

Discretionary Accruals, Audit-Firm Tenure and Auditor Tenure: An Empirical Case in Taiwan

Wuchun Chi

National Chengchi University

Huichi Huang

National Taiwan University

ABSTRACT: In this paper, we examine how audit tenure affects earnings quality. Specifically, we measure two kinds of auditor-client relationship, *auditor tenure* and *audit-firm tenure*, to represent the rotation effect “within” and “between” audit firms by Taiwan data. We have three major findings. First, either from the view of audit-firm tenure or auditor tenure, familiarity is helpful in auditing process to produce higher earnings quality, but excessive familiarity results in lower earnings quality. Second, Big 5 auditors are superior in obtaining learning experience in the initial period of engagement and hence improve earnings quality. It implies that the negative effect on earnings quality is more serious in the clients of non-Big 5 auditors if mandatory auditor rotation of audit firms were put into practice. Finally, when we jointly incorporate audit-firm tenure and auditor tenure into analysis, the results show that audit-firm tenure plays the key role in the transition of learning experience. We regard the empirical results as valuable reference to the regulator even though the results of the analysis origins from a non-mandatory auditor rotation regime.

Key Words: *Audit-Firm Tenure, Auditor Tenure, Earnings Quality, Mandatory Rotation*