pattern-matching techniques” (Yin, 2003, p. 20). According to Lukka and Modell (2010), there is a link between theory and practice, called abduction. This point of view is shared throughout this research.

The case studied, using a single-case design, are the auditors working at a regional office of a Big 4 audit firm in a regime where audit firm rotation is mandatory, the Netherlands. The primary units of analysis, Dutch auditors working for this type of audit firm, give a good representation of the audit profession, because they have sufficient audit experience and client relationships.

Within the case study, data and insights are gathered for the purpose of this study by conducting interviews and observing. Interviews allow researchers to ask people to tell us about themselves (Cozby, 2008). In this case, Dutch auditors are asked to tell about their own experience, thus their perception and interpretation, regarding how and why MAFR affects their audit quality and independence. The next paragraph provides more details on the process of how this data is collected.

3.2. Data collection

Semi-structured face-to-face interviews are conducted for which a few guiding themes have been set up in advance with several direct questions (themes can be found as ‘appendix 1’). In this type of interview there is room for flexibility and the own input of the respondent, which is important to discover the underlying reasons for a potential change in the daily audit practices due to MAFR. The first part of the interview is focused on achieving a general view of the auditor and to get an insight in the extent of how much MAFR plays a role in his/her daily practices. The biggest part of the interview is covered by questions that would lead to make sense of how and why MAFR affects audit quality and the independence of the auditor within this audit firm by looking at changes in the audit practices.

During the 60 days spent at the audit firm not only formal interviews were conducted but also interactions with and observations of auditors at the audit firm took place. This is realized by having informal conversations with auditors, working along with them and observe them both at the regional office of the audit firm as well as on client engagements. The informal conversations mainly occurred with auditors from the lower levels of the audit firm, which are the functions Staff Audit and Senior Staff Audit, because there was more often

direct contact with these levels when spending time at the audit firm. Notes on the observations and after the informal conversations were written down afterwards in short phrases or quotations. The observations are not all relevant to this research and therefore are processed in a limited manner in the result chapter of this paper.

Eight Dutch auditors, who are at the highest level within the organizational structure of the audit firm, have been selected to be formally interviewed. To be more specific, the following audit functions could be distinguished among the interviewees: four Partners Audit, one Executive Director Audit and three Senior Managers Audit. They have many years of experience and for this reason it is expected that they have a better view and understanding of how audit quality might be influenced by MAFR (see Table 2). On top of this, in their day to day work they are due to their higher level within the audit firm more often confronted with independence issues and with the MAFR policy. The interviews have been conducted and recorded in Dutch, and lasted between 30 to 50 minutes. All interviews were transcribed in Dutch after each interview was conducted. The transcriptions covered a total of 90 pages and on average 5,100 words per interview. Several quotations of the transcripts are used to support the analysis performed in chapter 4, which displays the results of this research. These quotations were translated into English, while trying to keep the translation as close as possible to the original Dutch transcript.

Table 2: *Characteristics of interviewed population within the audit department*

Role	Years of experience current role	Years of experience within audit
Partner	10	36
Partner	16	27
Partner	11	26
Partner	6	25
Partner	3	16
Senior Manager	15	26
Senior Manager	5	15
Senior Manager	1,5	11

In table 2 the Executive Director interviewed is also referred to as a Partner, since it is in the same hierarchy line within the organization and this creates more anonymity in the results of this research.

The qualitative research process is an iterative process in which the research process is repeated until there is enough data to answer the research question in a reliable way (Verhoeven, 2011). Therefore, the amount of conducted interviews with the primary units of analysis is based on this premise. Eight interviews were sufficient to provide enough data for this research. In this way the reliability is improved and also makes sure not too much or little data is collected. On top of this, there are time constraints which limit the amount of interviews that could be processed in this research.

3.3. Data analysis

The interview transcripts are coded systematically and are continuously compared with each other. According to Bleijenbergh (2013), in this way patterns can be discovered in the social reality, which could form the basis for a theory.

The process of coding and pattern matching has been realized manually. This means that the codes are manually noted next to the text of the transcribed interviews. An advantage of manual coding is that this process can be started quickly and a disadvantage is that comparing texts from different transcriptions is time consuming (Bleijenbergh, 2013). The codes can be found as an 'appendix 2'.

Based on pattern matching the results of this research are set out in chapter 4 to get a picture of how MAFR affects the audit quality and independence of an auditor at a Big 4 audit firm. Finally, the conclusions are compared with current literature.

3.4. General principles interviews

While conducting the interviews in this research, the following general principles on ethical matters are taken into account, which are recognized by Silverman (2013): voluntary participation of interviewees, obtaining informed consent, protecting the interviewee's confidentiality, assessing the potential benefits and risks of the research participants.

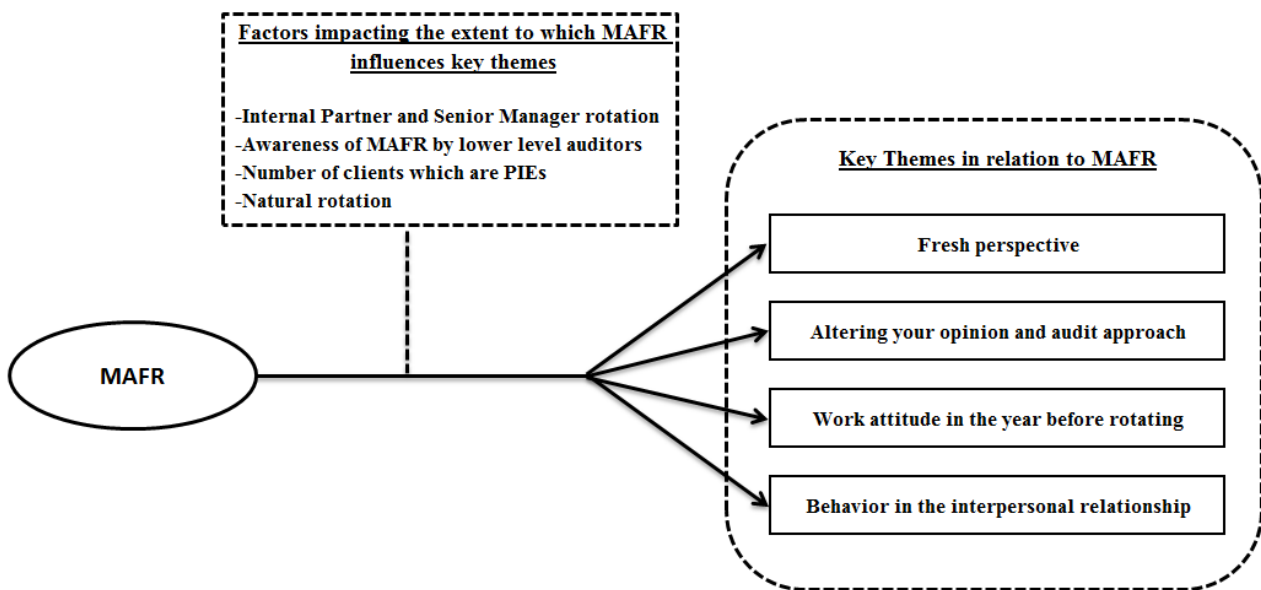
All interviewed participants are approached with the question whether they would like to take part in the research through an interview. Upfront the interview is mentioned that the data from the interview will be recorded and that the identity of the interviewees remains unknown in this research. Only the functions will be described in this research and the fact the case study is performed in the Netherlands at one of the Big 4 audit firms. Finally, the aim of this research and the practical relevance are explained to the interviewees.

4. Results

4.1. Introduction

The analysis based on the results of the case study at a Big 4 audit firm in the Netherlands is displayed in this chapter with the aid of quotations from interviews and observations. The outcomes of the analysis demonstrate that MAFR affects four key themes within the audit practices which are related to audit quality and auditor independence ‘in fact’: fresh perspective, altering your opinion and audit approach, work attitude in the year before rotating and behavior in the interpersonal relationship. Additionally four factors are identified that impact the extent to which MAFR influences these key themes: internal Partner and Senior Manager rotation, awareness of MAFR by lower level auditors, number of clients which are PIEs and natural rotation. Figure 2 presents a summary of the analysis, which displays these themes and factors.

Figure 2: *Summary of analysis*



First, in section 4.2 the interrelatedness of auditor independence and audit quality is described. Second, the case study revealed several key themes within the audit practices in relation to audit quality and independence, which are influenced by MAFR. These themes are elaborated in section 4.3. Third, in section 4.4 several factors are identified that impact the extent to which MAFR influences the key themes.

4.2. *Interrelatedness of audit quality and auditor independence*

While conducting interviews it appeared that the independence of the auditor and the quality of the audit are interrelated. This means that one possible change, induced by MAFR, may influence both the independence of the auditor and the quality of the audit.

Theory and data analysis shows two ways in which MAFR affects these components:

- (1) MAFR can affect the independence of auditors and subsequently the quality of the audit.
- (2) MAFR can directly affect the quality of the audit.

On top of this, there are also different interpretations on which components are affected by similar specified changes. For instance, interviewees define the same change in their day to day practices, due to MAFR. However, some of them only state that this change affects the quality of the audit, while the others argue that both independence and the quality of the audit are affected as expressed by the following respondents:

Researcher: Yes, but a fresh perspective, which yes you do not really see as something that has to do with independence or? Partner: Yes, I think so, because you can really be fresh and independent and be independent from all other interests that ventilate your opinion. (Partner, interview 8)

You get new insights, you look again very fresh to such a customer, to such an environment. So you actually see the quality go up. (Partner, interview 3)

Therefore, for some key themes it remains unclear whether it is related to only audit quality or both auditor independence and audit quality. However, it is more valuable to discuss the most important changes that occur due to MAFR and how they come into play.

4.3. *Key themes in relation to MAFR*

The case study revealed common key themes in relation to how and why MAFR influences the actions of auditors when performing an audit. From the analysis, four themes are identified within the actions of auditors which are affected the most by MAFR: fresh perspective, altering your opinion and audit approach, work attitude in the year before rotating, and behavior in the interpersonal relationship. These themes are elaborated in the subsequent paragraphs and are linked to audit quality and/or auditor independence.

4.3.1. *Fresh perspective*

Due to MAFR auditors have more frequently new clients, which results in having more first year audits. In these first year audits, as an auditor, the relationship with the client has to be build up from scratch and the auditor needs to become more familiar with the client's organization. In this way MAFR induces the auditor to more frequently look with a fresh pair of eyes at new clients.

This audit quality enhancing fresh perspective occurs during the first couple of audit years and tends to decrease over time. This occurs when the auditor becomes more familiar with the client and gets caught up in a sort of routinization. The following are quotes related to this aspect:

Those early years when you are new, then that fresh perspective is just very good. Yes and I think this this will continuously decreases a little (Senior Manager, interview 5).

You just notice at first you are much sharper than when you are having a client for three, four years. Then you are already in a specific flow. (Senior Manager, interview 5)

Well bring up for discussion the considerations that have been made. Take another look at it again and again add some perspectives to it. I think that is good. This prevents automatism and this prevents yes a routine character... So yes I actually applaud this. (Senior Manager, interview 6)

From the quotes, it can also be deduced that during the first audit years at a client, this fresh perspective is welcomed by the auditors and is perceived by them as a positive change of rotation.

From the analysis, changes are identified that may increase the quality of the audit, which are induced by MAFR through this fresh perspective. It forces the auditor to have a sharper view when performing an audit and dive into it totally refreshed. In this way light is shed on the blind spots that may arise when a client is audited before by the same audit firm for many years. Thus, new insights and perspectives are provided by a fresh pair of eyes. On top of this, the auditor is in the first year audit not influenced by any history with the client and this creates an unprejudiced look on the audit and the client. Furthermore, it creates a more critical attitude as compared to when the auditor is more familiar with the client and believe they know everything. The following are examples of quotes related to these changes:

The risk of blind spots is reduced by rotating, because you put new people on it who again hear and thereby set their own critical questions. (Partner, interview 2)

But you find yourself in the first year, if you are serving a new client, then you want to make the best out of it. Then you want to prove yourself. Get to the bottom of it. Then you really want to bring something new. So you are in a certain way motivated to make the extra step. And if you then compare with having a client for ten years. Yes, you know, it is business as usual. Maybe you lose some of your sharpness. (Partner, interview 8)

I think if you, certainly with a new client, than you really dive into it totally refreshed and then you just, then in the first year you go deeply through all and you will see things of which you think, yes I would have done that differently. Or I look at it differently. (Partner, interview 3)

You just actually really uninhibitedly look at something again and think hey what do I think about this. Without you, so to speak, being infected with the entire history. And whether you are infected or are influenced by it. So that helps. That is just a fresh perspective. (Senior Manager, interview 4)

However, this fresh perspective also arises due to the internal Partner and Senior Manager rotation, which has come into force about two years ago in this organization for all clients. This internal policy ensures that auditors also rotate as a person (Managers, Senior Managers and Partners) within the firm after seven years of auditing a specific client and also makes sure the transition is easier compared to when rotation of the audit firm takes place. When rotating as an audit firm, a lot of extra time is spent by auditors in the transition year, because auditors have to make their successor familiar with the client, answer their questions and on top of this get to know the new client assigned to themselves. In the first audit year, auditors run the risk that they have not gained all client specific knowledge, because the auditors are very busy processing information about the client and in the meantime are performing the audit. That is why it is unrealistic in these first year audits to assume that an auditor will get all the details out of the information he or she retrieves. For these reasons, internal Partner and Senior Manager rotation is a convenient way to also realize this fresh perspective, without having the possibility that accounting quality might decrease under the enormous pressure of

many first year audits that have to be performed due to MAFR, as mentioned by several respondents:

However, I only think that you run the risk in the first year, certainly at some of the larger jobs, that you just do not know everything and do not see everything or that you just do not ask the right question... I think that the biggest risk is in, that your, that your audit is still less good or might perhaps be less good than your predecessor. (Partner, interview 7)

So I am the first year very busy with auditing on the one hand, but also with discovering and mastering of that organization. So I am also convinced myself that the second year audit quality is much better than the first year audit. (Partner, interview 2)

I think that in the first year. You know you will get so much new information. Yes, I do not think that you get all the details out of it. I notice this also now with a client. Last year, the first year and now it is the second year. Shit, we again get something out of it. Not seen last year. (Partner, interview 8)

But that was all in a span of one year, that the entire carousel had to start spinning. And that is just really too much. (Senior Manager, interview 5)

Internal Partner and Senior Manager rotation is also brought up by auditors as a good solution for being less familiar with a client and to create this fresh perspective, as expressed by the following respondents:

We do believe in freshness and a lot more, but you can also resolve this internally. That should not have been a mandatory firm rotation at all. (Senior Manager, Interview 6)

Yes, I think in itself a fresh perspective, but I do not think that that necessarily has to be someone from a different firm. Or if that is just somebody else so to say. (Partner, interview 1)

In other words, internal Partner and Senior Manager rotation is seen as a possible substitute for the external MAFR to induce a fresh perspective on an audit during the first couple of

audit years. This substitute does not increase the risk that audit quality might decrease due to for example less client-specific knowledge. In contrast, there are other changes related to audit quality and independence, within the audit practice, which are only induced by MAFR. This means that Partner rotation only partially substitutes MAFR regarding this specific aspect. The other key themes induced by MAFR are discussed in the following paragraphs.

4.3.2. *Altering your opinion and audit approach*

When internal Partner and Senior Manager rotation is only applied to this organization, the new auditor who is rotated on the client has no past with the client. However, the auditor is in this situation still charged with history, because a colleague may have been in this position the year(s) upfront. This may create a similar challenging situation as when the auditor has a past with the client himself. There are cases in which the auditor alters his opinion compared to choices made in the past at a client by the auditor himself or a colleague. When an auditor is contradicting this opinion and/or audit approach, situations may arise in which the client tells: *“but last year you approved it”* (Senior Manager, interview 4). It is especially challenging when the environment has not changed and there is no reason to give rise to a change as mentioned by one of the interviewees:

Well look if the environment stayed the same it is off course difficult to then re-sell that is has been wrong. (Senior Manager, interview 5)

The auditors are in this way still less free to act when changes have to be made in the audit or at the client, which in the past have been done in another or have been approved before by a colleague. As explained by one of the audit Partners:

*Suppose I take over another job from another Partner who has been asleep and has errors in it. It's really hard for me to say, yes, it was my colleague, it was *Big 4 accounting firm*. It is obviously much easier to say this when it was another firm. (Partner, interview 8)*

MAFR ensures that the audit firm as a whole has no past with the client. A new relationship as an audit firm with the client is forced more frequently, which means that more often the auditor and the audit firm are not charged with any history. Therefore, MAFR makes it easier for an auditor, during the first year audit, to give his opinion on the different aspects of the

audit compared to when having an existing relationship with a client or when only internally rotating on the Partner, Senior Manager and Manager positions.

Thus when the audit was previously performed by another Big 4 audit firm it induces certain advantages as a new auditor in this first year audit. In this case MAFR creates less challenging situations for the auditor compared to only rotating as a person internally. However, based on the data and analysis, it is unclear whether this change is linked to both independence and audit quality or only audit quality.

4.3.3. *Work attitude in the year before rotating*

Now MAFR is into force, there is a fixed moment when an audit firm is mandated to rotate off a client after a certain amount of years. After the rotation period has passed, the client is going to be audited the following year by another audit firm towards whom the audit files, set up by the current audit firm, will be transferred. The subsequent audit firm will look with a fresh pair of eyes into the files of the previous auditors to get to know the client and get an understanding on how to perform the audit. As discussed previously, this first year the auditor is looking with a fresh perspective extra closely at the client and the audit files. In this way the predecessor automatically performs a review on the realized audit by the previous audit firm. The auditors are aware of this phenomenon and know when their final audit year will be at a specific PIE client. Auditors may take this event into account when auditing their current client for the last year. There is the tendency towards avoiding that the subsequent audit firm discovers defects and/or mistakes made in the audit as expressed by the following interviewees:

Off course nobody wants to transfer a file, and it appears that all skeletons fall out of the closet. (Partner, interview 8)

In the last year you definitely want that it is correct. So what you see, when you take over something, is that you take an extra good look at it, is everything right what is in it. Because you obviously do not feel like that another firm says hey it is still not quite right, so to speak. (Partner, interview 1)

This does not mean that at first something was approved in the audit and in the final audit year not anymore. The mentioned tendency is translated into the auditors being more challenged to provide tighter documenting, which means that it is clearer why they came to a

certain conclusion. Therefore, audit quality might increase the last year before rotating due to tighter documentation. The following are examples of quotes related to the mentioned aspects:

Whether you are sharper, I do not know, but you are tighter in documenting why you think something, because you know that that, what we do the first year when you sit somewhere, you take an extra good look. That is what our colleagues also do off course. So you know that you are more challenged to produce documents which show why you have come to a certain conclusion. (Partner, interview 7)

I guess that does not mean that now things, well had been good for five years and now no longer anymore. But the arguments and the underlying material why you come to a conclusion. There will be spent more time on this. (Partner, interview 7)

So it suddenly ensures that you suddenly think okay I have to make sure everything is properly transferred. Maybe this gives some extra help. That you are indeed thinking of hey, is everything indeed, does everything make sense, is everything sufficiently substantiated, is everything so to say professionally, technically. Does it live up? (Senior Manager, interview 4)

However, this change is not adopted formally in the procedures or strategy of the audit firm. This means it differs for each auditor on how they deal in these types of situations. For support the following quotations of several auditors:

This does not play a formal role in our procedures (...) okay there is coming another round so I might not be an auditor anymore. Yes, then you take this into account. (Partner, interview 8)

Do you give in the latter year. Do you give a whole other meaning to it? No, no I cannot say that, that we now [changed] our strategy or that we put more emphasis on (...) Than we have not changed our strategy, no. (Senior Manager, interview 6)

4.3.4. Behavior in the interpersonal relationship

In the relationship between the auditor and the client, mutual trust is build and this is realized during a longer relationship. Both parties have to build on this bond together. More openness

and respect is created when there is mutual trust in this interpersonal relationship. In these relationships, the client is more inclined to provide information and discusses problems more openly. This would not be the case when there has not been build any trust and the scenario arises in which the client only provides information based on the questions asked by the auditor. Therefore, auditors aim to build this trust with the client and this creates a bond between the auditor and the client. This would not be possible when the rotation period of MAFR would be too short. The current applicable rotation period of MAFR allows this trust building. However, it does limit the amount of years that can be used to build this trust even further.

Most auditors refute in different ways why a longer relationship and more trust does not influence their behavior. Thus, why MAFR would not make a difference for their behavior during an audit. Reasons for this are that the behavior and inter alia the independence of an auditor is based more on the character of the auditor himself, as mentioned by one interviewee:

But I think independence lies a lot more in how I am in the race myself, than whether I am somewhere for a longer period. I can be somewhere the first year and being absolutely not independent at all. I think that is much more dangerous. So I think independence is really ingrained in my DNA. (Partner, interview 7)

The DNA of the auditor mainly decides how is dealt with independence issues and this means that not every auditor is influenced by how long they are involved with a certain audit client. This means for instance that when it is required to rotate off the client in the near future or when it is the last year before rotating the client is mandatory, an auditor does not consider that there is now no need to please the client in such a way to retain this client and therefore is not more incentivized to budge on matter. Also the length of the relationship, between the auditor and the client, does not change whether an auditor tends to consider their point of view less during a discussion with the client. In other words, MAFR does not affect the behavior of most auditors, thus may not affect the independence of auditors and in particular does not translate in changing how is dealt with certain disagreements between the auditor and the client.

Furthermore, as mentioned by a partner, in the worst case when not being independent, there are many quality assurance mechanisms in a Big 4 audit firm who secure that an auditor acts in the right way:

If you look how many specialists, experts, there must watch before I can put a signature for a listed company. (Partner, interview 7)

Overall it can be concluded, based on the analysis, that the behavior of auditors is not influenced by a longer relationship with the client, thus the independence of auditors and subsequently audit quality. This means MAFR does not induce a change in the independence of an auditor and audit quality, because independence is based more on the character of the auditor himself. However, only two interviewees share the view that MAFR builds in a measure, which might avoid that auditors rely too much on trust or that a too close relationship could arise. As previously mentioned, the character of auditors determines whether they are independent and not the length of the relation. Therefore, some auditors could be more sensitive, based on their character, to longer relations with the client. This is because these two interviewees expect that auditors may unconsciously rely too much on trust or feel relationships may get too close. Examples of this are provided in the following sections.

The auditor can be affected by a longer relationship with the client due to trust in and integrity of the client, which plays a role in the deliberations of the auditor. When the auditor finds that the client is not acting in the right way and is not serious about the audit, this creates more awareness and the auditor becomes more critical. On the other hand when there is no reason to doubt about the integrity of the client, because the client has always acted in the right way, the auditor can unconsciously rely too much on trust as mentioned by an interviewee:

If you have a relationship with somebody for a long period of time and there has always been acted with integrity. Then you do not have those antennae relative to someone who enters there new and builds a relationship again and yet looks in a whole different way to such a customer. So with the rotation you avoid that you are going to rely too much on trust. (Partner, interview 3)

In other words, based on the character of the auditor, at a certain moment some auditors can build too much on the client in an unconscious way. MAFR in this way builds in a measure for these auditors, which avoids that the auditor in some cases relies too much on trust, because the relation between the auditor and the client is truncated by MAFR.

Furthermore, one interviewee mentioned that a relationship can become too close after a longer period of time. This means that there is not one view on whether close relationships are avoided by MAFR, because it mandates that the relationship is coming to an end after a certain period of time. One interviewee mentions that a too intimate relationship may arise between the auditor and the client:

If we look at positions within firms, we see that and we think sometimes it is good to switch, because then you have indeed yes if there is an intimate bond. Look, which can sometimes indeed have unwanted effects. Well then you break through this hard. Well then then you avoid that risk. (Senior Manager, interview 4)

In contrast, another respondent is very firmly about that no intimate relationship between the auditor and the client arises after a longer period of time:

Of course, a relationship arose, but that has to do especially with knowing where to get your information. But I cannot say. Look, at these assignments, the relationship always remained purely formal (...) Hè that you are too closely and too attached with your client. Sufficient, would have insufficient distance. Yes, I do not really see that. (Senior Manager, interview 6)

To conclude, this means there are different views on whether the behavior of the auditor is influenced when there is MAFR compared to having no limitation on the amount of years the relationship between the auditor and the client, in which trust is build, could last. Overall, the analysis shows that MAFR does not influence the behavior and thus independence of the auditor. When behavior is not changing this also counts for the independence of the auditor and subsequently audit quality. On top of this, internal Partner and Senior Manager rotation causes that no long relationships can arise between the auditor and the client. This internal policy decreases a possible change in behavior due to MAFR even more within this Big 4 audit firm.

4.4. Factors impacting the key themes

From the analysis, four factors are identified that impact the extent to which MAFR influences the different key themes, which are described in paragraph 4.3. One of these

factors, intern Partner and Senior Manager rotation, is already included in the previous sections. The other three remaining factors are elaborated in the subsequent paragraphs.

4.4.1. Awareness of MAFR by lower level auditors

Interesting differences between the different levels of auditors within the audit firm have been observed by having informal conversations with auditors, especially in terms of awareness of MAFR. For convenience, the different functions have been split up in two levels: (1) lower level auditors, which consists of the functions – Staff Audit and Senior Staff Audit. (2) higher level auditors, which is composed of the functions – Manager, Senior Manager, Executive Director and Partner.

It was being noticed that the auditors from the lower levels are not aware or fully aware of the new legislation on audit firm rotation and do not seem to take this policy into account in their daily practices. This is the result of different reactions on questions about MAFR. When these type of auditors were asked, during the informal conversations, to tell what they know about MAFR or when was being told that the object of research is MAFR, they replied and remarked for instance as following:

I do not know much about this policy on mandatory audit firm rotation.

Since when is this policy into force for the Netherlands?

How long is the period before we have to rotate, 10 years or something else?

From the observations, it can be deduced that there is a lack of awareness of MAFR by the lower levels. This causes that certain discussed key themes, such as a changing work attitude in the year before rotating off, are not influenced by MAFR for the lower level auditors. For instance, a fresh perspective will still be raised by MAFR since lower level auditors in this way are confronted with possibly more first year audits.

In contrast, most of the interviewed higher level auditors were familiar with the new policy of MAFR and similarly all were confronted with the internally mandated Partner and Senior Manager rotation. Still there was sometimes no clear picture on the exact MAFR rotation period and/or the mandated cool-off period.

However, the higher level auditors believe that the lower level auditors are more aware of MAFR than they actually are. For instance, interviewees believe that lower level auditors

are aware of audit firm rotation, because they see the changes primarily due to the audit engagement itself. They notice it is a first year audit when they are working at the client for example. Also it is often on the agenda for the team meetings that auditors have of clients and other events. On top of this, there are newsletters through which the latest news on changes within the practice of the auditor are communicated. Furthermore, the auditors do share a similar view on that the lower level auditors are only affected indirectly by MAFR and are in this way not so much influenced by it in their daily practices. This analysis is supported by the following quotations from respondents:

I think it will be dealt with in TPE's [Team Planning Events] and PI's [Post Interim event], so our team meetings. They are there often, but not always. I think that in their daily work routine that perhaps not jet so much... not so are influenced by it. (Partner, interview 8)

I think that in itself simply, when it comes to rotation and tender processes, yes they are just standing a little further away from this. (Partner, interview 8)

But the lower, the Staff and Senior Staff. Hè they have also not directly, they are not directly affected hè. (Senior Manager, interview 5)

So there they will see in particular in those events, which we have, where thus also Staff and Senior Staff's concubine, there you see that emphatically emerge yes. And if you are talking about audit firm rotation than they just make a part of the transition and then you perform an initial audit, with everything related to it. (Senior Manager, interview 6)

Researcher: Or is it more like... it plays a role especially at Partner and Senior level and yes if that really is communicated throughout the organization. Partner: No, it is particularly relevant at Partner and Senior level. The assistants they know it is there and they know it is happening. They see this happening, but they are not involved in that process. (Partner, interview 3)

In other words, the auditors in the higher levels of the audit firm think the auditors in the lower levels are more aware of MAFR then they actually are. Although they do remark that the daily practices of these lower level auditors are barely influenced by MAFR. They only notice this change when they are put more frequently on new first year audits. Hence, lower

level auditors, similar to the other auditors within the audit firm, notice the change in policy when they are put on new clients which are rotated due to MAFR. However, on how many clients of the audit firm is MAFR applicable? In other words, what is the extent of Public Interest Entities clients within this audit firm? This is discussed in the next section.

4.4.2. Number of clients which are Public Interest Entities (PIEs)

From the analysis, it can be concluded that this regional office of a Big 4 audit firm does not have many clients which are PIEs. Only one Partner and one Senior Manager currently have PIEs in their client portfolio. While two other Senior Managers and one Partner previously had PIEs as clients, which are rotated-off due to MAFR or because their client portfolio changed. Furthermore, some interviewees mention that they have clients which show look-a-like behavior. These clients voluntarily choose to rotate their auditors once in a while to copy what is mandated for PIEs.

Based upon the previous, MAFR is limited to a few clients for this regional office and therefore the daily audit practices are only for a part of the interviewed auditors affected by this policy. However, the clients which are PIEs are often of great size and because of this have a large stake in the total audit hours spend by the audit firm. In this way the impact is still sufficient for the audit firm as a whole, but only limited to the employees involved in these engagements.

4.4.3. Natural rotation

There is a limited amount of current clients who are touched by MAFR or who have been rotated off in the past. For these PIEs clients the same applies as for the majority of the clients, which is that both auditors within the teams and the people working on different positions at the client are naturally changing. For example, auditors change teams because they want to get more experience at a client in another sector. Another example, the financial director of a client, which is the main point of contact, decides to start working for another organization. This phenomenon was also observed in the field at client engagements where there was a new successor for the Controller. These events cause that sometimes the interpersonal relationships between audit firm personnel and the client is kept to a minimum. Thus it limits the extent to which interpersonal relationships could possibly arise and therefore the possible impact MAFR could have on this theme, or how many colleagues have expressed their opinions on the audit in the past or how many times the audit is viewed with a fresh pair of eyes. This described natural rotation is mentioned by two interviewees:

Yes, if there exists such a close relationship. I think if you walk by everybody here at the office and ask hey call call the client, call the number of years that you with your longest, what you are on the client where you come the longest. I think that at the level of Staff and Senior Staff and just graduated accountant. If someone calls more than four [number of years] then you have a lucky shot. (Partner, interview 7)

Yes, in that sense I have to say quite honestly. Also where we are a little longer auditor; you see that at the client there is also always changes on the positions. So in that sense it is not always true that people on each side really are endlessly working together for years. (Partner, interview 1)

5. Discussion

Based on the theory there are the expectations that a relationship with the client for a longer period of time increases familiarity with the client, which leads to a lack of detail due to staleness and redundancy (Arel et al., 2005). On top of this, there is the expectation that when rotating audit firms, the succeeding auditors could offer a fresh look on the audit (Corbella et al., 2015). Ebimobowei and Keretu (2011) similarly conclude in their research that MAFR allows for a fresh approach. In the results of this research this expectation and empirical evidence is confirmed by an identified audit quality enhancing fresh perspective, which arises in the first audit years and decreases the longer the relationship is between the auditor and the client. A fresh pair of eyes provides new insights, new perspectives on the audit, a more critical attitude and sheds light on the blind spots that may arise when a client is audited before by the same audit firm for many years. Sharpness of the auditor therefore could decrease and this eventually results in a lack of detail, because auditors can get caught up in a sort of routinization. This means that routine, which is seen as a threat of a longer client relationship (Ewelt-Knauer et al., 2013), is also displayed in the results of this research as something that can be avoided by MAFR. However, this fresh perspective also arises due to the internal Partner and Senior Manager rotation, which has come into force about two years ago in this organization for all clients.

A theme which aroused from the analysis, which was also expected based on the theory, is that MAFR has an advantage over internal Partner and Senior Manager rotation. This advantage is that it is less challenging to contradict the opinion of predecessors from other audit firms as compared to the opinion of a colleague or the auditor himself (Corbella et al., 2015; European Commission, 2011). The effect of this advantage on the audit practices cannot be linked directly to independence or quality. Another expected advantage that is indicated in the analysis of this research is that Partners and Senior Managers are aware that they are being reviewed by another audit firm, instead of a colleague, after rotating off their current client (Corbella et al., 2015). This paper shows that this awareness during the last audit year might create tighter documentation for this audit year and results in an enhancement of audit quality.

From theory it is also expected that a longer relationship creates a pressure to retain the client, which leads to more eagerness to please the client and this can be avoided by MAFR (Arel et al., 2005; Imhoff, 2003). These expectations are not confirmed by the analysis of this case study, because auditors do not consider that there is now, when MAFR is into force, no need to please the client in such a way to retain this client. Therefore, they are not more

incentivized to budge on matter due to MAFR. In other words, the independence of the auditor is not influenced, thus audit quality, by MAFR when looking at possible decrease in pressure to retain the client due to MAFR.

It can be also deduced from the analysis that it is important for auditors to build mutual trust in order to have clients that are more likely to share information. This was also one of the expectations in the theory and this build trust is paired with a longer auditor-client relationship (Arel et al., 2005). This trust may possibly influence the behavior of the auditor during the audit. Changes in auditor independence, and subsequently audit quality, depend on possible changes in the behavior of the auditor. From the analysis, there is not one consistent view on whether the length of an auditor-client relationship influences the behavior of the auditor. However, overall the results of this research show that the behavior, thus independence, is not influenced by a longer relationship in which trust is build. Independence depends more on the character of the auditor and not on the length of the relationship. As stated in the research of Hudaib & Haniffa (2009), “auditor independence which was once considered as a moral-ethical position has now been largely conceived an object that can be regulated (...) and checked on and verified through reviews” (2009, p. 222). From the analysis, the overall view is that independence is not regulated by MAFR. The results show that independence lies more in the moral-ethical position of the auditor, thus the character/DNA of the auditor.

Previous research shows inconsistency on whether independence of auditors is affected by MAFR (Ewelt-Knauer et al., 2013). Empirical evidence on MAFR shows both an improvement of independence ‘in fact’ (Ebimobowei and Keretu, 2011; Dopuch et al., 2001) and a negative impact on this construct (Ruiz-Barbadillo and Gómez-Aguilar, 2002; SDA Bocconi School of Management, 2002). This inconsistency is only seen in the fact that two views of auditors slightly deviate from the case study results as a whole, which are about auditors possibly relying too much on trust or the possibility that a too close relationship could arise. As mentioned before, overall the results of this research show that MAFR does not affect the independence and subsequently audit quality, thus shows no positive or negative influence on independence.

Proponents of MAFR also believe that MAFR would lead to a lower number of audit failures, thus higher audit quality, because the concern over retaining the client is eliminated (Casterella and Johnston, 2013; Imhoff 2003). In contrast, opponents state that MAFR leads to a lack of specific client knowledge, which is gained over a longer period of time and results in an audit quality decrease (Casterella and Johnston, 2013). Similarly, research also shows

both audit quality improvements (Ebimobowei and Keretu, 2011) and decreases (Cameran et al., 2015) due to MAFR or find no association (Ruiz-Barbadillo et al., 2009). For instance, previous research also shows that quality decreases the first audit years when comparing this with the year before rotating when the audit was performed by the previous audit firm (Cameran et al., 2015) or that the risk of audit failures is higher the first two audit years at a client due to no sufficient client-specific knowledge (AICPA, 1992). First, the results of this study show that MAFR does not change the concern over retaining the client. Second, the results actually show that MAFR causes many first year audits at one certain moment in time and hence causes pressure on the auditors. This is because a lot of extra time is spent in the first audit year to get to know the client and their environment, which means that client specific knowledge is lower. Furthermore, extra time is spent during the transition period to familiarize your predecessor with the audit that has to be performed for the client which has been rotated off. Due to these reasons, quality might be lower during the first year audit, which are more frequently forced due to MAFR, because auditors run the risk that they have not gained enough client-specific knowledge. This is more in line with the opponents of MAFR who believe that a short relationship between the auditor and the client causes that less client-specific knowledge is gained by the auditor, which results in a lower audit quality and thus being more vulnerable to audit failures. In contrast, as discussed in the previous sections, the results also display that in last audit year before rotating the client, auditors might provide tighter documentation. This results in that it is clearer why auditors came to a certain conclusion and is quality enhancing. This change could also explain the results in the study of Cameran et al. (2015) which shows that quality might partially decrease the first audit year(s) when comparing this with the quality of the last audit year before rotating.

As can be concluded, several viewpoints of opponents and proponents of MAFR are (partially) confirmed while other expectations are not found in the results of this research. It is interesting to see that most changes are like a double-edged sword. For instance, a fresh perspective, which is induced by MAFR and also by internal Partner and Senior Manager rotation, leads to better audit quality in the first audit years due to more sharpness, new perspectives, less routinization etc. However, in the first years when this fresh perspective arises there is less client-specific knowledge. Especially due to more first year audits being forced by MAFR. This may also result in lower audit quality when comparing this with other audit years, such as the last audit year which is also more frequently forced by MAFR. In this last year there might be a quality increase due to tighter documentation, which is induced by the fact that auditors are aware that they are reviewed the following year by the subsequent

audit firm. Therefore, it remains unclear whether MAFR is more in line with the proponents or opponents of MAFR. However, more consistency is found when looking at the different time periods within the audit firm rotation period. For instance, (1) the first two/three audit years and (2) the final audit year. It is therefore important that further research takes the different time periods within the rotation period into account.

6. Conclusion

MAFR for Public Interest Entities (PIEs) has recently been given prominence in the Netherlands, when it took effect 1 January 2016. Through a case study of a Big 4 audit firm's regional office located in The Netherlands, this thesis examines how and why mandatory rotation of the external audit firm affects audit quality and how auditor independence 'in fact' plays a role in this. The results of the case study are drawn from observations and interviews with auditors from the higher levels within the assurance department (4 Partners, 1 Executive Director and 3 Senior Managers).

The aim of this research is to provide input for the ongoing discussion related to MAFR in other countries by deepening our understanding into the actual relationship between MAFR and the constructs: audit quality and auditor independence 'in fact'. Independence is an important element from which audit quality is derived since it is the foundation of the public accounting profession.

The analysis of the case study indicates that MAFR affects four key themes, within the audit practices, in relation to audit quality and auditor independence 'in fact'. Furthermore, four factors are identified that impact the extent to which MAFR influences these key themes. Table 3 presents an overview of these key themes and factors. As can be seen, the factor 'internal Partner and Senior Manager rotation' is only affecting the key themes: 'fresh perspective' on the audit and the 'behavior in the interpersonal relationship' between the auditor and the client. This factor is not only affecting the extent to which the 'fresh perspective' is brought up by MAFR, but is also seen as a more convenient substitute to induce this perspective, because of a risk in audit quality decrease due to many first year audits that have to be performed. The other displayed factors are also affecting for other key themes the extent to which MAFR influences these.

Table 3: *Key themes induced by MAFR and factors impacting*

Key Themes within audit practices in relation to audit quality and independence	Factors impacting key themes			
	Internal Partner / Senior Manager rotation	Awareness of MAFR by lower level auditors	Number of PIEs clients	Natural rotation
1. Fresh perspective	x	x	x	x
2. Altering your opinion and audit approach		x	x	x
3. Work attitude in the year before rotating		x	x	
4. Behavior in the interpersonal relationship	x	x	x	x

The key themes are: (1) A fresh perspective during the first couple of audit years arises, when auditors have more frequently new clients due to MAFR and this perspective tends to decrease over time when auditors become more familiar with the client. This quality enhancing fresh perspective forces the auditor to have a sharper view when auditing, sheds light on the blind spots, provides new perspectives, creates an unprejudiced look and the auditor dives into the audit refreshed. (2) A new relationship with the client is forced more frequently by MAFR, which means the auditor of the audit firm is more often not charged with any history. MAFR creates in this way less of a challenging situation for auditors, during the first year audit, compared to when having an existing relationship with a client or only internally rotating on functions. This is because it is easier to contradict judgments of predecessors from other audit firms compared to their own opinion or the opinion of colleagues, on the different aspects of the audit. The effect of this advantage on the audit practices cannot be linked directly to independence and/or quality. (3) MAFR forces more last year audits in which the auditor knows that clients are going to be rotated off. During these last year audits, auditors are more challenged to provide tighter documentation, which means that it is clearer why they came to a certain conclusion. This is due to the fact that auditors tend to avoid that the subsequent audit firm discovers defects/mistakes in the performed audit. In this way audit quality might be improved by tighter documentation in the final audit year before rotating. (4) In the interpersonal relationship, between the auditor and the client, trust is built over the years. Overall, auditors refute in different ways that their behavior is not influenced by a longer relationship and more trust. This means a potential change in their independence is not induced by MAFR, which shortens the relationship between the auditor and the client. For instance, most auditors express that the length of the auditor-client relationship does not change whether an auditor considers their point of view more or less during discussions with the client. Their independency is based on their own character and not the length of the relationship. This also indicates that independence is not influenced by MAFR. However, there is not one consistent view on this matter among all the auditors.

The factors influencing the extent to which MAFR influences the key themes are: First, internal Partner and Senior Manager rotation which is also seen as a substitute for the fresh perspective. This internal policy does not cause, compared to MAFR, the risk of not having sufficient client-specific information. On top of this, due to this internal policy, which is already introduced at the audit firm, no long relationship can arise between the higher level auditors and the client. Therefore, decreases the possible change in behavior due to MAFR.

Second, the auditors from the lower levels are not (fully) aware of the new legislation on audit firm rotation and do not seem to take this policy into account in their daily practices. Third, there is a limited amount of PIEs clients for this regional office. Thus, there are a few clients on which MAFR is applicable and therefore the daily audit practices are only affected for a part of the auditors. However, the PIEs are of great size and often a lot of time needs to be spend on these type of engagements. In this way the impact is still great, but only limited to the employees involved in these engagements. Finally, both auditors within the teams and the people working on different positions at the client are naturally changing. This limits the extent to which interpersonal relationships could arise, how many colleagues have expressed their opinions on the audit in the past and how many times the audit is viewed with a fresh pair of eyes.

The results of this research should be interesting to policy makers and regulators, because it provides useful insights in the impact one may expect from MAFR. This ex ante evidence provides input for the ongoing discussion related to MAFR and can be used when considering to implement MAFR in other countries, such as the U.S. The influence of MAFR on audit quality and auditor independence can be taken into account when weighing all the pros and cons.

A limitation of this research is that only a part of the auditors working at a regional Big 4 audit firm office are interviewed and not all the different audit functions within the firm. Furthermore, there might be differences within the firm between the different regions, because the client portfolio per region differs, which are not taken into account for this research. For instance, each regional office might have a different amount of PIEs in their client portfolio. Lastly, MAFR has recently come into force and for this reason only the first preliminary changes in audit quality are identified in this thesis.

For further research into how audit quality is affected by MAFR it would be advisable to look at multiple regional offices of an audit firm and to have interviews with auditors from all the various audit job levels within these offices. In this way, the results of different auditor levels can be grouped and compared. It would also be interesting to perform a similar research after the policy has reached a more mature stage in the Netherlands and in this way more final results on this topic of research can be provided.

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Appendices

Appendix 1: Semi-Structured Interview Themes

- General view on the auditor
 - Experience and Clients
- MAFR in general
 - Effect of MAFR on daily practices
 - Viewpoint of auditors on MAFR
- MAFR and the audit practice
 - Changes in contact with client when having a long-term relationship compared to a short-term relationship
 - Changes when auditors have new client due to MAFR
 - Changes last year audit when switching client following year due to MAFR
 - Changes in discussions with client when you rotate in the near future
 - Effect of MAFR on independence of auditor
- Other themes
 - Length of the rotation period
 - Internal communication to lower levels within organization of the changes in the area of MAFR
 - Perception of others on MAFR

Appendix 2: Interview Code's

Code	Description
101	General view
102	Quality in general
103	Time
201	Fresh Perspective
202	Changing your opinion
203	Quality first year(s)
204	Work attitude last year
205	Interpersonal Relationship and Trust
301	Natural rotation
302	Internal Partner rotation
303	Communication to lower level auditors
401	Perception of others
402	Length of rotation period