
Mandatory Audit Firm Rotation and Its Implications on Maltese Listed Entities

Submitted 10/07/24, 1st revision 25/07/24, 2nd revision 11/08/24, accepted 15/09/24

Kyra Damato¹, Lauren Ellul², Peter. J. Baldacchino³, Norbert Tabone⁴,
Simon Grima⁵

Abstract:

Purpose: This paper has three objectives: (i) to examine the perspectives of Maltese Listed Entities (MLEs) and their external auditors (EAs) on the perceived effects of the implementation of the EU measure of Mandatory Audit Firm Rotation (MAFR); (ii) to pinpoint and analyse which major audit factors have or have not been affected by such implementation; (iii) to determine whether the particular objectives of the European Union (EU) Audit Reform, which ultimately mandates MAFR for MLEs, are thus being fulfilled.

Design/Methodology/Approach: The study adopts a qualitative research methodology. Semi-structured interviews were conducted with twenty-five participants, these consisting of fifteen representatives from MLEs, five EAs from Big-Four firms and five EAs from mid-tier firms., financial transparency, audit supervision and coordination are deemed unaffected by MAFR. The objectives of this European Union measure are thus not being completely fulfilled in Malta.

Findings: The findings indicate that MLEs generally demonstrate a favourable disposition towards MAFR, although a divergence of opinions regarding its necessity persists. On their part, EAs also exhibit support towards MAFR, perceiving it as essential for MLEs despite posing resource challenges for mid-tier auditors. Both MLEs and EAs recognise MAFR's role in improving client-auditor relationships, triggering knowledge disruption and increasing audit fees.

Practical Implications: While MAFR is having minimal impact on audit quality and auditor independence, it enhances audit market competition, particularly among Big-Four firms, and also strengthens professional scepticism.

Originality/Value: The originality of this research lies in its focus on raising awareness on the implementation of the European Union measure of MAFR within the unique context of smaller states like Malta, thus providing valuable insights into its applicability for listed companies, their auditors and other stakeholders in similar environments.

Keywords: Mandatory Audit Firm Rotation, Maltese Listed Entities, European Union Audit Reform, External Audit.

¹Graduate Accountant, University of Malta, Department of Accountancy, Faculty of Economics, Management and Accountancy, kyra.damato.19@um.edu.mt;

²Associate Professor and Head, the same as in 1, lauren.ellul@um.edu.mt;

³Professor, the same as in 1, peter.j.baldacchino@um.edu.mt;

⁴Senior Lecturer, the same as in 1, norbert.tabone@um.edu.mt;

⁵Associate Professor, Vice Dean, University of Malta, Department of Insurance and Risk, Faculty of Economics, Management and Accountancy, simon.grima@um.edu.mt;

JEL codes: M42, G34, G18, K22.

Paper type: Research article.

Acknowledgement: This article is based on a dissertation submitted in May 2024 by Damato, K. supervised by Ellul, L. in partial fulfilment of the requirements for the award of the Master in Accountancy degree in the Department of Accountancy at the Faculty of Economics, Management and Accountancy at the University of Malta.

1. Introduction

The Sarbanes-Oxley Act of 2002 of the United States defines mandatory audit firm rotation (MAFR) as the imposition of a limitation on the period during which a particular audit firm can serve as the external auditor (EA) for a specific corporation (Sarbanes-Oxley Act of 2002: conference report *(to accompany H.R. 3763)* 2002).

Through such limitation, MAFR aims to address the familiarity threat, a primary threat to auditor independence. (Accountancy Europe 2022). This threat arises due to prolonged client-auditor relationships which foster a personal relationship between the client and the auditor, thus compromising the auditor's independence in mind and appearance (Bamber and Iyer, 2007). Moreover, audit quality is further strengthened through enhanced auditor independence (European Commission, 2016). MAFR also aims to reduce the risks of carrying over recurrent discrepancies and to stimulate new insights, thus reinforcing the conditions for professional scepticism (European Commission, 2016).

This paper has three objectives: (i) to examine the perspectives of Maltese Listed Entities (MLEs) and their external auditors (EAs) on the perceived effects of the implementation of the EU measure of Mandatory Audit Firm Rotation (MAFR); (ii) to pinpoint and analyse which major audit factors have or have not been affected by such implementation; (iii) to determine whether the particular objectives of the European Union (EU) Audit Reform, which ultimately mandates MAFR for MLEs, are thus being fulfilled.

The originality of this paper lies in its focus on raising awareness on the implementation of the European Union measure of MAFR within the unique context of smaller states like Malta, thus providing valuable insights into its applicability for listed companies, their auditors and other stakeholders in similar environments.

Notably, since MAFR was introduced in Malta in 2016, there has been no detailed research in Malta on its effects on MLEs and/or their external auditors or other stakeholders. In this context, Gerada (2012) had earlier questioned the feasibility of MAFR in Malta owing to the limited audit market in a small state. This paper also

allows for comparison with recent EU studies, hopefully serving to inform regulators, academics and the accountancy professions in smaller states.

2. Literature Review

2.1 MAFR: Regulation and Debate

2.1.1 MAFR Regulation

MAFR was introduced in Malta through the EU Audit Reform which was published in 2014. This reform, comprising Directive 2014/56/EU (2014) and Regulation (EU) No 537/2014 (2014), came into effect on 17th June 2016. It introduced significant changes to the framework of statutory audits for public listed companies, particularly MAFR for public interest entities (PIEs).

Article 1.2.f of Directive 2014/56/EU (2014) defines PIEs as:

- a) Entities listed on a regulated market and governed by the law of a Member State;
- b) EU credit institutions;
- c) EU insurance undertakings; and
- d) Entities appointed by Member States as PIEs, such as undertakings of significant public relevance (based on the nature of their business, size or number of employees).

Additionally, listed MLEs, being companies with limited liability whose shares are publicly traded, fall within the above-mentioned definition under point (a) (Malta Business Registry, 2023). Therefore, such MLEs must comply with this legislation applicable to them, this including MAFR.

Article 17(1) of Regulation (EU) No 537/2014 (2014) specifies the time period for which PIEs shall appoint a statutory auditor. Under MAFR, the audit tenure must:

- a) be of at least one year for an initial engagement (subject to renewal);
- b) not exceed a maximum duration of ten years;
- c) not exceed twenty years in the case of tenders; and
- d) not exceed twenty-four years in the case of joint audits.

Furthermore, in exceptional circumstances, national regulators may grant an extension of an additional two years to the audit term.

The primary intent of this reform, specifically through the inclusion of MAFR, is to ameliorate audit quality by mitigating familiarity (European Commission 2016). The rationale behind this is that lengthy client-auditor relationships may reduce auditor independence and professional scepticism. Such regulation was also introduced to address the many shortcomings in the statutory audit market, such as reported

misstatements, decreased investor confidence, audit market concentration and systemic risk (European Commission, 2016).

In fact, the European Commission stated that this legislation forms part of its reaction to the 2008 global financial crisis. Additionally, MAFR seeks to safeguard transparency of financial information, encourage auditor independence and professional scepticism, move towards a more dynamic EU market and improve the supervision and coordination of statutory audits (European Commission, 2016).

2.1.2 Arguments for and against MAFR

Arguments in favour of MAFR:

Support for MAFR predominantly focuses on its potential to improve audit quality by enhancing auditor independence (Petty and Cuganesan 1996; Polychronidou *et al.*, 2020). As aforementioned, in the absence of MAFR, auditor independence is compromised by long-term client-auditor relationships as auditors may become more aligned with management's interests in lieu of the public interest. Moreover, since audit quality diminishes over time, long tenures may result in the impairment of auditor objectivity and professional scepticism (Hoyle, 1978).

MAFR is also believed to offer fresh perspectives on financial statements, thereby increasing the likelihood of detecting and rectifying errors that may have been disregarded by previous audit firms (McLaren, 1958, Polychronidou *et al.*, 2020). Furthermore, this regulation seeks to reduce EAs' extended familiarity with clients' systems and controls as this acquaintanceship may reduce auditors' creativity and lead to predictable and less effective audits (Hoyle, 1978).

Additionally, auditors succeeding in the rotation are incentivised to perform at their highest level, as they aim to avoid negative publicity resulting from failure in detecting the preceding firm's errors (Aschauer and Quick 2018; Hoyle, 1978).

MAFR also fosters greater competition among audit firms by distributing audit engagements among a larger pool of practitioners (Hoyle, 1978; McLaren, 1958; Polychronidou *et al.*, 2020) and through lower audit fees charged to clients (Ewelt-Knauer *et al.*, 2013). It is also argued that MAFR reduces the economic dependence between auditors and clients, thereby precluding management from threatening auditors with engagement termination when a modified audit opinion is issued (Arel *et al.*, 2005, Polychronidou *et al.*, 2020).

Arguments against MAFR:

Critics argue that MAFR imposes additional audit costs on both audit firms and clients. Audit firms face extra costs in terms of understanding the client, whereas clients suffer additional costs through time, effort for switching, uncertainty and other information costs (Fontaine *et al.*, 2016, Jong *et al.*, 2020, Polychronidou *et al.*, 2020). Furthermore, MAFR may result in significant low-balling, where auditors

initially charge lower fees to attract potential clients, with the intent of increasing them over time (Jong *et al.*, 2020).

Furthermore, although MAFR may be claimed to ameliorate competition, some academics argue contrarily that it may contribute to market concentration. Large companies tend to opt for Big-Four audit firms when changing auditors, so opportunities for smaller firms are limited (Ewelt-Knauer *et al.*, 2013). In fact, Dutch academics assert that, despite the implementation of this reform, “*the market of statutory audits at PIEs remains in the hands of the Big Four*” (Jong *et al.*, 2020, p. 18). Gerada (2012) also argued that MAFR may not achieve the anticipated infusion of dynamism.

Moreover, MAFR may also exacerbate the scarcity of available audit firms, particularly for bigger corporations seeking specialised industry expertise (Petty, Cuganesan 1996). It may also pose challenges for auditors in setting up multiyear audit plans and may decrease auditor motivation to invest in industry expertise (Aschauer and Quick, 2018).

Concerns are also raised regarding the possibility of errors in first-year audits and a potential decline in financial reporting quality during the transition period for new auditors. These risks are attributed to EAs’ limited understanding of clients’ businesses and industries (Jong *et al.*, 2020, Kim *et al.*, 2015).

Ultimately, some argue that the benefits of MAFR may be limited and do not outweigh its associated costs (Jackson *et al.*, 2008).

2.2 Perspectives on MAFR

2.2.1 MLEs’ Perspectives on MAFR

As stated earlier, Gerada (2012) had assessed the applicability of MAFR in Malta before the introduction of the reform, focusing on MLEs’ views at that time. Such research concluded that MLEs believed that the additional costs created through MAFR would be absorbed by themselves rather than by audit firms. Furthermore, Maltese MLEs exhibited resistance to voluntary audit firm rotation, except in cases of conflict of interest, this signalling opposition towards MAFR.

Similar cost concerns have also been observed internationally. Harber and Maroun’s (2020) study on listed companies revealed that chief financial officers (CFOs), audit committees and auditors believed MAFR results in needless costs. For audit clients, such costs may include research and tendering costs, whereas for EAs, additional costs comprise unfamiliarity costs (Harber and Maroun 2020).

Another study also found that Canadian audit committee members of publicly listed companies oppose MAFR and perceive it as “*an unnecessary intervention*” that undermines their authority to appoint auditors (Fontaine *et al.*, 2016, p. 487). Such

respondents favoured audit partner rotation, as it better preserves client knowledge and relationships (Fontaine *et al.*, 2016).

Despite these negative perceptions, several surveys show that MLEs support MAFR. A European survey found that 87% of participants support MAFR and the majority advocated for a three-year rotation period (Orlik 2011). Similarly, KPMG UK reported positive views among CFOs and audit committee members of the FTSE Index (KPMG 2022). An earlier survey conducted by O’Leary (1996) revealed that 63% of Australian MLEs view MAFR as beneficial in enhancing the perception of independence.

Overall, the perspectives of MLEs towards MAFR appear to be mixed. Some express concerns over additional costs and perceive it as unnecessary, whereas others believe it to be a beneficial change.

2.2.2 EAs’ perspectives on MAFR

Gerada’s (2012) study also focused on EAs, revealing that less than 15% of audit firms supported the implementation of MAFR in Malta. EAs argued that MAFR is not practicable locally due to the restricted number of audit firms with the adequate resources to deliver an appropriate audit service to large clients. Most audit firms established that they are likely to suffer additional costs in the first year of the rotation, owing to the additional time incurred in obtaining an understanding of the client. However, contrary to MLEs’ views, EAs expected to absorb these costs themselves rather than pass them on to clients. EAs also believed that MAFR would aid in diffusing the monopoly between the Big-Four audit firms.

A number of EAs perceive MAFR as unwarranted. For instance, Harber and Maroun (2020) reported that EAs favoured audit partner rotation over firm rotation, emphasising that MAFR could hinder auditors’ ability to develop in-depth client knowledge and might strengthen Big-Four monopolies.

Nonetheless, MAFR is deemed useful by certain auditors. For example, a Turkish study among EAs found that MAFR “*is regarded necessary in terms of objectivity and independence*” (Şeker and Türel, 2023, p. 46). Similarly, an Egyptian study revealed that auditors perceived MAFR as useful in ameliorating professional scepticism and auditor independence (Fathi and Rashed, 2021). Both studies noted that the benefits stemming from this policy would outweigh the cost increases. In addition, another Egyptian study found that EAs perceived MAFR necessary as it would lead to more effective audits through fresh perspectives and the avoidance of complacency (Anis, 2014).

EAs’ views on MAFR may also differ over time. Jong *et al.* (2020) found that, while MAFR was initially viewed as controversial in the Netherlands, eventually it became considered desirable by several stakeholders, including EAs.

In essence, EAs agree that MAFR results in supplementary time and effort to gain a thorough understanding of their clients, but views on its necessity and impact on market monopolisation remain mixed.

2.3 The Impact of MAFR on Audit Factors and Other Aspects

2.3.1 MAFR's Impact on Audit Quality, Auditor Independence and Auditor Professional Scepticism

Gerada (2012) suggested that MAFR could mitigate EAs' partiality, as auditors are incentivised to maintain diligence, knowing their work will be reviewed by another firm. This in turn would reinforce audit quality.

Studies across Europe reveal mixed outcomes on the implications of audit firm rotation on audit quality, auditor independence and auditor professional scepticism. Jong et al. (2020) found that not all the objectives of the EU Audit Reform are being achieved in the Netherlands with respect to MAFR. While MAFR successfully reduced familiarity threats and strengthened independence, it did not enhance audit quality.

Additionally, it was noted that the trophy-client effect, meaning the discount in audit fees given to larger PIEs for first-year audits, may aggravate the adverse effect on audit quality. Moreover, Austrian research suggests that, along with the prohibition of audit firm tax services, MAFR negatively impacts perceived auditor expertise and does not significantly improve audit quality or auditor independence (Aschauer and Quick 2018).

In France, MAFR faced opposition due to concerns over reduced audit quality and increased costs. However, the flexible rule of extending rotation to every twenty-four years for joint audits seemed to appease the French (Dattin 2017). Owing to such flexibility, it was noted that MAFR would probably not affect auditor independence, especially when amalgamated with audit partner rotation, a ban on non-audit services and joint audits.

A cross-European study further contradicted the assumption that long tenures reduce audit quality, revealing that higher audit quality is associated with longer tenures (Garcia-Blandon *et al.*, 2020).

Several non-EU countries have also implemented MAFR in their legislation. Nonetheless, others have opted to refrain from employing this rule, with some countries implementing the concept but abandoning it thereafter. For example, Singapore decided to discontinue MAFR owing to there being no conclusive evidence linking it to improved audit quality (Choudhury, 2016).

South African stakeholders argued that MAFR would not enhance auditor independence but result in cosmetic changes, thus deeming audit partner rotation

sufficient (Harber and Maroun 2020). Nonetheless, regulators advocated for its benefits in terms of enhanced auditor independence and professional scepticism and serving as protection against overall corporate failure (Harber and Maroun, 2020).

Australian studies suggested that longer tenures might actually improve audit quality and highlighted that, rather than MAFR, other measures could more effectively enhance independence (Jackson, Moldrich *et al.*, 2008). However, they also remarked that MAFR may ameliorate perceived audit quality, rather than actual audit quality (Jackson, Moldrich *et al.*, 2008).

American literature provides for two contradictory perspectives on the effect of auditor rotation on audit quality. While some research finds insignificant evidence that MAFR improves audit quality (DeFond and Francis 2005; Stefaniak *et al.*, 2009), others suggest it leads to better quality when compared to voluntary rotation (Casterella and Johnston, 2013).

In South Korea, MAFR was also associated with improved financial reporting quality through enhanced auditor independence (Kim *et al.*, 2015).

In conclusion, the effects of MAFR on audit quality, professional scepticism and auditor independence seem to vary. While professional scepticism appears to benefit from auditor rotation, the effects on audit quality and independence remain inconclusive, largely owing to the difficulty in measuring these factors accurately.

2.3.2 MAFR's Impact on other Aspects

MAFR may also result in financial implications. Harber, Marx, *et al.* (2020) uncovered that MAFR costs extend beyond marketing and tendering costs and may result in increased audit fees. It is also suggested that such financial burdens, coupled with audit firm disruption, could affect audit quality. While some argue that the pressure to replace clients might cause a disruption to audit quality in the later stages of the rotation period, others believe that auditor competence and professional behaviour should prevent this and preserve audit quality.

Furthermore, in Iran, Salehi *et al.* (2022) found that MAFR increased accruals-based earnings management but did not affect audit fees or real earnings management. It was also suggested that excessively short audit tenures could weaken audit effectiveness by rendering audit methods predictable and increasing the likelihood of undetected financial fraud. Particularly, this is prevalent in unstable economic environments like Iran, where audits are not risk-based.

Literature also offers mixed views on the relationship between MAFR and financial reporting quality (Chi *et al.* 2011; Myers *et al.*, 2003). For instance, Blouin *et al.* (2007) report no improvement in financial reporting quality subsequent to a change in auditor, while Nagy (2005) asserts that MAFR reduces discretionary accruals.

Market concentration is also affected by MAFR. Indyk's (2019) study revealed that large Polish companies typically rotate among Big-Four firms, this suggesting that MAFR would not alleviate market concentration in markets dominated by the Big-Four firms. Moreover, it was noted that the substantial number of brief tenures implies that Big-Four corporations possess robust negotiating leverage and stand to gain more from client rotation than retention.

3. Research Methodology

3.1 The Theoretical Framework

The theoretical framework for this study was the institutional theory in combination with Agency Theory. Institutional theory was employed to examine how MLE practices were being shaped by regulatory and cultural pressures, providing insight into how MAFR might be institutionalized and perceived by the MLEs and their external auditors (EAs) under the EU reform.

Agency theory also contributed to addressing the principal-agent relationship between shareholders on behalf of the MLEs (principals) and the MLE auditors (agents), explaining how MAFR could mitigate agency conflicts by possibly enhancing auditor independence and reducing familiarity risks. Together, these two theories illuminated the perceived effects and efficacy of MAFR in achieving EU Audit Reform objectives by balancing regulatory compliance with practical audit implications.

3.2 The Research Tool

3.2.1 Semi-structured interviewing

Semi-structured interviews were considered to be the most appropriate research tool in addressing the study's research objectives. These interviews contain a predetermined set of questions guiding the schedule rather than dictating it, since other questions may emerge from the discourse (Whiting, 2008). Therefore, this tool generates richer data and provides for substantial coverage flexibility (Smith, 1995). Interview questions were also standardised as much as possible to facilitate the comparability of data and for an effective analysis (Whiting, 2008).

3.2.2 Development of the Interview Schedules

Two interview schedules were prepared for MLE representatives and EAs respectively. They were designed to map the three research objectives, ensuring that the implications of MAFR were thoroughly explored. The protocol of both interview schedules consisted of a preamble followed by five sections, each section addressing one or two of the fundamental aspects of MAFR.

The first section focused on gaining an understanding of the respondents; the second section investigated their general perceptions of MAFR; the third section explored

the effects on client-auditor relationships; the fourth section then examined the effects on audit and other factors and the fifth section inquiring any future recommendations. The methodology was flexible enough to capture detailed insights while ensuring that the research remained focused on the key objectives, making it an ideal choice for addressing the nature of the research questions at hand.

3.2.3 Addressing variability and bias

One limitation of the semi-structured interviews was their inherent flexibility, which could lead to differences in the depth and scope of the information gathered. To manage this, a single interviewer conducted all interviews, using follow-up questions when necessary to ensure consistency. Additionally, the open-ended nature of most questions introduced potential risks of researcher bias or varied interpretations. To mitigate these risks, the first two co-authors held in-depth discussions to establish a shared understanding of the responses, ensuring the analysis remained objective and grounded in the data.

3.3 The Sample Population

Participation in this qualitative research consisted of representatives of MLEs and client-facing warranted auditors with a managerial position within the Big Four and mid-tier audit firms in Malta. A list of Maltese listed MLEs was obtained from the Malta Stock Exchange website. Fifteen interviews were purposively conducted with PLC representatives from sixteen MLEs, with one participant being involved in two MLEs. A further ten purposive interviews were carried out with EAs. Five of these were carried out with auditors from Big-Four firms and the remaining five were conducted with auditors from mid-tier firms.

Thus, twenty-five interviews were conducted in total. By the final interviews, responses suggested that qualitative saturation had been reached. Saturation was determined by ending the interview process once no new themes, insights, or information emerged, this signalling that further data collection would likely be redundant. Criteria for establishing saturation included the depth of understanding achieved, the topic's relative simplicity, the consistency of responses, and alignment with the study's objectives. Researchers also evaluated whether the research objectives had been fully addressed. Monitoring for saturation remained an active focus throughout the data collection process.

3.4 Data Analysis

Thematic analysis served as the primary approach to analyse the qualitative data gathered. Interviews were promptly transcribed, which along with interview notes, facilitated a comprehensive understanding and analysis of the data obtained. Additionally, multiple readings of the transcriptions allowed the researcher to familiarise oneself with the data and make note of preliminary observations. Next,

the data was systematically coded through the identification of phrases of text related to the research objectives.

Codes were created for frequently mentioned concepts, particularly focusing on the general views on MAFR, its implications and the respondents' recommendations. Key quotes were also extracted from the transcriptions, which were included in the research findings. The codes were then organised into themes and further refined to confirm that they faithfully reflect the data and contribute to a thorough comprehension of the research topic. Lastly, the themes were used to address the research objectives and reveal valuable insights regarding the implications of MAFR.

3.5 Other Limitations of the Study

Despite extensive efforts to conduct a thorough analysis of the research topic, this study does have certain limitations. Participant responses inherently included some subjectivity, and there were occasional instances where participants chose not to answer all questions. The study also only included relevant international developments up to March 31, 2024.

Additionally, the study's primary limitations, such as the potential for researcher bias, variability, and the intentionally small sample size as a qualitative study have been previously mentioned. However, further clarification on these two limitations is warranted: (i) Researcher Bias and Variability: Despite implementing safeguards as outlined in Section 3.2.3, there remains the possibility that residual researcher bias and variability may have influenced the study's design, data collection, analysis, or interpretation.

This could result in findings that align more closely with researchers' expectations rather than fully reflecting objective reality. While steps were taken to reduce this bias, it cannot be entirely eliminated and may subtly shape the findings. (ii) Sample Size Limitations: The sample size does not permit the generalizability of the results, as a small and potentially non-representative sample may not accurately capture the characteristics of the broader population.

Therefore, while the study offers valuable insights, these findings should be interpreted cautiously and may not be universally applicable. Future research utilising quantitative methods would be beneficial for confirming these findings and enhancing their broader applicability.

4. Findings and Discussion

4.1 MLEs' Perspectives on MAFR

4.1.1 Do MLEs favour MAFR?

The findings suggest a predominantly positive perception of MAFR among MLEs, while also acknowledging its drawbacks. In fact, approximately half of the MLE respondents^(8/15) perceive MAFR as having both advantages and disadvantages and thus opted for a neutral stance. Six respondents^(6/15) stated that they perceive MAFR as beneficial since it acts as a deterrent against the familiarity threat and reinforces independence. Only one respondent^(1/15) remarked that MAFR is detrimental to companies as it presents an additional concern to management, especially if they are content with their current EA.

This positive perception aligns with existing literature, exemplified by studies like Orlik (2011) and KPMG (2022), but contrasts with other research such as that of Fontaine et al. (2016). Additionally, the Maltese study by Gerada (2012) indicated a majority opposition towards MAFR among Maltese MLEs. Evidently, the Maltese sentiment appears to have changed over time, which may have been influenced by the practical experience of undergoing MAFR, as suggested by Jong et al. (2020).

4.1.2 Is MAFR deemed essential by MLEs?

Views among MLEs regarding the necessity of MAFR were divided, as seven^(7/15) considered MAFR necessary, another seven^(7/15) deemed audit partner rotation sufficient and the remaining respondent^(1/15) did not comment on the matter.

Those advocating for the necessity of MAFR contended that audit partner rotation fails to enact significant change. They also argued that audit partner rotation alone perpetuates a sense of complacency and fails to convey the impression of meaningful change to the public. Some emphasised that under audit partner rotation, a consistent approach to procedures is maintained. One respondent emphasised that, in the Maltese context, partner rotation is particularly ineffective due to the country's small size, where auditors within the same firm work closely together, unlike larger countries where distinct teams can operate independently.

The respondents perceiving audit partner rotation as a viable alternative to MAFR argued that it still offers several advantages, such the introduction of fresh perspectives while preserving continuity within audit processes. They contended that as long as EAs comply with professional regulations, partner rotation would suffice. Additionally, one respondent highlighted the benefit of knowledge continuity within the same firm, noting that the firm's retention of past work avoids inefficiencies. Such argument is precisely echoed by Fontaine et al. (2016), who cited benefits in client knowledge retention and client-auditor relationship preservation.

MLEs were also asked regarding their willingness to voluntarily rotate EAs if MAFR had not been implemented. Most MLEs^(10/15) expressed their reluctance to voluntarily rotate EAs, arguing that auditor rotation is unnecessary if the auditor consistently provides effective support and collaboration. They suggested that rotation would only be considered in cases of underperformance.

Some also emphasised that stakeholders, particularly financial institutions, prioritise the reputation of the auditor over the frequency of rotation. Gerada (2012) had also contended that MLEs generally resist voluntary audit firm rotation, unless faced with a conflict of interest. Evidently, this sentiment still holds true over a decade later. This is noteworthy, particularly in light of the fact that although some respondents advocate for the necessity of MAFR, they exhibit reluctance to voluntarily adopt it.

Only a minority of respondents_(3/15) indicated that they would voluntarily rotate auditors, whilst the remaining two respondents_(2/15) refrained from commenting.

4.1.3 How do MLEs adapt to MAFR?

When queried about their plans to comply with MAFR requirements, most MLEs_(11/15) expressed a preference for audit tendering, to possibly extend the audit tenure to a total of twenty years. Audit tendering affords MLEs the flexibility to either retain their current EA, thereby extending their tenure, or otherwise select a new EA if they offer more favourable services.

Furthermore, a significant proportion_(8/15) indicated that they would not pursue joint audits and a minority_(3/15) stated that they would forgo audit tendering and select a new EA directly, thereby adhering strictly to the ten-year rule. The lack of interest in joint audits marks a notable departure from practices observed in foreign jurisdictions like France, where joint audits are embraced by MLEs (Dattin, 2017).

Furthermore, most respondents_(9/15) expressed a preference for a Big-Four audit firm, citing reasons such as their company's size, public perception, stakeholder comfort, listing status, specialised support and preference by banks. This preference may stem from perceived advantages associated with larger audit firms, such as credibility, resources and expertise. However, it also brings to light the challenges faced by mid-tier audit firms in attracting new clients, despite the increased opportunities presented by MAFR.

Other MLEs_(4/15) exhibited indifference between Big-Four firms and mid-tier firms, opting to tender to both. Lastly, two respondents_(2/15) stated that they will exclusively choose a mid-tier firm.

4.1.4 How can Policymakers Facilitate MAFR Implementation for MLEs?

Policymakers can play a crucial role in supporting MLEs to navigate the challenges of MAFR through the enforcement of additional regulations. In view of this, MLEs were consulted for their recommendations to policymakers. Several respondents asserted that policymakers should mandate and regulate the handover of audit files between incoming and outgoing EAs to ensure seamless knowledge transfer. This measure is also proposed by Jong *et al.* (2020), as it would maintain continuity of knowledge, thus mitigating disruptions, by warranting that the incoming auditor has access to all relevant information from the previous audit cycles.

Other suggestions included providing clearer guidelines and mandating joint audits with the incoming auditor for the final audit of the outgoing auditor. The latter proposition can further enhance continuity in the audit process by emphasising the collaboration of both EAs and enabling the incoming auditor to gain valuable insights into the client's business operations and audit history. As highlighted by Dattin (2017), this collaboration also allows for the sharing of technical skills between EAs and instils greater confidence in stakeholders by leveraging the expertise and oversight of multiple EAs.

MLEs also recommended policymakers to require clients to maintain written documentation detailing current operations and past records to facilitate the transition process by providing crucial information to incoming audit firms. Some also suggested shortening the minimum ten-year period, deeming it excessively long, aligning with findings by Orlik (2011).

4.2 EAs' Perspectives on MAFR

4.2.1 Do EAs Favour MAFR?

The findings reveal a tendency among EAs to favour MAFR, driven by factors such as the perceived enhancement of audit quality and independence. The majority^(7/10) of EAs interviewed exhibited a positive sentiment towards MAFR, commensurate with international research conducted by Fahti and Rashed (2021), Jong et al. (2020) and Şeker and Türel (2023). Additionally, EAs associate MAFR with enhanced opportunities within the audit market, transparency, credibility, auditor scepticism and fresh perspectives.

A departure from the former Maltese perspective of EAs identified by Gerada (2012) is noted, as previously EAs opposed MAFR. This shift in perception could be attributed to the non-materialisation of the anticipated negative effects associated with MAFR (Jong et al. 2020).

One mid-tier auditor^(1/10) expressed a negative perspective towards MAFR, citing concerns that since mid-tier audit firms typically have a limited number of PLC engagements, MAFR will lead to the loss of these clients after the prescribed ten-year period. A minority^(2/10) adopted a neutral position, acknowledging MAFR's benefits for the auditing profession but recognising its negative impact on business.

4.2.2 How do EAs Perceive the Value of MAFR for their Clients?

Half^(5/10) of the EAs interviewed emphasised that MAFR's benefits to clients, particularly in terms of the introduction of diverse perspectives, outweigh its associated costs. They highlighted that MAFR diminishes familiarity, thereby reducing complacency. Moreover, they stated that starting afresh rather than revisiting existing processes allows for the identification of new weaknesses and uncovering errors and overlooked areas, as highlighted by McLaren (1958) and Polychronidou *et al.* (2020).

It was also noted that while lower-level staff who interact regularly with EAs may be less supportive of the rotation due to the disruption in their workflow, top management and audit committees appreciate the fresh perspective, as it contributes to the overall improvement of the company through rigorous audit practices.

Only one mid-tier auditor_(1/10) contended that the costs of MAFR surpass its benefits to their clients. They highlighted the increased workload resulting from commencing afresh, noting that these costs are subsequently passed on to clients, consistent with the findings of Fontaine *et al.* (2016), Jong *et al.* (2020) and Polychronidou *et al.* (2020). They also emphasised the additional costs associated with client staff adapting to the new auditor's methodology and re-explaining company processes.

The remaining EAs_(4/10) expressed uncertainty about whether the fresh perspective gained through MAFR justifies its costs, noting that the balance depends largely on whether the new auditor's fees align with market rates. As noted by McLaren (1958), the practical dilemma is whether the fresh perspective is justified by its cost.

4.2.3 Do EAs Consider MAFR as Feasible and Necessary?

EAs' opinions on the feasibility of MAFR in Malta were divided, with six respondents_(6/10) considering MAFR feasible, whilst the remaining four_(4/10) deemed it unfeasible. Notably, the majority_(4/5) of Big-Four EAs regarded MAFR as feasible locally, whereas only a minority_(2/5) of mid-tier EAs shared this perspective. The majority of Big-Four EAs attributed this view to the expansion in the size of audit firms in Malta and to their sufficient skills and resources to serve large clients. On the contrary, mid-tier EAs emphasised the resource constraints they encounter, hindering their ability to cater for such large clients.

Gerada (2012) had highlighted EAs' concerns regarding MAFR's practicality in the local context, citing the limited number of audit firms equipped with the necessary resources to meet the needs of large clients. Consequently, mid-tier EAs agreed with Gerada's assertion, whilst Big-Four EAs contested such findings.

Despite varying opinions on feasibility, the majority_(8/10) of both Big-Four and mid-tier EAs consider MAFR necessary in Malta. Findings from Anis (2014) and Şeker and Türel (2023) also assert that EAs perceive MAFR as necessary, especially for enhancing audit effectiveness, particularly in terms of objectivity and independence. However, this stance contrasts with Gerada's (2012) findings, where fewer than 15% of EAs supported MAFR's implementation in Malta. Furthermore, in Harber and Maroun's (2020) findings, EAs deemed partner rotation sufficient, raising doubts about the necessity of full firm rotation. Only one respondent_(1/10) considered MAFR to be unnecessary and another respondent_(1/10) remained neutral.

4.2.4 What Strategies can EAs Employ to Effectively Adapt to MAFR?

EAs may adopt proactive strategies in navigating the challenges brought about by MAFR. The predominant suggestions by EAs included adapting to new client needs,

ensuring the adequacy of resources and offering non-assurance services. Moreover, respondents highlighted the importance of preparing clients for rotation, diversifying client portfolios, enhancing expertise and keeping abreast with regulations.

4.3 The Merits and Demerits of MAFR

4.3.1 What are the Advantages Attributed to MAFR?

MLEs and EAs remarked on several benefits associated with MAFR, as highlighted in Figures 1 and 2 respectively.

In line with McLaren (1958) and Polychronidou *et al.* (2020), both groups believe that MAFR provides a fresh perspective to audits, thereby increasing the likelihood of error detection. Consequently, this is likely to result in enhanced audit quality and service, as implied by Petty and Cuganesan (1996) and Polychronidou *et al.* (2020). Similarly, Hoyle (1978) asserts the effectiveness of MAFR in refining audit approaches.

Moreover, some respondents believe that MAFR reinforces independence by reducing familiarity, corroborating Hoyle (1978), Petty and Cuganesan (1996) and Polychronidou *et al.* (2020). Ultimately, as acknowledged by EAs, such benefits contribute to credibility in the audit profession.

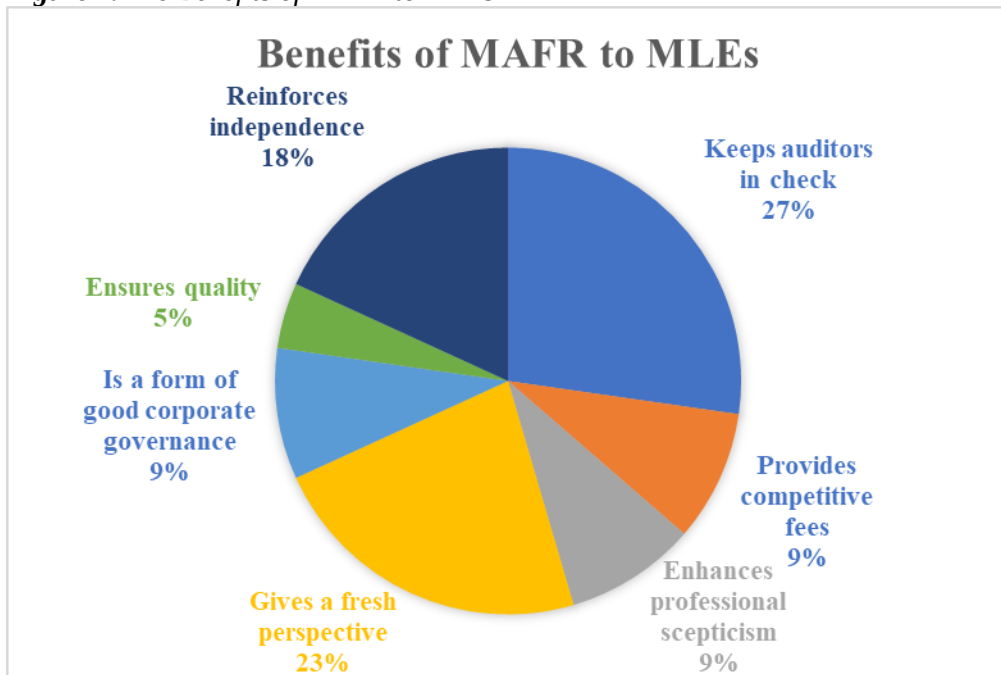
MLEs further appreciate the benefit of increased professional scepticism, consistent with the assertions of Hoyle (1978) and note that MAFR holds auditors accountable. This is also corroborated by Aschauer and Quick (2018), citing auditors' incentive to perform well to avoid negative publicity resulting from failures to detect errors in previous engagements. Competitive fees were suggested as another advantage, echoing the findings of Ewelt-Knauer *et al.* (2013).

EAs benefit from further effects of MAFR, such as the opportunity to gain new clients and ensure equal business opportunities. These align with the views of Hoyle (1978), McLaren (1958) and Polychronidou *et al.* (2020), who suggest that MAFR leads to a more equitable distribution of audit engagements among a broader spectrum of practitioners.

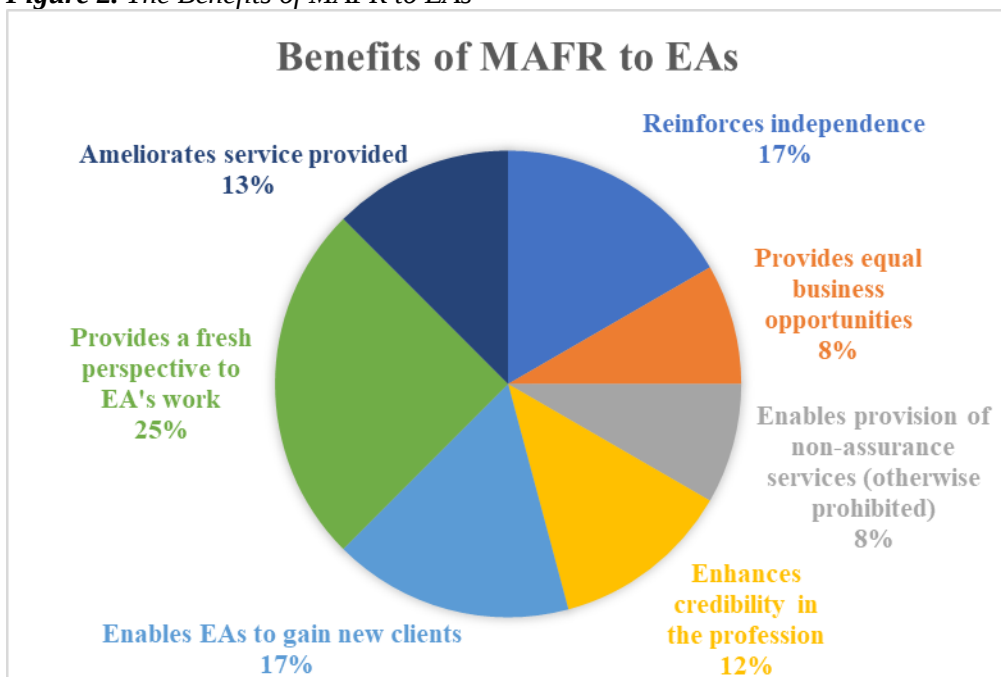
Additionally, EAs remark that when audit firms rotate out of audit engagements, they are able to provide non-assurance services to their clients, thus maintaining relationships and increasing profitability.

4.3.2 What are the Disadvantages Attributed to MAFR?

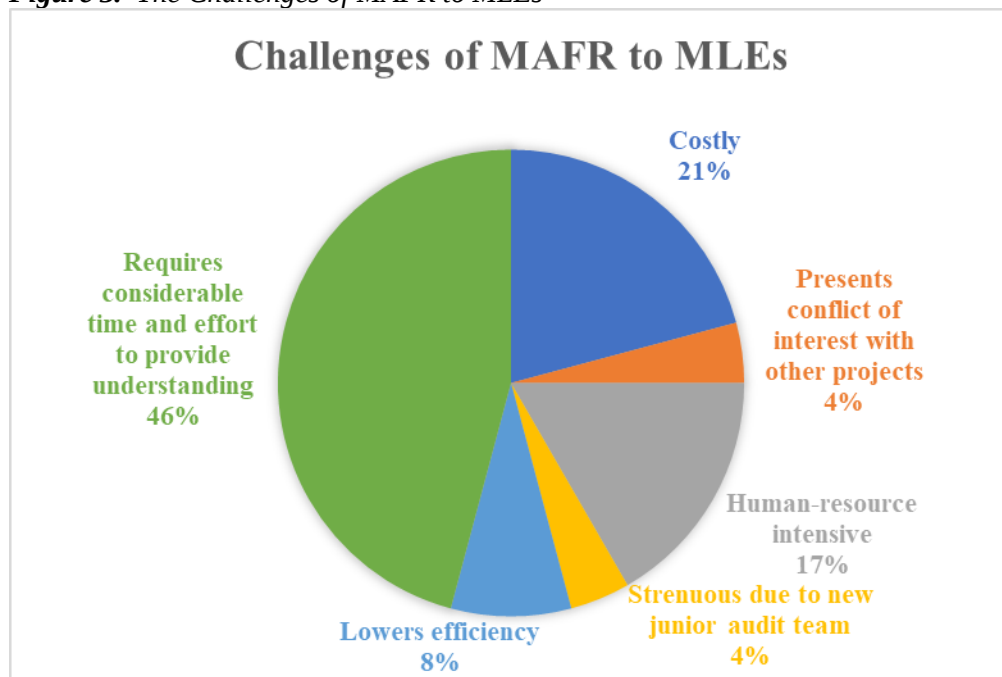
MLEs and EAs also express their perspectives on the challenges presented by MAFR, as depicted in Figures 3 and 4 respectively.

Figure 1. *The Benefits of MAFR to MLEs*

Source: Own study.

Figure 2. *The Benefits of MAFR to EAs*

Source: Own study.

Figure 3. *The Challenges of MAFR to MLEs*

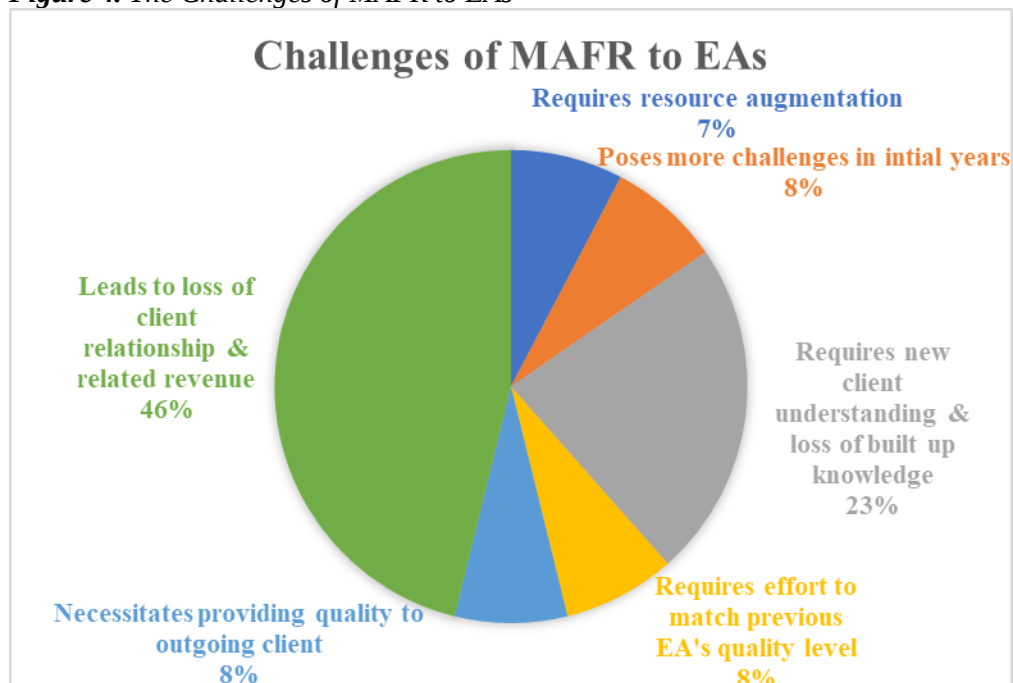
Source: Own study.

A primary drawback noted by both parties is the loss of accumulated client knowledge. MLEs find it burdensome to re-explain their company's operations to new auditors, while EAs must invest time and resources to understand the client's business from scratch.

This challenge is substantiated by Fontaine *et al.* (2016), Harber and Maroun (2020), Jong *et al.* (2020) and Polychronidou *et al.* (2020), who highlight the increased costs and inefficiencies associated with gaining an understanding of the client under MAFR.

Furthermore, MLEs raise concerns about reduced audit efficiency stemming from such loss of knowledge. EAs further believe that the initial years of a new audit present more challenges due to limited understanding of clients' businesses. Such additional challenges may take the form of errors in first-year audits (Jong *et al.* 2020) and may lead to a deterioration in the quality of financial reporting (Kim *et al.* 2015).

Additionally, MLEs find the process of changing auditors time-consuming and resource intensive. Another concern noted by MLEs is the creation of a potential conflict of interest where the newly appointed EA had previously provided non-assurance services to the company. This would result in a self-review threat as the new auditor reviews their own work from preceding years.

Figure 4. *The Challenges of MAFR to EAs*

Source: Own study.

EAs also remark on the loss of client relationships and associated revenue as major disadvantages of MAFR. As noted by Harber and Maroun (2020), this loss leads to switching costs as EAs are required to engage in tender offers to gain new clients and fill the gap left by the departing ones.

Furthermore, mid-tier EAs, in particular, face significant hurdles to gain and service clients under MAFR, such as resource augmentation and increased efforts to match the quality of the previous auditor.

Lastly, both MLEs and EAs seem to be absorbing the costs associated with MAFR. This contrasts with the predictions made by MLEs and EAs in Gerada's (2012) study, wherein both parties had anticipated bearing the supplementary costs stemming from MAFR themselves. However, Gerada (2012) had rightly concluded that MAFR would increase costs for both parties.

4.4 The Perceived Implications of MAFR on Audit Factors and Other Aspects

4.4.1 How is the Client-Auditor Relationship Affected by MAFR?

A number of MLEs_(7/15) and a minority of EAs_(2/10) reported that MAFR has no discernible effect on client-auditor relationships, contrary to findings by Fontaine *et al.* (2016).

However, others acknowledge significant changes. Five MLEs_(5/15) and three EAs_(3/10) noted that MAFR necessitates the establishment of new client-auditor relationships by building trust. Notably, EAs must invest more effort into ensuring the success of these new relationships to ensure their continuity.

Moreover, four MLEs_(4/15) indicated that MAFR keeps EAs in check, resulting in increased accountability in such relationships. Similarly, four EAs_(4/10) noted that MAFR upholds professionalism in such relationships, while two EAs_(2/10) believed that auditors will continue delivering high-quality service to avoid scrutiny from the incoming auditor. Similarly, Gerada's (2012) findings highlight that under MAFR EAs would become more diligent in ensuring thorough and error-free audits. However, Aschauer and Quick (2018) and Hoyle (1978) suggest that it is the succeeding EA, rather than the outgoing one, who is incentivised to perform at their best to prevent such negative publicity.

Additionally, two MLEs_(2/15) and three EAs_(3/10) expressed that MAFR enhances such relationships by fostering client appreciation among auditors and by enabling outgoing auditors to provide non-assurance services, thus transforming the relationship into a client-advisor dynamic.

4.4.2 Is the Continuity of Knowledge and Expertise Impacted by MAFR?

Most MLEs_(14/15) and all EAs_(10/10) concurred that MAFR results in a loss of cumulative knowledge as newly rotated auditors must understand and construct from scratch new knowledge about their clients' functions, processes and operations. This sentiment is supported by Fontaine *et al.* (2016). Additionally and Gerada (2012), Jong *et al.* (2020) and Polychronidou *et al.* (2020) also highlight the financial and other costs incurred by both parties due to such loss of knowledge.

One PLC_(1/15) and three EAs_(3/10) further highlighted that the rebuilding of knowledge and expertise makes the initial years of an audit particularly difficult. However, they noted that this challenge neutralises over time.

Additionally, three MLEs_(3/15) noted that some benefits stem from this challenge as new insights emerge during the accumulation of new knowledge, ultimately contributing to audit quality. Furthermore, two EAs_(2/10) commented that for certain complex client specific items, EAs must restart consultations and communication with external authorities and develop new expertise.

Conversely, only one PLC_(1/15) and two EAs_(2/10) asserted that auditor expertise is unaffected by MAFR.

4.4.3 Which Audit Factors are Affected by MAFR?

Audit Quality:

Gerada's (2012) findings had anticipated that MAFR would reinforce audit quality, yet current prevailing views are mixed. In fact, 56%_(14/25) of the respondents

indicated that MAFR has no significant impact on audit quality, whilst 32%_(8/25) perceived a positive effect and 12%_(3/25) acknowledged both positive and negative effects.

Most MLEs_(11/15), along with some EAs_(3/10), asserted that MAFR has no impact on audit quality. Both groups suggested that such quality should remain consistent regardless of MAFR, substantiating studies by Aschauer and Quick (2018), DeFond and Francis (2005) and Stefaniak et al. (2009).

A number of MLEs_(4/15) and EAs_(4/10) argued that MAFR has a positive effect on audit quality. They highlighted that audit quality will improve as audit files would be kept up to scratch in view of the possible scrutiny by the successor auditor. EAs further noted the value of fresh perspectives brought by new auditors which ultimately results in improved audit quality. Both sentiments resonate with findings from studies by Casterella and Johnston (2013), Jackson, Moldrich *et al.* (2008), Petty and Cuganesan (1996) and Polychronidou et al. (2020).

Only a number of EAs_(3/10) expressed both positive and negative views on audit quality. On the one hand, they reasoned that a deep client understanding (resulting from long tenures) bolsters audit quality. This aligns with findings by Garcia-Blandon et al. (2020), positing that MAFR decreases audit quality as firms with longer tenures demonstrate higher levels of audit quality. On the other hand, these respondents also argued that fresh perspectives from new auditors may also enhance it.

Auditor Independence:

Opinions regarding the effect of MAFR on auditor independence are diverse, partially contradicting Gerada's (2012) forecasts of MAFR reinforcing auditor independence. Indeed, 56%_(14/25) of respondents perceived MAFR as having no significant impact on auditor independence, whereas 40%_(10/25) viewed a positive effect and 4%_(1/25) perceived a negative effect.

The majority of MLEs_(9/15) and half of EAs_(5/10) stated that MAFR is unlikely to have a significant impact on auditor independence, echoing Aschauer and Quick (2018) and Dattin (2017). Both groups reasoned that independence should be inherently present as it is the duty of auditors, regardless of rotation requirements, thus corroborating Harber and Maroun (2020). EAs argued that independence is rigorously assessed both before engagement acceptance and during the audit and that threats to independence can arise irrespectively.

Some MLEs_(5/15) and half of EAs_(5/10) contended that MAFR positively impacts auditor independence. MLEs highlighted that the primary objective of MAFR is to enhance independence by mitigating familiarity, substantiating Fathi and Rashed (2021), Kim *et al.* (2015), Petty and Cuganesan (1996) and Polychronidou *et al.* (2020). They suggested that without rotation, familiarity between auditors and

clients may lead to a greater willingness to overlook discrepancies and to place undue trust in client assertions, as similarly argued by Hoyle (1978). Additionally, MLEs and EAs emphasised that MAFR enhances the public perception of independence, as noted by O'Leary (1996).

Only one PLC_(1/15) stated that auditor independence will be reduced due to MAFR, referencing the self-review threat. They pointed out that a conflict of interest would emerge if the new EA were to audit a non-assurance service previously rendered.

Auditor Professional Scepticism:

Both this study's findings and literature suggest that MAFR positively impacts auditor professional scepticism. In fact, 64%_(16/25) of respondents asserted that MAFR positively affects auditor professional scepticism, while 36%_(9/25) believed it has no impact on such factor.

The prevailing view among both MLEs_(9/15) and EAs_(7/10) was that MAFR positively impacted professional scepticism, aligning with Fathi and Rashed (2021), Harber and Maroun (2020) and Jong et al. (2020). MLEs argued that MAFR enhances the public perception of scepticism and EAs highlighted that MAFR compels them to ensure that estimates and projections are rigorously checked.

This sentiment corroborates Gerada's (2012) forecast regarding the heightened awareness of EAs on the scrutiny of their work leading to more diligence. They also noted that fresh perspectives tend to be more sceptical, resonating with Hoyle's (1978) assertion that extended tenures may compromise auditor objectivity and professional scepticism. Some MLEs_(6/15) and EAs_(3/10) adopted a neutral stance on the issue. Both argued that auditors should always maintain a level of scepticism regardless of MAFR.

4.4.4 What other Factors does MAFR Impact?

Transparency of Financial Information:

This study concludes that MAFR has limited influence on the transparency of financial information, implying no significant effect on the quality of financial reporting. Indeed, most respondents (76%)_(19/25) noted that MAFR does not substantially affect the transparency of financial information, whereas 24%_(6/25) perceived a positive effect.

The majority of MLEs_(11/15) and EAs_(8/10) asserted that MAFR does not significantly affect the transparency of financial information. MLEs argued that transparency is primarily the responsibility of the Board of Directors and hinges on compliance with regulatory standards. Similarly, EAs contended that any auditor can ascertain compliance with such standards, suggesting that transparency should remain consistent regardless of auditor rotation, substantiating Blouin *et al.*'s (2007) findings.

In contrast, a minority of MLEs_(4/15) and EAs_(2/10) perceived MAFR as enhancing the transparency of financial information. MLEs suggested that MAFR improves the perception of transparency and instils greater confidence in users. EAs echoed this sentiment, highlighting that rigorous scrutiny is carried out during rotation, as two different EAs reconfirm all items in a first-year audit, providing users with more assurance of transparency.

However, these findings contradict those of Kim et al. (2015), who suggested a possible decline in the quality of financial reporting attributable to MAFR. It is argued that this decline stems from the new EA's limited understanding of clients, which is crucial for identifying specific risk factors in financial statements.

Supervision and Coordination of Audits:

The findings suggest that MAFR does not significantly impact the supervision of audits, by either audit partners or regulatory authorities. Notably, most respondents (60%)_(15/25) indicated that MAFR has no effect on the supervision of audits by audit partners, in overseeing and reviewing the work conducted by the audit team and by regulatory authorities. They also contended that MAFR does not impact audit team coordination and planning.

However, 12%_(3/25) noted a positive impact on both supervision and coordination, while another 8%_(2/25) noted a negative impact on both aspects. 8%_(2/25) reported a positive impact on supervision alone, while another 8%_(2/25) identified a negative impact on coordination alone. 4%_(1/25) observed a negative impact on coordination but a positive impact on supervision.

The prevailing opinion, shared by MLEs_(12/15) and some EAs_(3/10), was that MAFR has no discernible effect on the supervision and coordination of audits. MLEs highlighted that the inherent difficulties in supervision and coordination apply irrespectively, due to the constant rotation of audit teams. Additionally, EAs pointed out that even without rotation, senior auditors may not supervise or coordinate the same audit in consecutive years.

Conversely, two EAs_(2/10) noted a positive effect on audit supervision in terms of regulatory oversight and in checking that audits are being carried out effectively. One EA_(1/10) pointed out the difficulty in planning resources for coordination while acknowledging the positive aspect of regulatory oversight for supervision.

One EA_(1/10) and one PLC_(1/15) expressed concerns about negative impacts on both coordination and supervision, arguing that the current auditor may coordinate and supervise more efficiently due to previous experience with the client. Another EA_(1/10) and PLC_(1/15) highlighted the initial challenges in coordination, requiring more effort until the team becomes accustomed to the client. This observation substantiates findings by Aschauer and Quick (2018), indicating difficulties for EAs in establishing multiyear audit plans.

Audit Fees:

Additionally, this study revealed mixed views regarding MAFR's impact on audit fees, with a predominant sentiment suggesting an increase in such fees, corroborating Jong *et al.* (2020), but contradicting Ewelt-Knauer *et al.* (2013). In fact, 48% of respondents_(12/25) expressed that MAFR could lead to increased audit fees, while a mere 4%_(1/25) anticipated a decrease in fees. Another 24%_(6/25) believed there would be no impact and an equal percentage (24%)_(6/25) felt that the outcome would depend on specific circumstances.

The majority of MLEs_(8/15) and some EAs_(4/10) suggested that audit fees are likely to rise under MAFR. MLEs noted that in long-standing relationships, auditors may be hesitant to increase fees. However, with rotation, fees tend to align with market rates as EAs might take advantage of MAFR, knowing that MLEs must rotate mandatorily. EAs echoed this view, while also emphasising that audits now entail additional work, particularly in the first year. This is consistent with findings by Harber, Marx *et al.* (2020), who noted that additional costs incurred by audit firms due to rotation are often passed on to clients.

Some MLEs_(3/15) and EAs_(3/10) suggested that the impact of MAFR on fees hinges on specific circumstances. MLEs opined that EAs may either reduce audit fees amidst heightened competition or seize the opportunity to raise fees. EAs expressed similar considerations such as the dilemma of securing renowned clients through negotiations versus increasing prices. They also noted that their revenue from audit fees may decline as clients rotate out, but they expect to offset this through new fees from other services.

Some MLEs_(3/15) and EAs_(3/10) contended that MAFR will have no significant impact on audit fees, aligning with the conclusions drawn by Salehi *et al.* (2022). MLEs argued that any potential increase in fees would be offset by increased competition in the market. Similarly, EAs suggested that fees would remain unchanged or revised regardless of MAFR.

One PLC_(1/15) asserted that there would be a decrease in audit fees, attributing it to competition, as EAs attempt to regain clients for the subsequent ten-year period in tendering.

Competition:

Lastly, the findings imply that MAFR fosters competition, as the majority of respondents (72%)_(18/25) affirmed that MAFR enhances competition, while 28%_(7/25) perceived it to have no effect in this regard. This substantiates research by Hoyle (1978), McLaren (1958) and Polychronidou *et al.* (2020), highlighting a broader distribution of audit engagements among more practitioners.

Most MLEs_(10/15) and EAs_(8/10) suggested that MAFR enhances audit market competition. MLEs emphasised the mandatory increase in the number of companies

changing EAs, leading to a healthier mix of competition among audit firms. EAs concurred, further noting that the primary objective of MAFR is to ameliorate competition.

However, as previously mentioned, MLEs still express a preference for Big-Four audit firms over mid-tier firms, citing reasons such as company size, listing status, public perception and stakeholder comfort. This preference aligns with observations by Ewelt-Knauer *et al.* (2013), Indyk (2019) and Jong *et al.* (2020), indicating the continued dominance of the Big-Four in the market for PIE audits. Moreover, the reluctance to engage mid-tier audit firms may stem from perceived deficiencies in specialised expertise among these firms (Petty and Cuganesan, 1996).

A minority viewpoint among both MLEs_(5/15) and EAs_(2/10) suggested that MAFR will have little to no impact on competition. One PLC cited their limited experience, noting that they received only two offers when tendering. Others reflected on the limited choice within the Maltese market and believed that any initial effects of MAFR on competition will likely diminish over time.

EAs argued that MLEs will predominantly remain with Big-Four firms due to perceived resource limitations among mid-tier firms, despite the potential for increased opportunities. EAs also alluded to a balancing act in which some clients are gained and some are lost, resulting in minimal net change.

These findings raise a question about the extent of MAFR's impact on the dynamism of the audit market, echoing Gerada's (2012) prediction. While MAFR has diversified the audit landscape to some extent, it may not have fully achieved its intended goal of significantly altering the competitive dynamics of the audit market. Mid-tier firms still face barriers to fully participate in PLC audits, indicating that further measures may be needed to promote competition among such EAs.

4.5 MAFR's Implementation in Malta

The findings reveal a significant acclimation to MAFR in Malta, by both MLEs and EAs. With regards to MLEs, a considerable proportion (37.5%)_(6/16) of those interviewed have undergone MAFR or are actively preparing for imminent rotation (18.75%)_(3/16).

Additionally, another 43.75%_(7/16) have rotated auditors for other reasons. It is noteworthy that among the MLEs preparing for rotation, many have never undergone auditor rotation in the past, with audit firm tenures extending up to seventy-six years. This indicates a notable shift driven by regulatory exigencies, highlighting the significant adjustment these MLEs are making in response to regulatory demands.

With regards to EAs, the majority_(8/10) have experienced such rotation, as two respondents have rotated out of engagements, three have rotated into new engagements, two are currently in discussions to rotate out of engagements and one is currently in discussions to rotate into engagements. A few respondents_(2/10) have undergone voluntary rotation only thus far.

These findings offer valuable insights into the extent of MAFR implementation in Malta, highlighting its profound impact on the audit landscape and indicating a potential broader shift towards more frequent rotation practices within the jurisdiction.

4.5.1 Are the Objectives of the EU Audit Reform being Achieved in Malta?

The findings suggest a partial degree of success in the achievement of the objectives set forth by the EU Audit Reform in Malta.

In terms of enhancing audit quality, the outcomes are less favourable, with only 32% of respondents acknowledging MAFR's positive impact in this area. This is consistent with findings from Austria and the Netherlands, where MAFR did not substantially affect perceived audit quality, as noted by Aschauer and Quick (2018) and Jong *et al.* (2020) respectively.

Similarly, the objective focused on improving auditor independence yielded mixed responses, with only 40% recognising MAFR's positive effect on this factor. Comparable findings in France and Austria suggest that MAFR did not significantly impact perceived auditor independence, according to Dattin (2017) and Aschauer and Quick (2018) respectively.

Conversely, the objective related to increased professional scepticism showed more positive outcomes, with 64% of respondents noting a reinforcement in this aspect. This finding aligns with research from the Netherlands, where MAFR was found to reinforce professional scepticism, according to Jong *et al.* (2020).

Regarding the goal of fostering a more dynamic market and strengthening competition, 72% of respondents agreed that competition in the audit market is reinforced. However, this competition primarily occurs among the Big-Four firms, indicating limited broader market dynamics.

Similar observations in Poland and the Netherlands highlight reinforced competition within the dominance of Big-Four firms, as noted by Indyk (2019) and Jong *et al.* (2020) respectively.

Overall, while objectives like professional scepticism and competition enhancement show relatively positive outcomes, there are mixed views regarding audit quality and auditor independence improvement in Malta.

5. Conclusions

This study concludes that Maltese MLEs generally view MAFR favourably, while acknowledging its drawbacks. A notable shift in perspective is evident when compared to earlier findings by Gerada (2012), as MLEs previously opposed MAFR. Such shift suggests that practical experiences with the regulation have challenged MLEs' initial perceptions of MAFR.

Nevertheless, opinions among MLEs regarding the necessity of MAFR remain varied, with some advocating for it, while others deem audit partner rotation sufficient. While some MLEs recognise its benefits, not all would have voluntarily adopted this measure had it not been mandatory. Additionally, MAFR has prompted MLEs to engage in audit tendering, albeit without embracing joint audits and they have also shown a preference for selecting Big-Four firms as their EAs.

Similarly, the study reveals a significant shift in EAs' attitudes towards MAFR, from previous opposition to a more positive view. This change could be attributed to the non-materialisation of anticipated negative effects associated with MAFR. Furthermore, EAs now perceive MAFR as advantageous for their clients, particularly in providing fresh perspectives, despite the additional costs incurred.

Moreover, Big-Four EAs regard MAFR as feasible locally owing to their ample skills and resources to cater to large clients, challenging previous views highlighted in Gerada's (2012) study. However, mid-tier EAs deem MAFR unfeasible due to resource limitations, aligning with the aforementioned prior perspectives. Nonetheless, both Big-Four and mid-tier EAs consider MAFR indispensable in Malta.

Regarding the effects of MAFR, MLEs and EAs perceive increased accountability and appreciation in client-auditor relationships. EAs further express heightened diligence and a stronger commitment to delivering a high-quality service in the later stages of client-auditor relationships. Thus, professionalism is upheld in such relationships. Additionally, certain relationships transform into client-advisor dynamics due to MAFR, as EAs offer non-assurance services to clients rotating outwards to maintain relationships and revenues. Simultaneously, EAs seek and establish new client-auditor relationships to replace prior audit revenue streams.

Moreover, concerns are raised regarding the disruption to the continuity of knowledge and expertise due to MAFR, presenting challenges for MLEs in the initial years of new audits as they are required to re-explain their processes to EAs.

Nonetheless, some MLEs perceive this as an opportunity for novel insights to emerge during the acquisition of fresh knowledge. EAs further noted that due to such disruption, they have to invest additional efforts during the initial years of new audits and also strive to enhance their levels of expertise.

The study also concludes that MLEs and EAs diverge slightly on their perceptions of MAFR's impact on audit quality and independence. While MLEs largely contend that these aspects remain unaffected, EAs partially concur with MLEs, but also note a positive influence on both quality and independence. Furthermore, both groups believe that MAFR strengthens auditor professional scepticism, as new auditors are more likely to challenge existing assumptions.

Additionally, both respondent groups perceive no significant impact on the transparency of financial information and supervision and coordination of audits. They argue that transparency is primarily driven by adherence to financial reporting standards and that supervision and coordination challenges persist regardless of MAFR. Conversely, both groups observe increased audit fees and intensified competition. Fee increases result from EAs' greater flexibility in revisions and added workload.

Competition has primarily intensified among Big-Four firms, as mid-tier firms struggle to secure PLC clients due to resource limitations and MLEs' preference for Big-Four auditors. Comparing the findings with the objectives of the EU Audit Reform, increased professional scepticism and competition are perceived as achieved locally. However, audit quality and auditor independence remain unaffected, since they are considered to be already fulfilled.

In conclusion, MAFR has brought about a significant shift within the local audit landscape. This study highlights the acceptance of MAFR, emphasising that while change is challenging, it can ultimately lead to enhanced service delivery and diversified expertise.

As expressed by a PLC representative, the initial resistance towards change gradually dissipates, leading to the realisation that *"maybe they should not be so afraid of change after all."* Similarly, an EA aptly concludes that *"while such change does not always go down well, its long-term benefits are indispensable."*

References:

General

- Accountancy Europe. 2022-last update, Mandatory rotation of auditors – streamlining European countries' Audit rules [Homepage of Accountancy Europe], [Online]. Available: https://www.accountancyeurope.eu/wp-content/uploads/Audit-Rotation-2022_Accountancy_EU.pdf.
- Anis, A. 2014. Auditors' Perceptions Of Audit Firm Rotation Impact On Audit Quality In Egypt. *Accounting and Taxation*, 6(1), pp. 115-116.
- Arel, B., Brody, R.G., Pany, K. 2005. Audit firm rotation and audit quality. *The CPA journal* (1975), 75(1), pp. 36-39. DOI: 10.1016/S0882-6110(06)22001-7.

- Aschauer, E., Quick, R. 2018. Mandatory audit firm rotation and prohibition of audit firm-provided tax services: Evidence from investment consultants' perceptions. *International journal of auditing*, 22(2), pp. 131-149. DOI: 10.1111/ijau.12109.
- Bamber, E.M., Iyer, V.M. 2007. Auditors' identification with their clients and its effect on auditors' objectivity. *Auditing: a journal of practice and theory*, 26(2), pp. 1-24. DOI: 10.2308/aud.2007.26.2.1.
- Blouin, J., Grein, B.M., Rountree, B.R. 2007. An Analysis of Forced Auditor Change: The Case of Former Arthur Andersen Clients. *The Accounting review*, 82(3), pp. 621-650. DOI: 10.2308/accr.2007.82.3.621.
- Casterella, J.R., Johnston, D. 2013. Can the academic literature contribute to the debate over mandatory audit firm rotation? *Research in accounting regulation*, 25(1), pp. 108-116. DOI: 10.1016/j.racreg.2012.11.004.
- Chi, W., Liscic, L.L., Pevzner, M. 2011. Is enhanced audit quality associated with greater real earnings management? *Accounting horizons*, 25(2), pp. 315-335. DOI: 10.2308/acch-50082.
- Choudhury, F. 2016. Mandatory Audit Firm Rotation - Are We Going 'Round in Circles'? *Supporting International Standards*, 1, pp. 1.
- Dattin, C.F. 2017. Developments in France regarding the mandatory rotation of auditors: Do they enhance auditors' independence? *Accounting history*, 22(1), pp. 44-66. DOI: 10.1177/1032373216674968.
- Defond, M.L., Francis, J.R. 2005. Audit Research after Sarbanes-Oxley. *Auditing: a journal of practice and theory*, 24(1), pp. 5-30. DOI: 10.2308/aud.2005.24.s-1.5.
- European Commission. 2016-last update, Fact Sheet Reform of the EU Statutory Audit Market - Frequently Asked Questions (Homepage of European Commission). https://ec.europa.eu/commission/presscorner/detail/fr/MEMO_16_2244.
- Ewelt-Knauer, C., Gold, A., Pott, C. 2013. What Do We Know About Mandatory Audit Firm Rotation? *Accountancy Ireland*, 45(1), pp. 91.
- Fathi, E., Rashed, A.S. 2021. Exploring the Impact of Mandatory Audit Firm Rotation on Audit Quality: An Empirical Study. *Academy of Accounting and Financial Studies journal*, 25(6), pp. 1-18.
- Fontaine, R., Khemakhem, H., Herda, D.N. 2016. Audit committee perspectives on mandatory audit firm rotation: evidence from Canada. *Journal of management and governance*, 20(3), pp. 485-502. DOI: 10.1007/s10997-015-9308-2.
- Garcia-Blandon, J., Argilés-Bosch, J.M., Ravenda, D., 2020. Audit firm tenure and audit quality: A cross-European study. *Journal of international financial management & accounting*, 31(1), pp. 35-64. DOI: 10.1111/jifm.12098.
- Gerada, A. 2012. The applicability of mandatory audit firm rotation in Maltese public limited companies. B. ACCTY. (HONS) Dissertation, Malta: University of Malta. Available: <https://www.um.edu.mt/library/oar/handle/123456789/5373>.
- Harber, M., Maroun, W. 2020. Mandatory audit firm rotation: a critical composition of practitioner views from an emerging economy. *Managerial auditing journal*, 35(7), pp. 861-896. DOI: 10.1108/MAJ-09-2019-2405.
- Harber, M., Marx, B., De Jager, P. 2020. The perceived financial effects of mandatory audit firm rotation. *Journal of international financial management & accounting*, 31(2), pp. 215-234. DOI: 10.1111/jifm.12115.
- Hoyle, J. 1978. Mandatory auditor rotation: The arguments and an alternative. *Journal of accountancy*, 145(5), pp. 69-78.

- Indyk, M. 2019. Mandatory audit rotation and audit market concentration—evidence from Poland. *Economics and business review*, 5(4), pp. 90-111. DOI: 10.18559/eb.2019.4.5
- Jackson, A.B., Moldrich, M., Roebuck, P. 2008. Mandatory audit firm rotation and audit quality. *Managerial Auditing Journal*, 23(5), pp. 420-437. DOI: 10.1108/02686900810875271.
- Jong, B.J., Hijink, J.B.S., Veld, L. 2020. Mandatory Audit Firm Rotation for Listed Companies: The Effects in the Netherlands. *European business organization law review*, 21(4), pp. 937-966. DOI: 10.1007/s40804-020-00193-w.
- Kim, H., Lee, H., Lee, J.E. 2015. Mandatory Audit Firm Rotation and Audit Quality. *Journal of Applied Business Research (JABR)*, 31(3), pp. 1089-1106. DOI: 10.19030/jabr.v31i3.9245.
- KPMG. 2022. Audit tenders: Survey of CFOs and audit committee chairs. KPMG Board Leadership Centre.
- Malta Business Registry, 2023-last update, Limited Liability Companies (Homepage of Malta Business Registry). Available: <https://mbr.mt/limited-liability-companies/>.
- Mclaren, N.L. 1958. Arguments for rotation. *Journal of accountancy*, 106(1), pp. 41.
- Myers, J.N., Myers, L.A., Omer, T.C. 2003. Exploring the Term of the Auditor-Client Relationship and the Quality of Earnings: A Case for Mandatory Auditor Rotation? *The Accounting review*, 78(3), pp. 779-799. DOI: 10.2308/accr.2003.78.3.779.
- Nagy, A.L. 2005. Mandatory audit firm turnover, financial reporting quality, and client bargaining power: The case of Arthur Andersen. *Accounting horizons*, 19(2), pp. 51-68. DOI: 10.2308/acch.2005.19.2.51.
- O’leary, C. 1996. Compulsory rotation of audit firms for public companies? *Accountancy Ireland*, 1, pp. 1.
- Orlik, R. 2011-last update. 87% of CFOs support mandatory auditor rotation (Homepage of Accountancy Age). Available: <https://www.accountancyage.com/2011/10/24/87-of-cfos-support-mandatory-auditor-rotation/>.
- Petty, R., Cuganesan, S. 1996. Auditor rotation: Framing the debate. *Intheblack*, 66(4), pp. 40.
- Polychronidou, P., Drogalas, G., Tampakoudis, I. 2020. Mandatory rotation of audit firms and auditors in Greece. *International journal of disclosure and governance*, 17(2-3), pp. 141-154. DOI: 10.1057/s41310-020-00080-3.
- Salehi, M., Zimon, G., Tarighi, H., Gholamzadeh, J. 2022. The Effect of Mandatory Audit Firm Rotation on Earnings Management and Audit Fees: Evidence from Iran. *Journal of risk and financial management*, 15(3), pp. 102. DOI: 10.3390/jrfm15030102.
- Şeker, Y., Türel, A. 2023. Mandatory Audit Firm Rotation: Evidence From Turkish Auditors’ Perceptions. *Sosyal Bilimler Enstitüsü Dergisi*, 13(1), pp. 46-47. DOI: 10.30783/nevsosbilen.1065187.
- Smith, J.A. 1995. *Semi-Structured Interviewing and Qualitative Analysis*. London: SAGE Publications Limited.
- Stefaniak, C.M., Robertson, J.C., Houston, R.W. 2009. The Causes and Consequences of Auditor Switching: A Review of the Literature. *Journal of accounting literature*, 28, pp. 47-121.
- Whiting, L.S. 2008. Semi-structured interviews: guidance for novice researchers. *Nursing standard*, 22(23), pp. 35-40. DOI: 10.7748/ns2008.02.22.23.35.c6420.

Regulatory:

Directive (EU) 2014/56/EU of the European Parliament and of the Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. 2014. Directive edn. Strasbourg: Official Journal of the European Union.

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC Text with EEA relevance. 2014. Regulation edn. Strasbourg: Official Journal of the European Union.

Sarbanes-Oxley Act of 2002: conference report (to accompany H.R. 3763). 2002. Federal Act edn. United States of America.

ANNEX:

Interview Schedule for Public Limited Company Representatives

Preamble:

The European Union Audit Reform of 2014 introduced mandatory audit firm rotation (MAFR) in Malta by way of a Directive and Regulation, as a response to the global financial crisis of 2008. Article 17(1) of the regulation states that the audit tenure for auditors of public interest entities shall not exceed 10 years (or 20 years in the case of tenders or 24 years in the case of joint audits) and in exceptional circumstances, may be extended for an additional two years pursuant to the request of the entity being audited to national regulators.

Section A: General Questions

1. Could you give a brief description of your role within the company?
2. How long have you been in this position?
3. How long has your company been engaging with the current external audit firm?
4. Have you previously been audited by different firms due to MAFR or other reasons?

Section B: Perceptions on Mandatory Audit Firm Rotation (MAFR)

5. What are your thoughts on MAFR as a regulatory requirement?
 - a. Has it proven to be beneficial, detrimental, or neutral?
 - b. Are there any concerns or challenges you foresee in rotating auditors?
 - c. Do you think that it was a necessary mechanism or audit partner rotation would have sufficed?
6. Had MAFR not been implemented in Malta, would you still have chosen to rotate auditors voluntarily?

Section C: The implications of Mandatory Audit Firm Rotation (MAFR) on Audit Relationships and Client-Auditor Interactions

7. How do you think MAFR affects the relationship between your company and the external auditors?
8. Do you believe that MAFR has enhanced or compromised the audit service delivered?
9. How do you think the continuity of knowledge and expertise is affected by MAFR?

Section D: The implications of Mandatory Audit Firm Rotation (MAFR) on Audit (and other)

Factors

10. How do you believe MAFR would affect each of the following?
 - a. Audit quality
 - b. The transparency of financial information
 - c. Auditor independence
 - d. Auditor professional scepticism
 - e. Audit market competition/concentration
 - f. Supervision and coordination of statutory audits
 - g. Audit fees
11. Do you believe MAFR has an impact on any other factor not mentioned above?

Section E: Future Perspectives and Recommendations

12. From your company's standpoint, how do you plan to adapt to the requirements of MAFR? Is it likely that you would opt for a joint audit or audit tendering in order to lengthen the audit tenure?
13. What factors would you consider when selecting a new audit firm after rotation?
14. Would you consider opting for a small audit firm rather than a Big Four audit firm?
15. After completing the first auditor rotation would you consider rotating back to the original auditor or rather a new auditor?
16. Based on your insights and experiences, do you have any recommendations for policymakers or auditors to improve the implementation of MAFR?
17. Do you have any other comments you believe to be pertinent to this study?

Interview Schedule for External Auditors

Preamble:

The European Union Audit Reform of 2014 introduced mandatory audit firm rotation (MAFR) in Malta by way of a Directive and Regulation, as a response to the global financial crisis of 2008. Article 17(1) of the regulation states that the audit tenure for auditors of public interest entities shall not exceed 10 years (or 20 years in the case of tenders or 24 years in the case of joint audits) and in exceptional circumstances, may be extended for an additional two years pursuant to the request of the entity being audited to national regulators.

Section A: General Questions

1. Could you give a brief description of your role within the audit firm?
2. For how long have you had a client-facing role as an auditor of MLEs?
3. During this period have you been involved in audit engagements that were subject to mandatory audit firm rotation? If yes, how many and what were your experiences?

Section B: Perceptions on Mandatory Audit Firm Rotation (MAFR)

4. What do you perceive as the main benefits and challenges of MAFR for auditors and the profession?
5. Do you think that the "fresh look" that new auditors would provide has more benefits than costs for the client?
6. How do you believe MAFR affects the client-auditor relationship?
7. Have you noticed any changes in client cooperation or willingness to share information after implementing MAFR?

8. Do you think that the continuity of knowledge and expertise is affected by MAFR?
If so, how?

Section D: The implications of Mandatory Audit Firm Rotation (MAFR) on Audit (and other)

Factors

9. How do you think MAFR impacts each of the following?
 - a. The quality of audits
 - b. Auditor independence and threats thereto
 - c. Professional scepticism
 - d. Audit fees
 - e. The transparency of financial information
10. Do you believe that MAFR has improved the supervision and coordination of statutory audits?
11. In relation to audit market concentration, how do you believe MAFR has impacted audit market competition:
 - a. Between the Big Four audit firms?
 - b. Between the Big Four audit firms and mid-tier or smaller firms?
12. In a 2012 local study, it was found that “such a system might not be feasible to Malta due to the limited number of local audit firms with the necessary resources to audit certain large clients”. A decade later, would you still agree with this statement?
13. Do you believe MAFR has an impact on any other factor not mentioned above?

Section E: Future Perspectives and Recommendations

14. Do you consider MAFR to be unnecessary and audit partner rotation only would have been sufficient?
15. Would you consider the overall effects of MAFR to be positive or negative? Why?
16. From your experience, how can auditors effectively adapt to the challenges posed by MAFR?
17. Do you have any other comments you believe to be pertinent to this study?