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Is audit quality impacted by auditor relationships?

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Abstract

The objective of this study is to provide empirical evidence on the association of audit quality with audit tenure which would support the argument for auditor rotation being prescribed by regulation. Auditor tenure is measured having regard to both the duration of relations between the lead audit partner and client firm management (person-to-person relations), as well as the duration of the audit firm's engagement by the client (firm-to-firm). Using the setting of when Australian firms were adopting the *International Financial Reporting Standards* (IFRS), we examine 266 publicly listed Australian firms and find evidence of a negative association between the length of tenure between the lead audit partner and client firm management (person-to-person relations) and audit quality. Conversely we find a positive relation between audit firm engagement by the client (firm-to-firm) and audit quality. This suggests there may be quality benefits from prescribing audit partner rotation, and quality costs from prescribing audit firm rotation.

Key words; **Audit quality, Auditor independence, Auditor rotation, IFRS**

JEL: M41, M42, M48

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