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The International Journal of Accounting 51 (2016) 1–22

The International Journal of Accounting

# Client Following Former Audit Partners and Audit Quality: Evidence from Unforced Audit Firm Changes in China ☆

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Received 8 August 2014
Available online 21 January 2016

**Abstract**

In China's audit market, audit clients occasionally follow an audit partner who moves to another audit firm in an unforced setting (i.e., not due to the predecessor audit firm suffering regulatory sanctions). By examining a sample of Chinese listed companies during 2001–2013, we find that turnover audit partners are significantly less likely to issue a modified audit report to their unforced follower clients, as compared either with all other audits in the same successor audit firm in the same year, or with post-follow audits of forced follower clients (where the predecessor audit firm suffers regulatory sanctions). We also document evidence of turnover partners treating unforced follower clients favorably prior to the partner turnover event. Our evidence suggests that a close audit partner–client bonding impairs audit quality when lacking regulatory and public attention, and has implications for regulators, investors, and audit firms' quality control in emerging markets where clients are usually closely tied to audit partners rather than to the audit firm, and where a non-compete agreement between an audit partner and the audit firm is unavailable or weakly enforced.


*JEL classifications:* M42; M48
*Keywords:* Audit partner turnover; Follower clients; Modified audit opinion; China

☆ We are grateful to Nikos Vafeas (co-editor) and two anonymous reviewers for insightful and constructive comments. Contributions from Charles Jieping Chen and Xiaohong Liu on earlier versions of the paper are gratefully acknowledged. We also thank Jeffrey Callen, Zhihong Chen, Jong-Hag Choi, Mark DeFond, Bin Ke, Jeong-Bon Kim, Clive Lennox, Oliver Rui, Dan Simunic, Bin Srinidhi, and workshop participants at the City University of Hong Kong and University of Hong Kong for helpful comments. We appreciate the senior audit partners for generously sharing their information and views with us during our interviews with them. Xi Wu acknowledges financial support from the National Natural Science Foundation of China (No. 70602020), the Beijing Municipal Commission of Education 'Joint Construction Project' and 'Pilot Reform of Accounting Discipline Clustering', CUFE '2011 Project' on the Development of China's Auditing Profession, and CUFE Innovative Research Team Project 'Empirical Accounting and Auditing'.
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http://dx.doi.org/10.1016/j.intacc.2016.01.001

## 1. Introduction

Economic bonding between audit partners and their clients and its impact on audit quality have received increasing attention from regulators and academics after a series of major accounting scandals that led to the passage of the Sarbanes-Oxley Act of 2002 (e.g., Blouin, Grein, & Rountree, 2007; Carey & Simnett, 2006; Chen, Sun, & Wu, 2010; Gul, Wu, & Yang, 2013; Lennox, 2005; Menon & Williams, 2004). The understanding of how this bond may affect audit quality has significant policy implications for improving investor protection and financial reporting quality.

In this study, we exploit a unique setting where an audit partner left the predecessor audit firm and took some clients with him or her to the new audit firm, while the predecessor audit firm was not suffering regulatory sanctions and continued its operation. In such a setting, an increased economic bonding may develop between an audit partner and the follower clients because the turnover partner's payoff, which is expected from switching to the new audit firm (including compensation and position), is often enhanced by the number of clients he or she can bring to the new firm. Turnover audit partners and their follower clients can use audit quality as a bargaining tool to divide the incremental payoff generated from the client-following practice. We thus hypothesize that turnover partners treat their unforced follower clients more favorably (by being less likely to issue a modified audit opinion) compared to other audits conducted in the same successor audit firm and in the same year. We also hypothesize that turnover partners treat their follower clients in an unforced setting more favorably than in a forced setting, as the latter is often associated with a greater level of regulatory and public scrutiny.

Using data during the 2001–2013 period from China, where the names of audit partners in charge of listed companies are disclosed, we find evidence supporting both of our hypotheses. Moreover, our additional analyses reveal that our main results are driven by the circumstances where turnover audit partners serve on the audit of follower clients as a review partner rather than simply as a field engagement partner, which is consistent with turnover partners exerting greater influence on the audit reporting decision when they are at a relatively senior position. We also find some evidence that audit quality is impaired for audits of follower clients by turnover partners even before the client-following practice, which likely explains why some clients would like to follow their auditor to a new audit firm. Finally, we recognize that selection bias may arise in this study in the sense that successor audit firms likely keep riskier follower clients away from turnover partners as a means of quality control. However, our additional analyses show that our main results are not likely to be affected by such a potential selection bias.

Our study contributes to the literature in a number of ways. Prior studies have examined clients following former audit partners in a forced setting where the predecessor audit firms were subject to regulatory sanctions (Blouin et al., 2007; Chen, Su, & Wu, 2009; Vermeer, Rama, & Raghunandan, 2008), as well as documented evidence that financial reporting/audit quality is not apparently impaired for follower clients when audited by turnover partners. However, our study shows that under the unforced audit firm switching setting where the predecessor audit firm is not subject to regulatory sanctions, audit quality is likely to be compromised for follower clients audited