

## **Audit Tenure and Audit Quality: Evidence from Turkey**

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The rise of accounting scandals in the last decade has reduced trust of the users in audited financial statements, so users have started questioning the quality of audit work. This paper aims to test empirically whether audit-firm tenure reduces audit quality. After the accounting scandals in the USA and the Europe, and the associated failure of Arthur Andersen, benefits of audit firm or partner rotation on audit quality becomes a controversial subject. Sarbanes Oxley Act of 2002 considered audit firm tenure as a potential area that needed to be investigated because the consecutive years of auditor-client relationship has the potential to impair auditor independence. It is argued that the audit quality and therefore the quality of general purpose financial statements increase when a new auditor with fresh and skeptical eyes evaluates the financial statements. Using the same senior personnel on an audit engagement over a long period of time believed to create self-interest and familiarity threats to independence (Eilifsen, Messier, Glover and Prawit, 2010). For example, in the Enron case, it appears that the auditors became too familiar with the company personnel, such that independence in fact and in appearance both may have been compromised (Ryken et al, 2007). Familiarity lead to learned confidence about the results when making assumptions about outcomes and using less rigorous audit procedures or static audit programs.

According to the new Independent Audit Communiqué issued in December 2012 by Turkish Public Oversight Accounting and Auditing Standards Board (POAASB), in an audit of the public interest entity, a firm shall not be the auditor for more than seven years for the last ten years. In addition to that, an individual shall not be a key audit partner for more than five years in the last seven years. After such time the individual shall not be a

member of the engagement team or be a key audit partner for the client for two years (Official Gazette, 25809).

This paper tests whether a statistically significant association exists between the audit firm tenure with a client and evidence of reduced audit quality as measured by the propensity of modified audit opinions. We assume that the decline in audit quality is indicated by the auditor not issuing a modified opinion for firms whose financial statements are materially misstated. Based on a sample of 253 firms listed on Istanbul Stock Exchange (ISE) and 2277 firm-year observations of audit reports during the 2002-2010 periods, the analysis produces evidence that the number of consecutive years of audit firm-client relationship negatively affects the auditor quality measured by the propensity of modified audit opinions. We choose the 2008 and 2009 periods for our main analysis because in 2010 a mandatory audit firm rotation policy was executed for the companies listed in the ISE. Before this period Turkey has an environment where the rotation policy is not mandatory. The results of this study are expected to contribute the regulation of the quality of auditing by the regulator (POAASB) with regard to auditor rotation.

**Keywords:** Audit Tenure, Audit Quality, Audit Opinion, Independence