THE IMPLICATIONS OF MANDATORY AUDIT FIRM ROTATION IN MALTESE PLCS

BY

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Abstract

TITLE: The Implications of Mandatory Audit Firm Rotation in Maltese PLCs

PURPOSE: The objectives of this study involved determining the implications of mandatory audit firm rotation (MAFR) on Maltese Public Limited Companies (PLCs) by examining the perspectives of listed PLCs and external auditors (EAs) regarding this regulatory measure. Moreover, it aimed to identify the specific audit factors influenced by audit firm rotation, evaluating whether MAFR exerted a positive or negative influence on these factors.

DESIGN: A qualitative research methodology was employed through twenty-five semi-structured interviews. These comprised fifteen representatives from listed Maltese PLCs, five EAs from Big-Four firms and five EAs from mid-tier firms.

FINDINGS: While PLCs demonstrate a predominantly favourable view of MAFR, there remains a nuanced perspective regarding its necessity. EAs also exhibit a positive sentiment towards MAFR, perceiving it as vital for PLCs, despite resource challenges for mid-tier firms. Both respondent groups attributed the enhancement of client-auditor relationships, the disruption to knowledge continuity and the increase in audit fees to MAFR. This regulation is perceived to minimally affect audit quality and independence but positively influence scepticism and competition, particularly among Big-Four firms. Lastly, financial transparency and audit supervision and coordination are deemed unaffected.

CONCLUSIONS: While the European Union (EU) Audit Reform sought to implement MAFR to ameliorate auditor independence, audit quality and audit market competition, only the latter factor appears to be strengthened in the local scenario, as independence and quality are already inherent.

VALUE: This study seeks to raise awareness on the implications of MAFR in the local scenario. It also explores whether particular objectives of the EU Audit Reform (which mandates firm rotation for PLCs) are being achieved in Malta.

KEYWORDS: Mandatory Audit Firm Rotation, Maltese Public Limited Companies, European Union Audit Reform, External Audit

Dedication

To my beloved grandparents, now also guiding me from heaven, whose unconditional love, guidance and wisdom remain my beacon of inspiration.

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List of Abbreviations

CFO	Chief Financial Officer
EA	External Auditor
EEA	European Economic Area
EU	European Union
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
MAFR	Mandatory Audit Firm Rotation
MFIN	Ministry For Finance
MSE	Malta Stock Exchange
PIE	Public Interest Entity
PLC	Public Limited Company

Chapter 1

Introduction

1.1 Introduction

The aim of this chapter is to introduce the dissertation and provide a foundation for the research undertaken. As presented in Figure 1.1, the background to the topic is presented in Section 1.2, which is divided into two subsections that explore pertinent concepts which are necessary for comprehending the research conducted. Section 1.3 discusses the motivations behind the study and Section 1.4 outlines the research objectives. The scope and limitations to the study are identified in Section 1.5. Lastly, Section 1.6 offers an overview of the entire study.

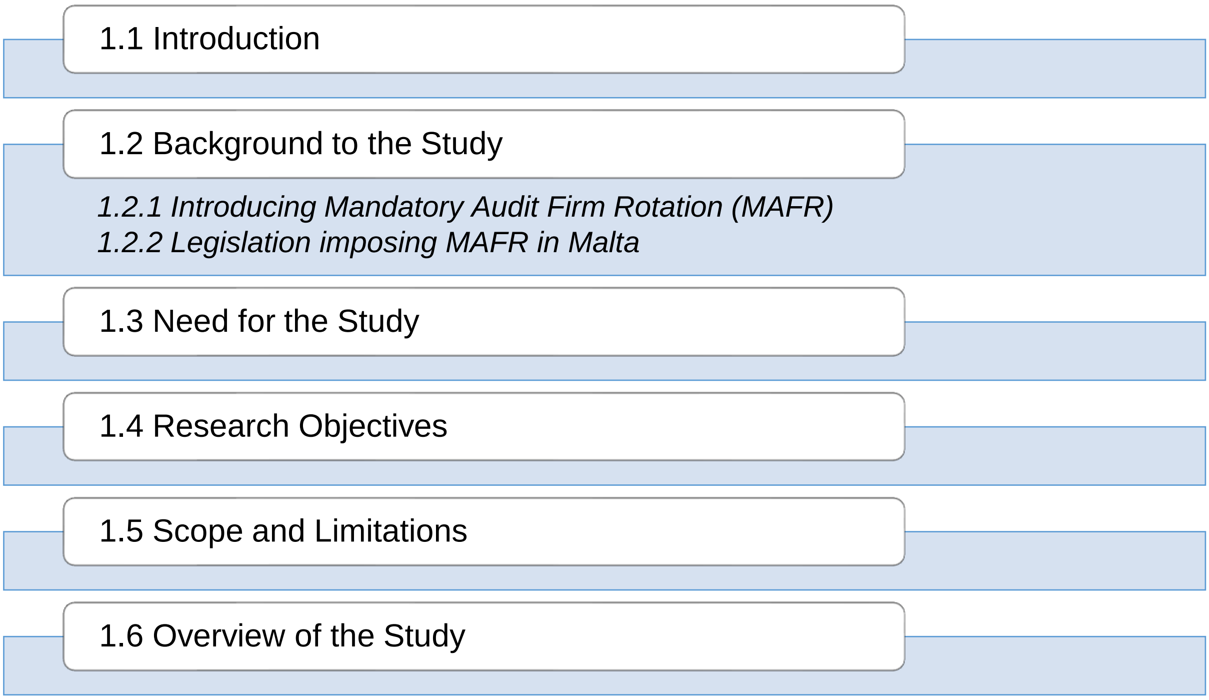

Figure 1.1: Overview of Chapter 1

1.2 Background to the Study

1.2.1 Introducing Mandatory Audit Firm Rotation

Auditor rotation has its inception in the late 1930s when the concept was initially introduced in America in response to the McKesson Robbins scandal, where Price Waterhouse failed to detect considerable misstatements in McKesson Robbins' financial statements (Barton 2002). This concept was not legally imposed but rather a temporary market response to such scandal and similar controversies. However, while auditor rotation has not been enforced in the United States to this date, it has been mandated in Europe in recent years. In fact, auditor rotation was introduced within the European Union (EU) in 2014 and was made mandatory in 2016, through the EU Audit Reform (European Commission 2016).

Mandatory audit firm rotation (MAFR) is commonly referred to as the requirement for companies to replace their external auditors (EAs) following a defined time period (Accountancy Europe 2022). Similarly, the Sarbanes-Oxley Act of 2002 of the United States defines this concept as the implementation of a limitation on the period during which a specific audit firm can serve as the EA for a particular corporation (Sarbanes-Oxley Act of 2002: conference report (to accompany H.R. 3763) 2002).

MAFR has gained international attention and is being implemented in numerous jurisdictions, with the intention of promoting robust auditing practices and maintaining trust in financial reporting (Augustsson, Österlind 2017). The notion of MAFR aims to address one of the most significant threats to audit independence, this being the familiarity threat (Accountancy Europe 2022). Such a threat arises as a result of a prolonged client-auditor relationship, as this fosters a personal relationship between the client and the auditor, thus compromising the independence of the auditor in mind and in appearance (Bamber, Iyer 2007). Therefore, MAFR aims to strengthen auditor independence (Hussey 1999).

In addition to reinforcing independence, the International Federation of Accountants (IFAC) has agreed that MAFR also enhances investor protection (Choudhury 2016). Furthermore, as will be elucidated further on, numerous academics have also drawn connections between MAFR and enhanced audit quality.

Nevertheless, MAFR is not devoid of criticism and controversy. In fact, this dissertation will highlight the various arguments favouring and opposing the concept, as well as ongoing debates surrounding the effectiveness and drawbacks of MAFR.

1.2.2 Legislation imposing MAFR in Malta

The EU Audit Reform, published in 2014, comprises Directive 2014/56/EU (2014) and Regulation (EU) No 537/2014 (2014). This legislation came into force on 17th June 2016 and it is thought to be one of the most pertinent changes to the framework of statutory audits of public listed companies. Such reform contemplates various aspects, one of which is the MAFR for public interest entities (PIEs).

Article 1.2.f of the Audit Directive, being Directive 2014/56/EU (2014), defines PIEs as follows:

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 public limited companies (PLCs) are defined as companies with limited liability, whose shares can be offered to the public and subsequently traded freely (Malta Business Registry 2023). As such, Maltese listed PLCs, being the focus of this study, fall within the above-mentioned definition of PIEs under point (a). Therefore, such listed PLCs must comply with legislation applying to PIEs, such as MAFR.

Article 17(1) of the aforementioned regulation, being Regulation (EU) No 537/2014 (2014), articulates the time period for which PIEs shall appoint a statutory auditor or audit firm. The audit tenure in such instances shall:

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.

Moreover, in exceptional circumstances, the audit term may be extended for an additional two years pursuant to the request of the entity being audited to national regulators.

The main intent of this reform, specifically through the inclusion of MAFR, is to "*contribute to a better audit quality*" as threats of familiarity are mitigated (European Commission 2016, p. 4). As aforementioned, this is primarily due to the concern that lengthy client-auditor relationships may reduce auditor independence and professional scepticism.

In addition, this legislation also aims 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.

1.3 Need for the Study

Ever since MAFR was introduced in Malta in 2016, there has been no research in the local context about the effects and implications of this concept on the affected stakeholders. Thus, this study brings to light the consequences of the implementation of mandatory EA rotation.

This research is of significant importance as current and previous studies contemplating the EU Audit Reform have not yet indicated whether the stated objectives of such reform are actually being met in the local scenario through the introduction of MAFR. In other words, research ought to be conducted to understand whether the implementation of MAFR leads to the amelioration of the said audit factors highlighted in Section 1.2.2.

Moreover, this research builds upon the work of Gerada (2012), who analysed the applicability of MAFR in Malta in order to decipher whether the merits and demerits of this concept were precisely forecasted. Briefly, such study had concluded that MAFR will fail to add dynamism in the local audit market and it is not a feasible concept due to the limited number of audit firms in Malta. Various advantages and disadvantages were also mentioned, but it is worthy to note that such inferences were formed over a decade ago and, as such, may or may not still apply in the contemporary scenario. Therefore, this study is key to addressing such dilemma.

Furthermore, numerous studies on the effects of MAFR were also conducted throughout the EU in recent years. Hence, the findings of this study could be compared to those of other member states in order to identify any similitude with the rest of the EU.

Lastly, this study may be of interest to various stakeholders, namely regulators, who may review the implications of MAFR in Malta to inform decision-making and policy-refinement. Academics and the local accountancy profession, such as the Malta Institute of Accountants and the Accountancy Board, may also find this study enriching.

1.4 Research Objectives

This study has three primary objectives which focus on determining the implications of MAFR on Maltese PLCs. These constitute the following:

a) To examine the perspectives of Maltese listed PLCs on MAFR in order to determine the perceived effects of such concept;
b) To examine the views of EAs of such PLCs regarding the implications of MAFR; and
c) To identify which audit factors are affected by audit firm rotation and whether positively or negatively.

1.5 Scope and Limitations

The leading constraints of this study revolve around participation. Due to time restrictions, participants to the study were limited only to Maltese listed PLCs, particularly focusing on equity-listed PLCs[1]. Efforts were made to obtain a good participation rate, such as contacting respondents through emails as well as via telephone and following up within reasonable time periods. The aforementioned PLCs were contacted to participate in the study, however not all PLCs agreed to participate.

Furthermore, while all of the Big-Four audit firms agreed to participate in this research, not all mid-tier audit firms volunteered to take part.

1.6 Overview of the Study

The dissertation outline, consisting of six chapters, is summarised below.

Chapter One provides an introduction to the study by defining the concept of MAFR and accompanying legislation. The chapter further highlights the rationale for the study, presents the objectives of the research and acknowledges any relevant limitations.

Chapter Two analyses national and international literature pertaining to studies conducted on MAFR. This comprehensive examination serves as a basis for assessing the potential implications of MAFR in the local scenario, in the context of PLCs and the various audit factors being influenced as a result.

Chapter Three specifies the appropriate research methodology which was adopted to address the objectives of the study and gives a thorough description of the data collection and analysis methods employed.

Chapter Four reports the qualitative findings of the study, demonstrating the perceptions of local EAs and PLCs regarding MAFR, as well as identifies the affected audit factors.

Chapter Five provides an exhaustive discussion on the research findings. This involves analysing the resulting findings and comparing them to the literature

[1] Vide Appendix 1.1 for the list of Maltese Listed Public Limited Companies

explored in Chapter Two, aiming to determine any affiliation or deviation between results.

Chapter Six concludes the study by summarising the key findings, offers recommendations for future research endeavours and presents final remarks on the overall research.

Chapter 2

Literature Review

2.1 Introduction

This chapter examines both local and international contemporary literature on the implications of MAFR so as to address the research objectives previously outlined. Section 2.2 provides an in-depth background on audit regulation, highlighting the benefits and challenges of MAFR. Subsequently, Section 2.3 investigates the contrasting perceptions towards MAFR, both by PLCs and EAs. Section 2.4 discusses the impact of audit rotation on various audit factors and finally, Section 2.5 concludes this chapter. Figure 2.1 provides an illustration of the above-mentioned.

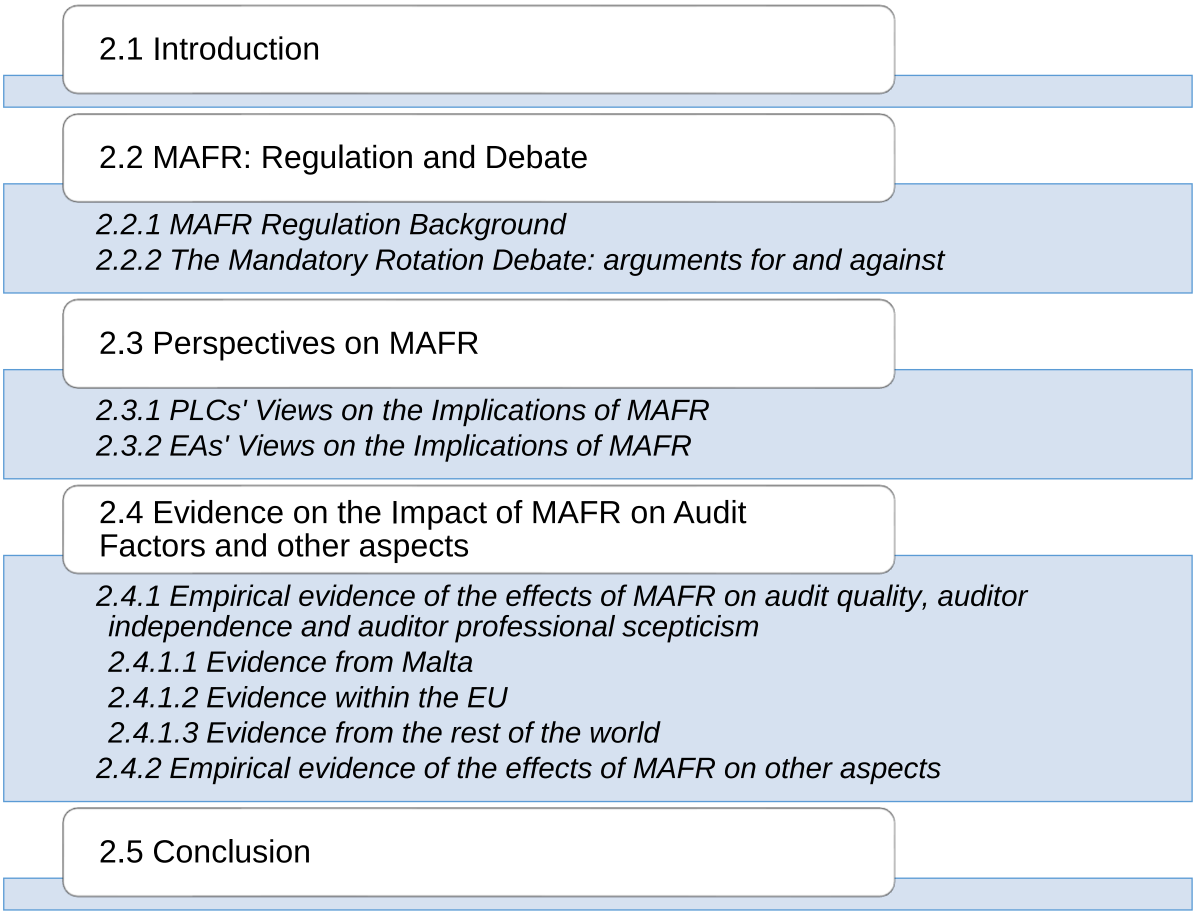

Figure 2.1: Overview of Chapter 2

2.2 MAFR: Regulation and Debate

2.2.1 MAFR Regulation Background

Statutory auditors aim to certify firms' financial statements by issuing an opinion on the truth and fairness of their accounts. A wide range of stakeholders rely on such an opinion, suggesting that auditing promotes the orderly functioning of markets through enhancing financial statement integrity and efficiency. In fact, the pertinence of an accurate and valid audit opinion is highlighted through the legislation regulating statutory audits.

The EU Audit Reform of 2014 is perceived to be one of the most pertinent reforms in Europe in relation to the undertaking of statutory audits. Such regulation was introduced to address the many shortcomings recognised in the statutory audit market, such as reported misstatements, decreased investor confidence, threats to independence (particularly familiarity threats), audit market concentration and systemic risk (European Commission 2016). The European Commission also stated that such audit legislation forms part of its reaction to the 2008 global financial crisis. In fact, proposals for this reform were issued subsequent to a public consultation in 2011 and ultimately adopted by the Council and Parliament in 2014.

MAFR was introduced in Malta through this reform in 2016, as well as in twenty-seven other member states across Europe and in the three European Economic Area (EEA) countries. As aforesaid, the EU Audit Reform took the form of a Directive and a Regulation. The former amended the Statutory Audit Directive of 2006, whereas the latter provided for additional obligations for PIEs, such as the imposition of MAFR. Other revolutions included changes to the duties and roles of audit committee members, a limitation on the provision of non-audit services and other changes to the oversight regime.

In a nutshell, the European Commission insists that MAFR is necessary to "*reduce excessive familiarity between the statutory auditor and its clients, limit the risks of carrying over repeated inaccuracies, and encourage fresh thinking, thus strengthening the conditions for genuine professional scepticism*" (European

Commission 2016, p. 4, para. 3). As such, it would contribute to enhanced audit quality.

In the local context, well before the EU Audit Reform was implemented in Malta, the Accountancy Board in collaboration with the Ministry for Finance had described their views on MAFR in a memorandum on a proposal for a regulation. Their perceptions differed from those of the EU, as they expressed the following:

> *"Mandatory rotation interferes with companies' and shareholders' freedom to decide. It has been discredited by various studies which point to the dangers of an auditor who is not yet fully conversant with the business of its client, a point that is particularly important in larger groups. If applied properly, it would lead to an increase in costs as the incoming auditor invests to get to know its new client. Where it has been applied, however, the effect has often been a savage undercutting of fees that has in consequence diluted, not strengthened, the quality of audits."*
>
> (MFIN Memorandum COM (2011)779 2013, p. 5, para. 3.1.3)

2.2.2 The Mandatory Rotation Debate: arguments for and against

Various literature, including both classic and contemporary, examine the benefits of MAFR for both auditors and clients.

The majority of arguments in favour of MAFR primarily revolve around the beneficial effect on audit quality. The predominant assertion is that MAFR contributes to improved audit independence and the overall quality of audits (Petty, Cuganesan 1996; Polychronidou et al. 2020). In the absence of MAFR, long-term client-auditor relationships may compromise the EA's independence as auditors may become more aligned with the interests of management in lieu of the interest of the public. Moreover, since audit quality diminishes over time, long tenures may result in the impairment of auditor objectivity and professional scepticism. As such, MAFR aims to avert the development of such subconscious partialities (Hoyle 1978).

MAFR is also advocated for its potential to offer a fresh perspective on clients' financial statements. In fact, this mechanism increases the likelihood of detecting and rectifying errors that may have been disregarded by the previous audit firm (McLaren 1958, Polychronidou et al. 2020). Furthermore, as auditors become increasingly acquainted with a firm’s financial statements, systems and controls, their level of creativity may diminish. This familiarity, along with the use of standard audit programs to assess a firm’s financial statements and internal controls, can lead to a predictable and less effective audit approach (Hoyle 1978).

In addition, succeeding auditors 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, Quick 2018; Hoyle 1978).

Another argument in support of MAFR is that it results in increased competition among audit firms through an enhanced distribution of 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).

Additionally, MAFR is argued to break the economic bond or reduce the economic dependence between auditors and clients (Arel et al. 2005, Polychronidou et al. 2020). In other words, it precludes management from using the threat of engagement termination when an auditor modifies the audit opinion.

Lastly, the regulator imposing MAFR has conveyed its prominent advantages, which also align with the views of many authors. Indeed, the European Commission expressed that MAFR is useful in diminishing undue familiarity, mitigating the risks of recurring errors and promoting innovative perspectives (European Commission 2016). As a result, such rule contributes to increased professional scepticism, enhances the quality of audits and should result in a more dynamic market (European Commission 2016).

Despite the significant support for the advantages of MAFR, various opponents within the accountancy profession raise objections to its merit.

A number of academics argue that MAFR presents additional audit costs to the main stakeholders. Extra costs are incurred by the audit firm in terms of understanding the client, whereas the client suffers extra costs through time, effort for switching, uncertainty and other information costs (Fontaine et al. 2016, Jong et al. 2020, Polychronidou et al. 2020). Furthermore, it is claimed that MAFR results in significant low-balling, meaning that auditors charge a small fee in the early years of the engagement so as to attract potential clients and subsequently increase fees over time (Jong et al. 2020).

In addition, although MAFR is debated to ameliorate competition, other academics argue that this mechanism would rather give rise to increased market concentration, as large companies tend to opt for Big-Four audit firms when changing auditors, resulting in decreased competition (Ewelt-Knauer et al. 2013). Another similar view is that MAFR may not achieve the anticipated infusion of dynamism (Gerada 2012). This trend contrasts with the EU Audit Reform goal of promoting competition and access to smaller audit firms. 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 audit firms*” (Jong et al. 2020, p. 18).

Furthermore, MAFR may also worsen the challenge of the scarcity of available audit firms, particularly for bigger corporations seeking specialised industry expertise (Petty, Cuganesan 1996).

Others argue that MAFR results in an increased likelihood of errors in first-year audits, which may occur in the transition and adjustment period for new auditors (Jong et al. 2020). Moreover, concerns are raised regarding a possible decline in the quality of financial reporting, as new auditors may have limited understanding of clients’ businesses and industries (Kim et al. 2015).

Additionally, Jackson, Moldrich et al. (2008) claim that the benefits emanating from MAFR may be limited, especially when considering the additional costs correlated with auditor switching, overall having a detrimental effect on the market.

Lastly, MAFR may also pose challenges for auditors in setting up multiyear audit plans and decreases motivation for auditors to invest in industry expertise (Aschauer, Quick 2018).

2.3 Perspectives on MAFR

2.3.1 PLCs' Views on the Implications of MAFR

In the national context, a preliminary study by Gerada (2012) focused on the applicability of MAFR in Malta and extracted the views of PLCs on the matter at that time. This research concluded that PLCs are of the opinion that most of the additional costs created through MAFR would be absorbed by themselves rather than by audit firms. Such additional costs were predicted to be suffered in selecting and supporting the audit firm rotation. Furthermore, such study found that, overall, PLCs are more likely to resist audit firm rotation rather than implement it on a voluntary basis within their company, except in cases of conflict of interest. This statement suggests that the majority of Maltese PLCs opposed audit firm rotation, implying an antagonism to MAFR.

The concept of additional costs also sprouts overseas. A peer-reviewed study by Harber and Maroun (2020), which was conducted with practitioners, chief financial officers (CFOs) and audit committee members of Johannesburg Stock Exchange listed companies, captured the views on the effects of MAFR. From this study it was concluded that, both CFOs and audit committees, as well as auditors, believe MAFR will result in needless costs. For audit clients, such costs take the form of research and tendering costs, whereas for EAs, additional costs comprise unfamiliarity costs (Harber, Maroun 2020).

Another peer-reviewed study found that audit committee members of publicly listed companies are "*adamantly opposed to MAFR*" and perceive it as "*an unnecessary intervention*" (Fontaine et al. 2016, p. 487). Research participants, consisting of audit committee members of Canadian publicly listed corporations, viewed MAFR as an intimidation to their authority to appoint auditors. In fact, such participants believe that the best means to ensure auditor independence depends upon their own professional judgement as well as observation and communication with the auditor. The vast majority of the respondents agreed that audit partner rotation was more desirable as audit firms are able to transition client knowledge and understanding more effectively and maintain the client-auditor relationship (Fontaine et al. 2016).

Despite the various negative perceptions on MAFR, several surveys show that CFOs and audit committee members support this enforcement. A European survey found that 87% of participants support MAFR and the majority advocated for a rotation period of three years (Orlik 2011). Additionally, a survey conducted by KPMG UK discovered that CFOs and audit committee members of the FTSE Index viewed MAFR as a positive development (KPMG 2022). An earlier survey conducted by O'Leary (1996) among three hundred Australian companies revealed that 63% of PLCs view MAFR as beneficial in enhancing the perception of independence.

Overall, the prominent views of PLCs towards MAFR appear to be mixed. Some believe it to be unnecessary and causes them to incur additional costs to support the rotation, whereas others perceive it to be a beneficial change.

2.3.2 EAs' Views on the Implications of MAFR

Gerada (2012) also focused her research on EAs, showing that locally similar views were shared between audit firms and PLCs at the time of her study. Findings revealed that less than 15% of audit firms agreed that MAFR should be implemented in Malta. Audit firms also argued that MAFR might not be practicable locally due to the restricted number of audit firms with the adequate resources to deliver an appropriate audit service to large clients. However, the perspectives of auditors and PLCs differed in relation to costs. Contrary to the view of PLCs, audit firms were of the opinion that additional costs created through MAFR will be absorbed by themselves rather than cascaded to the client. The majority of 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. With regards to competition, the author found that auditors believed MAFR would aid in diffusing the monopoly between the Big-Four audit firms.

A number of EAs perceive MAFR as unwarranted, or rather needless. The aforementioned study by Harber and Maroun (2020) also explored the perspectives of EAs. The authors commented that EAs perceive audit partner rotation as sufficient, thus audit firm rotation being unnecessary. Additionally, it was also highlighted that MAFR hinders auditors' ability to gain detailed client understanding and results in a monopolisation by the Big-Four audit firms.

Nonetheless, MAFR is deemed useful for certain auditors. A Turkish study among EAs found that MAFR "*is regarded necessary in terms of objectivity and independence*" (Şeker, Türel 2023, p. 46). The main perception highlighted in this study is that the benefits of MAFR, such as lower risk of audit failure and higher audit quality, would outweigh its costs (Şeker, Türel 2023). Similarly, an Egyptian study revealed that auditors perceived MAFR as useful in ameliorating professional scepticism and auditor independence (Fathi, Rashed 2021). It was also noted that the benefits stemming from this policy, such as enhanced independence and audit quality, would outweigh the cost increases.

In addition, another Egyptian study found that EAs perceived MAFR necessary as it would lead to more effective audits, for instance, by taking advantage of a fresh look and would refrain them from becoming complacent (Anis 2014).

Audit-firm views on MAFR may differ over time. A peer-reviewed study by Jong et al. (2020), conducted within the Netherlands, found that at the adoption timeframe MAFR was viewed controversially but eventually it became considered as desirable by several stakeholders, including EAs.

In essence, both local and international auditors agree that MAFR results in supplementary time and effort to gain a thorough understanding of their client. However, certain auditors regard MAFR as essential. Mixed views on market monopolisation prevail.

2.4 Evidence on the Impact of MAFR on Audit Factors and other aspects

A myriad of literature theorises that audit firm rotation, whether voluntary or mandatory, may have an effect on various audit factors mainly audit quality, auditor independence and auditor professional scepticism. These factors are examined collectively as they are considered to be interconnected, in the sense that the level of auditor independence and professional scepticism will impact audit quality. Other factors, such as, financial implications, earnings management, financial reporting quality and market concentration have also been reported to be affected.

2.4.1 Empirical evidence of the effects of MAFR on audit quality, auditor independence and auditor professional scepticism

2.4.1.1 Evidence from Malta

The aforementioned local study anticipated that audit firm rotation could beneficially mitigate auditors' partiality (Gerada 2012). Under MAFR, EAs are conscious that their work will be looked over by a succeeding audit firm, so they will use their best endeavours to preserve their reputation by ensuring that their work is carried out diligently and in accordance with regulations and legislation, meaning in an impartial and independent manner. In other words, MAFR would ensure audit quality, auditor independence and professional scepticism are reinforced.

2.4.1.2 Evidence within the EU

The implications of audit firm rotation have been recently studied within the EU, namely, in the Netherlands, Austria and France.

A Dutch study by Jong et al. (2020) conducted with both auditors and PIEs highlighted that not all the objectives of the EU Audit Reform are being achieved in the Netherlands with respect to MAFR. On one hand, the objective of addressing the familiarity threat is being fulfilled, as well as strengthening independence and reinforcing professional scepticism. However, there seems to be no contribution to enhanced audit quality. In addition, the academics noted that the trophy-client effect, meaning the discount in audit fees given to larger PIEs for first year audits, may actually aggravate the adverse effect on audit quality.

Austrian academics Aschauer and Quick (2018) conducted a study to uncover investment consultants' perceptions towards MAFR and the prohibition of audit firm tax services. In their study they found that the level of perceived audit quality is not substantially impacted by MAFR and similarly, perceived auditor independence is not affected. Additionally, the implementation of MAFR along with the prohibition of the aforementioned services, were found to have an adverse effect on perceived auditor expertise, resulting in a negative learning curve effect (Aschauer, Quick 2018).

In the French context, the EU Audit Reform did not challenge national legislation. An article by Dattin (2017) outlined that French professionals as well as regulators were previously against MAFR as they insisted it reduced audit quality and led to increased audit costs in the primary years of an audit relationship. Nonetheless, the flexible rule of extending rotation to every twenty-four years for joint audits seemed to appease the French. Due to such flexibility, it was noted that MAFR "*will probably not affect the independence of auditors, especially … when combined with joint audit, a ban on non-audit services, and mandatory rotation of key audit partners every 6 years*" (Dattin 2017, p. 61). Thus, in such context, the MAFR provision would not add additional value towards auditor independence since there are other measures in place to ensure it.

Another study examines the relationship between audit firm tenure and audit quality in a cross-European context. Such study noted that higher levels of audit quality were observed for firms with tenures over ten and twenty years. This contrasts with the common belief that long term tenures result in lower audit quality. Researchers state that:

> "*if there does not seem to be a problem of lack of audit quality associated with long audit tenures in the EU, the limitation of the audit firm tenure imposed by the new European regulation lacks sound academic support, and we would not expect higher levels of audit quality to result from it.*"

(Garcia-Blandon et al. 2020, p. 61)

2.4.1.3 Evidence from the rest of the world

Several non-EU countries have also implemented MAFR in their legislation. Nonetheless, others have opted to refrain from employing this rule, with some countries experimenting by instigating the concept but abandoning it thereafter.

Academics in South Africa have recently undertaken research regarding the implications of MAFR on auditor independence, audit quality and professional scepticism. With regards to ensuring auditor independence, it was deemed that solely implementing audit partner rotation would suffice. The authors also concluded that MAFR would not enhance auditor independence but would simply result in a cosmetic change (Harber, Maroun 2020). Stakeholders who participated in the study advocated that no evidence proves that auditor independence and audit quality are hindered by long audit tenures and they seem to oppose MAFR. Nevertheless, the perspective of the South African regulators differs greatly as they believe that MAFR would ameliorate various audit factors, mainly auditor independence and professional scepticism and it would serve as a protection against overall corporate failure.

In Australia, a peer-reviewed study by Jackson, Moldrich et al. (2008), examined the relationship between audit firm tenure and audit quality. The study focused on two main proxies to measure audit quality, being, the likelihood of issuing a going concern opinion and discretionary accruals. The former has indicated that longer tenures enhance audit quality, whereas the latter concluded that there is no observed correlation between the two. The researchers also broadly suggested that for the improvement of auditor independence and audit quality, "*other initiatives are more likely to have a greater impact than imposing mandatory audit firm rotation*" (Jackson, Moldrich et al. 2008, p.16). However, they also remarked that perceived audit quality, rather than actual audit quality from the client companies' perspectives, may actually ameliorate due to MAFR (Jackson, Moldrich et al. 2008).

In addition, the effects of MAFR on audit quality have been reported in Singapore. In 2016, the Monetary Authority of Singapore announced its intention to discontinue MAFR because according to their sources, international research provided no conclusive evidence that links improved audit quality to MAFR (Choudhury 2016). Notably, this idea conflicts with the main rationale behind the concept of MAFR, which is to actually enhance audit quality.

Evidence from South Korea is extracted from an article studying MAFR and audit quality. Researchers claim that auditor independence is more likely to be present in "*newly rotated auditors under MAFR*" (Kim et al. 2015, p. 1102). This consequently leads to an amelioration in financial reporting quality.

American literature provides for two contradictory perspectives on the effect of auditor rotation on audit quality. Some research indicates that there is insignificant evidence that MAFR is successful in enhancing audit quality (DeFond, Francis 2005; Stefaniak et al. 2009). On the other hand, other studies show that MAFR results in better audit quality, at least when compared to voluntary auditor rotation (Casterella, Johnston 2013).

In conclusion, the effects of MAFR on audit quality, professional scepticism and auditor independence seem to vary. With regards to audit quality, mixed views prevail in existing literature, with a predominant view that MAFR simply has no effect on audit quality. Such contradictory or inconclusive findings may result due to the significant difficulty in measuring audit quality. Similarly, auditor independence is deemed unaffected, but at times positive associations are noted. Overall, professional scepticism seems to be positively influenced by MAFR.

2.4.2 Empirical evidence of the effects of MAFR on other aspects

MAFR may also result in financial implications. Namely, literature by Harber, Marx, et al. (2020) has uncovered that costs associated with MAFR extend beyond marketing and tendering costs, or as better known by the profession, setup and transition costs. For instance, cost increases may be reflected in the audit fees charged to clients. In addition, financial implications along with audit firm disruption may impact audit quality. Views on this aspect seem to be mixed. On one hand, the pressure to replace or secure new clients might cause a disruption to audit quality in the later stages of the rotation period, whereas on the other hand, auditor competence and professional behaviour are supposed to prevail, enabling auditors to overcome such distractions and retain audit quality.

Another study assesses whether MAFR affects earnings management and audit fees. Salehi et al. (2022) conducted such study in Iran, focusing on a pressured market experiencing economic sanctions. Such academics concluded that MAFR escalated accruals-based earnings management but did not affect audit fees or real earnings management. Due to the particular economic situation in Iran and the lack of risk-based audits, MAFR was not able to control the aggressive actions of management. Notably the economic advancement in Iran lags behind other progressive countries such as EU member states, so the findings in this study may not be directly applicable to different economic scenarios. However, a crucial insight from this study emerges, being that since the average client-auditor relationship in Iran lasts around two years, audit methods are anticipated and financial fraud is likely to go undetected. Thus, it is suggested that too short audit tenures may have a detrimental effect. Another important remark is that "*the length of an audit firm's tenure should be based on the characteristics of the audit market structure of each country*" or else "*it may act as a sharp double-edged sword*" (Salehi et al. 2022, p.17).

Additionally, a myriad of literature links MAFR to financial reporting quality, but a mixed perspective prevails. For instance, Blouin et al. (2007) report no improvement in financial reporting quality subsequent to a mandatory auditor change. Nonetheless, according to Nagy (2005), discretionary accruals are reduced for the same population of clients after they switched auditors, thus supporting MAFR. Other studies also note mixed results on the association between financial reporting quality and MAFR (Chi et al. 2011, Myers et al. 2003).

Market concentration is another factor affected by the imposition of MAFR. According to Indyk's (2019) study in Poland, Big-Four audit firms remain the preferred choice for large capital groups and if they opt to replace their auditor, they usually appoint another Big-Four firm. Moreover, the substantial number of brief tenures implies that Big-Four corporations possess robust negotiating leverage and stand to gain more from client rotation than client retention (Indyk

2019). These discoveries notably augment the belief that MAFR would not alleviate the issue of market concentration, at least in the context of the Polish audit market.

2.5 Conclusion

This chapter investigated local and foreign literature surrounding the regulation behind MAFR as well as the mechanism's merits and demerits and the numerous implications of MAFR, extracting insights from auditors, client companies, as well as other stakeholders. MAFR was also found to influence several audit factors, such as, audit quality, auditor independence, professional scepticism and other industry factors. Some evidence shines a positive light on MAFR, whereas other evidence abstains or opposes the view that MAFR is beneficial. This contradiction prompts the necessity for supplementary research so as to ascertain where EAs and their clients stand. The next chapter looks into the research methodology adopted in carrying out the study.

Chapter 3

Research Methodology

3.1 Introduction

This chapter delves into the research methodology adopted for this study. As illustrated in Figure 3.1, Section 3.2 focuses on the preliminary secondary research undertaken, whilst Section 3.3 outlines the research method chosen. Section 3.4 subsequently presents the research tool applicable to this study. Next, Section 3.5 addresses the selection of research participants. Sections 3.6 and 3.7 identify and explain the data collection method and data analysis method respectively. The research limitations are then specified in Section 3.8. Lastly, Section 3.9 concludes the chapter.

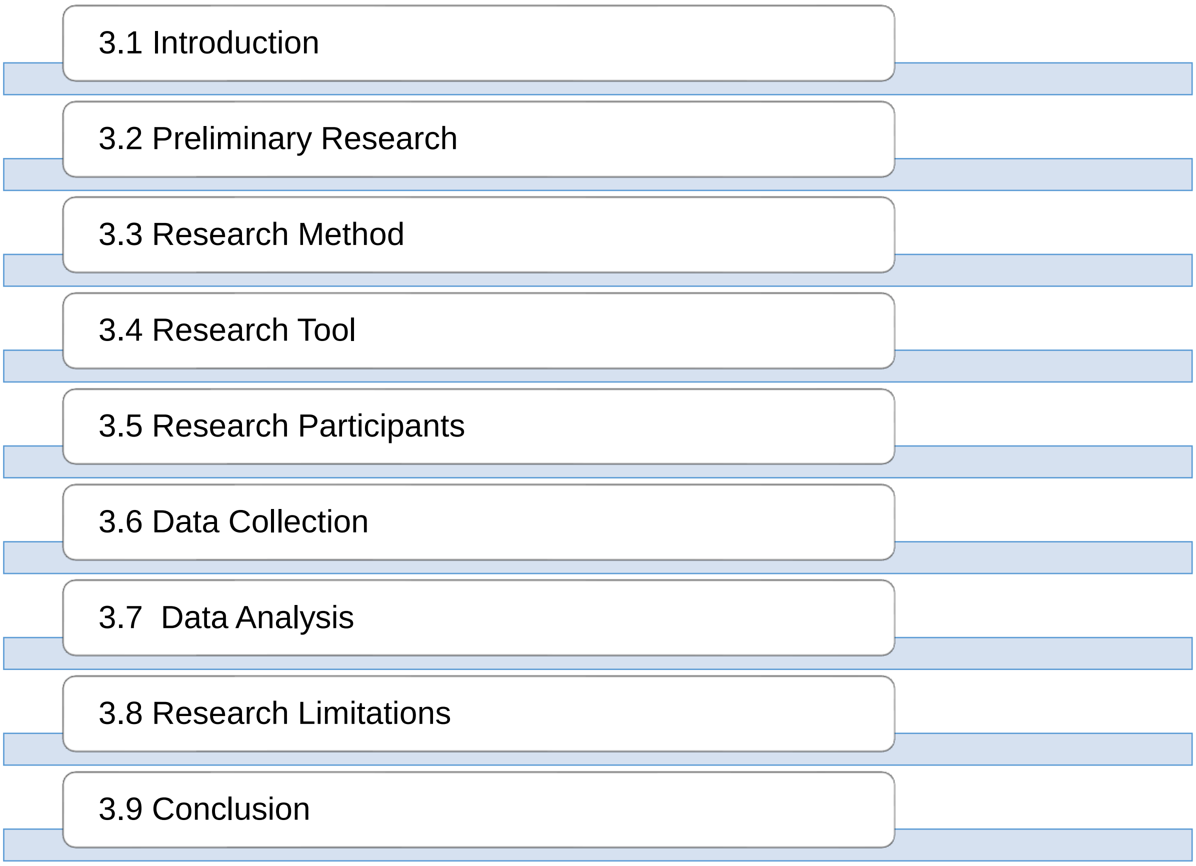

Figure 3.1: Overview of Chapter 3

3.2 Preliminary Research

In the initial stages of the study, information on the research topic was gathered through a comprehensive literature review, which enabled a foundational understanding of the implications of MAFR. Information was assembled from relevant and up to date sources such as published academic journals, peer-reviewed articles, dissertations, books, reports and documents published by local and international institutions. Some of the key search terms included '*mandatory audit firm rotation*,' '*audit quality*,' '*audit independence,*' '*professional scepticism*' and '*audit factors*.'

Furthermore, the review also permitted the exploration of different perspectives on the topic, including the views of PLCs, EAs, regulatory bodies and academics. Local research was found to be quite limited in this regard, which highlighted the gap in local literature. In addition, informal discussions were also held with academics to confirm the viability of this research topic.

This preliminary secondary research served as a vital groundwork for formulating the research questions, shaping the interview schedule and guiding the subsequent primary data collection and analysis.

3.3 Research Method

The methodological choice for the study depends on various factors such as the research philosophy and research approach, which are ultimately underpinned by the research questions and objectives (Saunders et al. 2019). Other notable factors include the available time, resources and the extent of present knowledge on the topic (Opoku et al. 2016).

The theoretical concept of the '*Research Onion*' introduced by Saunders et al. (2019) was used as a guide to identify the most appropriate methodology for the study. This model was employed by addressing each layer within the onion, starting from the outer layer and progressing inward. Each layer represents a different dimension of the research, moving from the broad concepts in the outer layers to the more specific elements in the inner layers. First, the core research philosophy is chosen, followed by the research approach, strategy, time horizon, data collection and data analysis methods (Saunders et al. 2019).

The interpretivist research philosophy was adopted for this study, as it centres on exploring diverse interpretations of individuals (Saunders et al. 2019). Through the consideration of perspectives of diverse individuals and contextual interpretation of data collected, one can arrive at an understanding of reality (D O'Gorman, MacIntosh 2015). This philosophical stance was deemed suitable since it empowers the researcher to recognise varying ideologies in analysing the implications of MAFR through the eyes of PLCs and EAs.

Furthermore, the study employs an inductive approach, wherein the researcher initiates the research by making reference to relevant literature and theorising based on the collected data (Saunders et al. 2019). This research approach constitutes observing data, seeking patterns and drawing general conclusions. It places a strong emphasis on understanding others' perspectives through meanings and interpretations, which is well-aligned with the objective of this study (Morgan 2013).

The main research designs generally used by researchers to collect primary data include the qualitative, quantitative and mixed methods (Paoletti et al. 2021). Qualitative research "*uses words as data that it collected and analysed in all sorts of ways*" whereas quantitative research "*uses numbers as data and analyses them using statistical techniques*" (Clarke, Braun 2013, p. 2). Mixed research can be considered a mix of both methods, which entails understanding experiences (Merriam, Tisdell 2015).

Based on the interpretivist research philosophy and the inductive approach, the qualitative research method was selected for this study. Furthermore, such study does not depend on any numerical data analysis and focuses on gathering and understanding participants' perceptions.

3.4 Research Tool

Semi-structured interviews were believed to be the most befitting research tool for this study, so as to address the research objectives stated in Chapter 1. Such interviews contain a predetermined set of questions which guide the schedule rather than dictate it, as other questions may surface from the discourse (Whiting 2008). Some of the prevailing advantages of such interviews are that they allow the production of richer data and allow significant coverage flexibility (Smith 1995). In addition, questions were as standardised as possible to allow for comparability of data, for an effective analysis (Whiting 2008).

Two interview schedules were prepared, for EAs and PLC representatives respectively[2]. As outlined in Table 3-1, the prevalent sections of the schedules start off with a preamble and the next five sections tackle the implications of MAFR and its effect on audit factors. The structure of both schedules remained similar, with the first section focusing on obtaining an understanding of the respondent, the second section exploring the general perceptions of MAFR, the third section inquiring the effects on client-auditor relationships, the fourth section examining the effects on audit and other factors and lastly, the fifth section investigating any future recommendations.

[2] Vide Appendices 3.2 and 3.3 respectively

Section	Section Heading	Question No. (EAs' Schedule)	Question No. (PLCs' Schedule)
A	General Questions	1 – 3	1 – 4
B	Perceptions on MAFR	4 – 5	5 – 6
C	The implications of MAFR on Audit Relationships and Client-Auditor Interactions	6 – 8	7 – 9
D	The implications of MAFR on Audit (and other) Factors	9 – 13	10 – 11
E	Future Perspectives and Recommendations	14 - 17	12 – 17

Table 3-1: Structure of the Interview Schedules

The research objectives were addressed through the interview questions as illustrated in Figure 3.2.

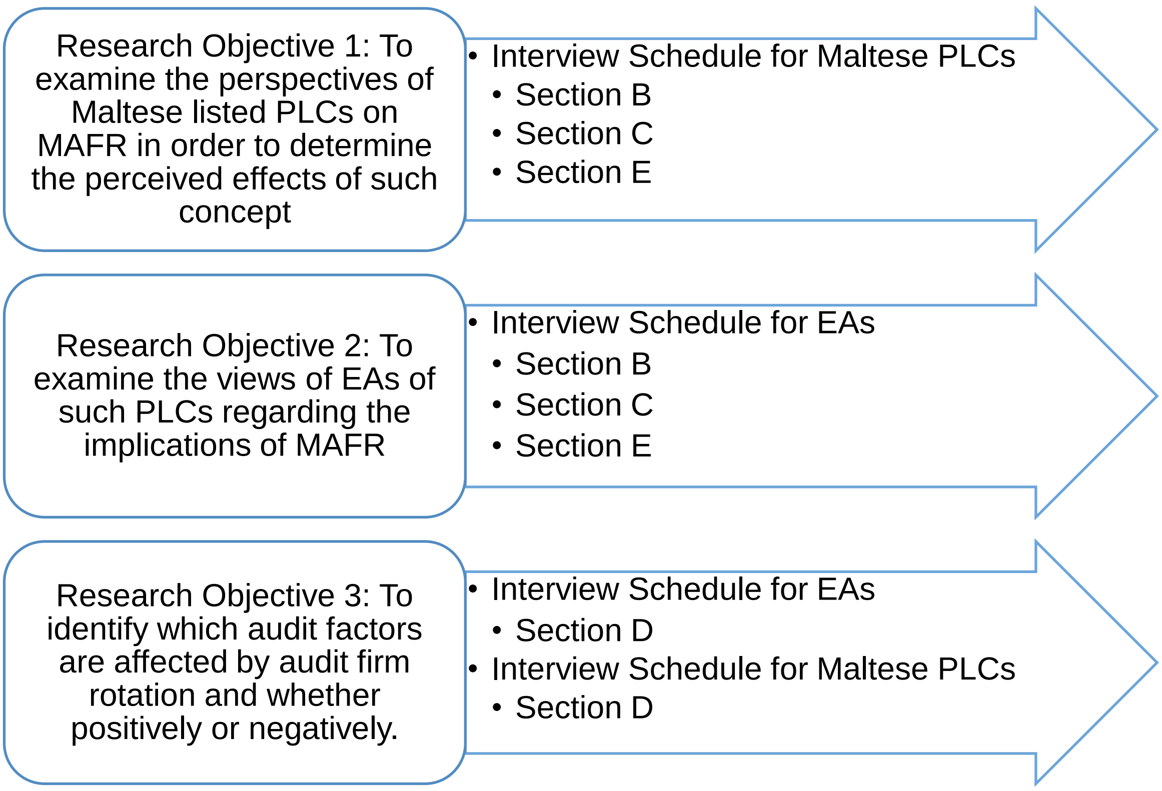

Figure 3.2: Qualitative Research Outline

3.5 Research Participants

Participation in the research consisted of two categories of interviewees:

a) Representatives of Maltese PLCs (CFOs/Financial Controllers/Heads of Finance/Audit Committee Members/Heads of Audit)
b) Client-facing warranted auditors with a managerial position within the Big-Four and mid-tier audit firms in Malta.

Such population consists of professional and reputable individuals, with a suitable background to answer the interview questions.

A list of Maltese listed PLCs was obtained from the Malta Stock Exchange (MSE) website on 10th September 2023. This comprised thirty-three equity-listed companies and the remainder were debt-listed companies. Financial representatives from each company were then contacted through emails or messages through professional social platforms. Additionally, follow-up reminder phone calls and emails were sent.

Audit firms were contacted via email, through Human Resources, who in turn reached out to their auditors.

Initial contact was accompanied with the Letter of Introduction and Invitation to Participate in Research, endorsed by the Head of Department of Accountancy of the University of Malta. This provided a brief introduction to the subject matter and demonstrated the participants' contribution to the study.

Tables A3-1 and A3-2 in Appendix 3.1 demonstrate further details with regards to the participants of the twenty-five interviews carried out. Fifteen interviews were conducted with PLC representatives from sixteen PLCs, since one participant was involved in two PLCs and the remaining ten interviews were carried out with EAs. Five of these were carried out with auditors from Big-Four audit firms and the remaining five were conducted with auditors from mid-tier audit firms.

3.6 Data Collection

Interviews were conducted between the 16th of October and 21st of December 2023. The majority of interviews were held virtually, with the exception of four being held in person. For the online interviews, Microsoft Teams and Google Meet were used. Notably, all interviews were held at the participants' convenience and a copy of the interview schedule was also given beforehand. Interviews were conducted in English to eliminate the risk of losing or changing the meaning of the responses upon translation. On average, interviews with auditors extended for a duration of twenty-four minutes, while those with PLC representatives lasted approximately seventeen minutes.

To uphold confidentiality, all interviewees were ensured anonymity. Additionally, each participant willingly consented to voice recording, which greatly facilitated data analysis.

3.7 Data Analysis

Thematic analysis served as the primary approach to analyse the extensive qualitative data. This involves "*identifying, analysing, and interpreting patterns of meaning ('themes') within qualitative data*" (Clarke, Braun 2017, p. 297).

The interviews were promptly transcribed, which along with interview notes, facilitated a comprehensive understanding and analysis of the information gathered. For most interviews, the researcher leveraged Otter, a transcription tool, for simplification purposes.

Furthermore, multiple readings of the transcriptions allowed the researcher to gain familiarity with the material and enable preliminary observations. Next, the researcher systematically coded the data through identifying and highlighting phrases of text related to the research objectives. Codes were created for concepts that were frequently mentioned by participants, particularly focusing on the general views on MAFR, its implications and the respondents' recommendations. Key quotes were also extracted from the interviews, which were later included in the research findings.

The codes were then organised into themes, such as '*the necessity of MAFR*' and '*the adaptation to MAFR*.' Such themes were reviewed and refined to confirm that they faithfully reflect the data and contributed to a thorough comprehension of the research topic. Lastly, the themes were used to address the study's objectives and produce valuable insights regarding the implications of MAFR.

A detailed analysis of this data will be presented in the subsequent chapter.

3.8 Research Limitations

The study was subject to two primary research limitations. Firstly, the population of Maltese PLCs was restricted to Maltese listed PLCs and despite having contacted each and every company, not all were available or willing to participate in this study. Secondly, the interview period coincided with the busiest period for the majority of the respondents, resulting in rescheduling of a number of interviews.

Another limitation arose as a minority of the respondents chose to provide their responses to the interview questions via email instead of participating in an in-person interview. This could have possibly resulted in the respondents researching the questions online rather than providing their own professional opinion.

Despite the research limitations, data saturation was successfully reached and further interviews would have resulted in similar replies. Sufficient data was obtained and the study objectives were also met.

3.9 Conclusion

This chapter presented a thorough overview of the research methodology employed for this study. The next chapter will present the research findings derived from the organised interviews.

Chapter 4

Research Findings

4.1 Introduction

This chapter presents the research findings obtained from twenty-five semi-structured interviews. As outlined in Figure 4.1 below, Section 4.2 delves into the perspectives of PLCs on MAFR and its implications, whilst Section 4.3 presents the perspectives of EAs on this concept. Subsequently, Section 4.4 investigates the effect of MAFR on various audit factors and other aspects. Finally, Section 4.5 concludes this chapter.

4.1 Introduction

4.2 PLCs' Perspectives on MAFR

- *4.2.1 Focal Views on MAFR*
- *4.2.2 Implications of MAFR*
- *4.2.3 Necessity of MAFR*
- *4.2.4 Adaptation and Recommendations*

4.3 EAs' Perspectives on MAFR

- *4.3.1 Focal Views on MAFR*
- *4.3.2 Implications of MAFR*
- *4.3.3 Feasibility and Necessity of MAFR*
- *4.2.4 Adaptation to MAFR*

4.4 The Impact of MAFR on Audit Factors and other aspects

- *4.4.1 The effects of MAFR on Audit Factors*
  - *4.4.1.1 Audit Quality*
  - *4.4.1.2 Auditor Independence*
  - *4.4.1.3 Auditor Professional Scepticism*
- *4.4.2 The effects of MAFR on other aspects*
  - *4.4.2.1 Transparency of Financial Information*
  - *4.4.2.2 Supervision and Coordination of audits*
  - *4.4.2.3 Audit Fees*
  - *4.4.2.4 Competition*

4.5 Conclusion

Figure 4.1: Overview of Chapter 4

4.2 PLCs' Perspectives on MAFR

In the preliminary part of the interview, PLC representatives were asked whether they have previously rotated audit firms due to MAFR or other reasons[3], to get an understanding of the extent to which MAFR has been implemented in Malta. Although only 37.5%$_{(6/16)}$ of PLCs interviewed have undergone MAFR in recent years, 18.75%$_{(3/16)}$ are preparing to undergo MAFR in the next year and another 43.75%$_{(7/16)}$ have rotated auditors for other reasons. Notably, two of the three PLCs who are preparing to undergo MAFR have never rotated auditors, with audit firm tenures extending up to seventy-six years.

4.2.1 Focal Views on MAFR

PLC representatives were questioned on their perception on MAFR as a regulatory requirement[4]. Approximately half of the respondents$_{(8/15)}$[5] indicated that they perceive this regulation as having both advantages and disadvantages and thus opted for a neutral stance. PLC009 effectively captured such a view in the following comment:

> *"I can see the benefits, I can understand the concept because the auditor and the client, they should not become very comfortable in their relationship … there is this saying in English, familiarity breeds contempt … I fully understand that, but I think it will be quite a pain when we come to change the auditor."*

A significant number$_{(6/15)}$ stated that they find MAFR to be beneficial as it acts as a deterrent against the familiarity threat and reinforces independence. Only one respondent remarked that MAFR is detrimental to companies as it presents an additional concern to management, especially if they are content with their current EA.

Respondents remarked on several benefits and challenges associated with MAFR. Amongst the advantages noted throughout the interviews, the more prominent examples include giving a fresh impetus to the audit, reducing the

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[3] Vide Q3 in Appendix 3.2
[4] Vide Q5 in Appendix 3.2
[5] Since one respondent represented two PLCs, a total of fifteen responses were obtained, representing the views of sixteen PLCs

familiarity threat, keeping auditors and fees in check, facilitating high-quality audits and contributing to sound corporate governance. Conversely, the main disadvantages of undergoing MAFR include high costs, a time-consuming process, the burden of explaining the company's operations to the new auditors, potential conflicts of interest with other advisory engagements being undertaken by the new auditors, reduced audit efficiency and the inconvenience of having to interact with a new junior audit team. These points are illustrated below in Figures 4.2 and 4.3 respectively.

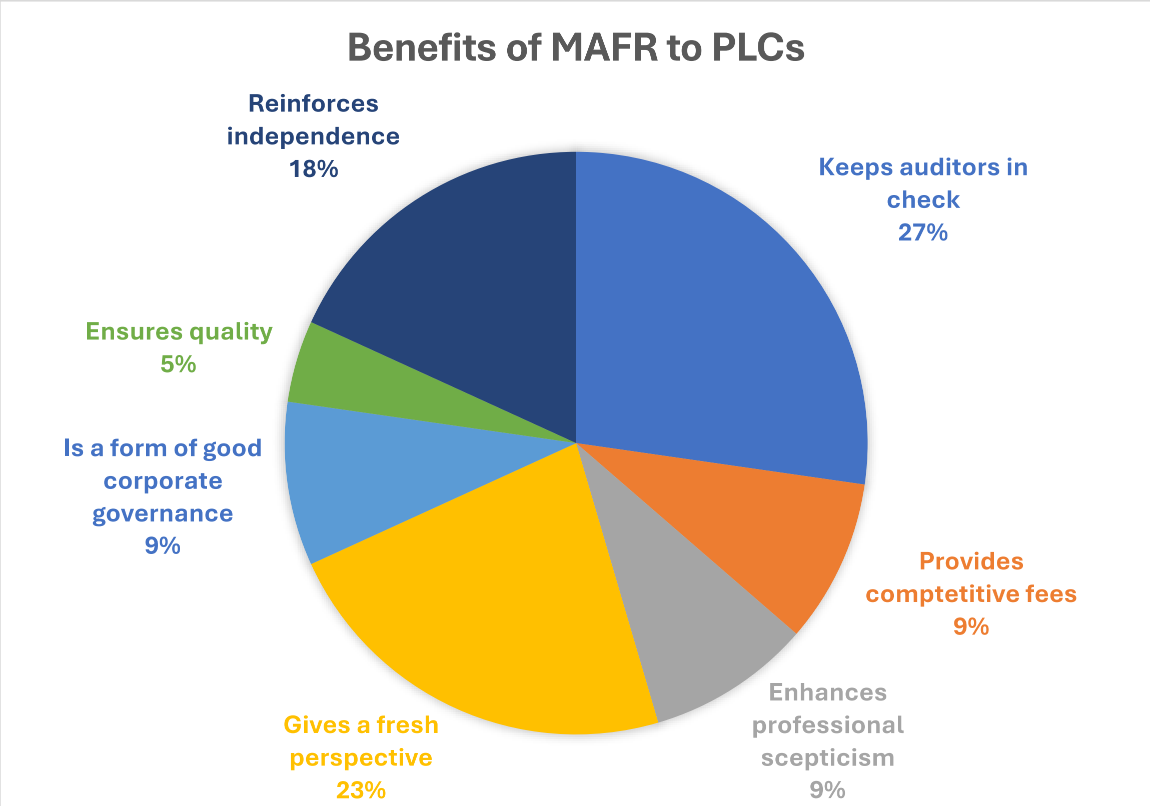

Figure 4.2: The Benefits of MAFR to PLCs

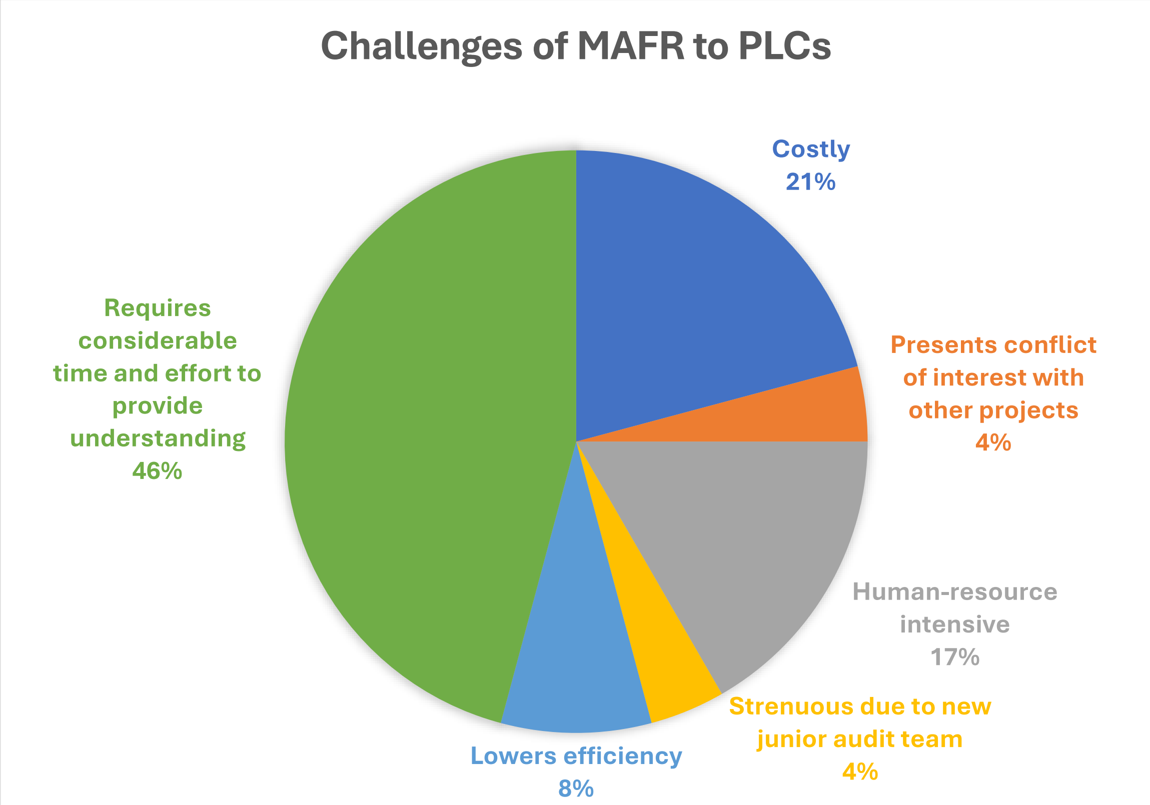

Figure 4.3: The Challenges of MAFR to PLCs

4.2.2 Implications of MAFR

Respondents were queried on the impact of MAFR on such companies. They were asked regarding the effect that MAFR has on client-auditor relationships[6].[7] Five respondents$_{(5/15)}$ noted that MAFR necessitates the building of new client-auditor relationships, which constitutes a prolonged process. Another four respondents$_{(4/15)}$ indicated that MAFR serves as a mechanism to keep EAs in check, which results in increased accountability in the relationship. Additionally, two respondents$_{(2/15)}$ expressed that the client-auditor relationship is enhanced for two primary reasons. Firstly, MAFR fosters a sense of appreciation in EAs towards their clients, as auditors know they will eventually lose them and they will strive to regain such clients for an additional ten years, if possible, or to be

[6] Vide Q7 in Appendix 3.2
[7] A total of eighteen responses were obtained as some respondents provided multiple responses

reappointed in subsequent rotations. Secondly, MAFR provides an opportunity for new services to be provided by the outgoing auditor, such as non-assurance services, which are otherwise prohibited. This in turn transforms the client-auditor relationship into other relationships such as a client-advisor dynamic. On the other hand, seven respondents$_{(7/15)}$ reported no discernible effect on client-auditor relationships.

When questioned about MAFR's impact on the continuity of knowledge and expertise accumulated during the audit[8], the majority of respondents$_{(14/15)}$ concurred that MAFR results in a loss of knowledge, particularly noticeable during the initial years of an audit. One respondent$_{(1/15)}$ also noted that such "*teething problem*" is only significant in the first one or two years and then neutralises over time. Additionally, three respondents$_{(3/15)}$ commented that some benefits stem from this challenge, as new insights emerge during the accumulation of new knowledge, which might contribute to the quality of the audit. For instance, PLC003 stated that:

> *"The moment you rotate everything is lost, you start from scratch, which I think also has some advantages… because everything gets questioned and there is always something popping up."*

Only one respondent$_{(1/15)}$ asserted that auditor expertise is unaffected by MAFR.

Research also delved into the impact of MAFR on the audit service delivered[9]. The majority of respondents$_{(9/15)}$ noted that MAFR does not affect the quality of the audit service provided, reasoning that all auditors are expected to deliver a high-quality service. Conversely, five respondents$_{(5/15)}$ asserted that MAFR actually enhances the audit service. Some noted that the outgoing auditor delivers improved service since their work will undergo meticulous scrutiny by the incoming auditor. Others highlighted that the incoming auditor brings fresh perspectives and independence, ultimately improving the service. Only one respondent$_{(1/15)}$ raised concerns that the audit service might be compromised,

[8] Vide Q9 in Appendix 3.2
[9] Vide Q8 in Appendix 3.2

commenting on the difficulty of identifying an incoming auditor who strikes the right balance between cost-effectiveness and expertise.

4.2.3 Necessity of MAFR

PLC representatives were also asked about their view on the necessity of MAFR in comparison to audit partner rotation[10]. Views among respondents were divided, as seven$_{(7/15)}$ considered MAFR necessary, another seven$_{(7/15)}$ believed audit partner rotation would suffice 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. PLC005 argued that under audit partner rotation, the presence of audit partners within the same firm sustains familiarity and preserves a consistent approach to procedures. Similarly, PLC010 stated that audit partner rotation by itself perpetuates a sense of complacency. PLC006 also argued that the mere rotation of partners may fail to convey the impression of meaningful change to the public. The challenge of sourcing new partners was highlighted by PLC011, highlighting the need for MAFR as "*you need to provide the partners to be able to rotate the partners and partners don't grow up on trees*". PLC003 argued that MAFR is essential due to Malta's small size, by arguing that:

> *"audit partner rotation does not help….I mean look at Malta. Malta is so small. It may help in the US, or in the UK, or in Germany, where you have different offices and you can have a completely separate team that is detached from the other. But especially in Malta, they are all sitting in the same floor… it does not really help."*

The remaining respondents perceived audit partner rotation as a viable solution, stating that it still offers benefits such as introducing fresh perspectives while maintaining continuity within audit processes. PLC012 highlighted that as long as every firm and partner adhere to professional regulations, partner rotation would suffice. Furthermore, PLC009 commented that audit partner rotation would ensure continuity of knowledge by stating that:

> *"If the audit partner moves on, then obviously we experience a change, but at least it is within the same firm and they can always look at their*

[10] Vide Q5 in Appendix 3.2

> *past workings rather than waste my time … asking me the same questions or asking for calculations that I would have given them last year is a waste of time… the last thing you want is to repeat yourself year in year out."*

Respondents were subsequently asked regarding their willingness to voluntarily rotate EAs if MAFR had not been implemented[11]. Despite half of respondents recognising the necessity of this concept, the majority of PLC representatives$_{(10/15)}$ expressed their reluctance to voluntarily rotate EAs. The rationale behind this stance is rooted in the belief that if the auditor has consistently provided support and collaborated effectively with the company, there should be no change. The consensus among such respondents is that they will only consider changing EAs if the current auditor fails to perform their duties adequately. PLC004 further points out that stakeholders value the reputation of EAs over the frequency of auditor rotation by stating:

> *"I am not sure that they really care that you are changing auditors. I think with regards to financial institutions in Malta, they are more interested in seeing who your auditors are."*

Only three respondents$_{(3/15)}$ expressed that they would voluntarily rotate EAs and the remaining two respondents$_{(2/15)}$ did not comment on the matter.

4.2.4 Adaptation and Recommendations

Research respondents also shared their perspectives on adapting to this regulation. When queried about their future plans to comply with MAFR requirements[12], the majority of respondents$_{(11/15)}$ expressed a preference for audit tendering, to possibly extend the audit tenure to a total of twenty years. Furthermore, a significant proportion$_{(8/15)}$ indicated they would not pursue joint audits and a minority$_{(3/15)}$ stated they would forgo audit tendering and select a new EA directly, thereby adhering strictly to the ten-year rule without seeking extensions.

[11] Vide Q6 in Appendix 3.2
[12] Vide Q12 in Appendix 3.2

Respondents also articulated the attributes they will look for when selecting a new auditor for the rotation. The predominant factors include audit fees and reputation of the audit firm. These criteria are illustrated in Figure 4.4 below.

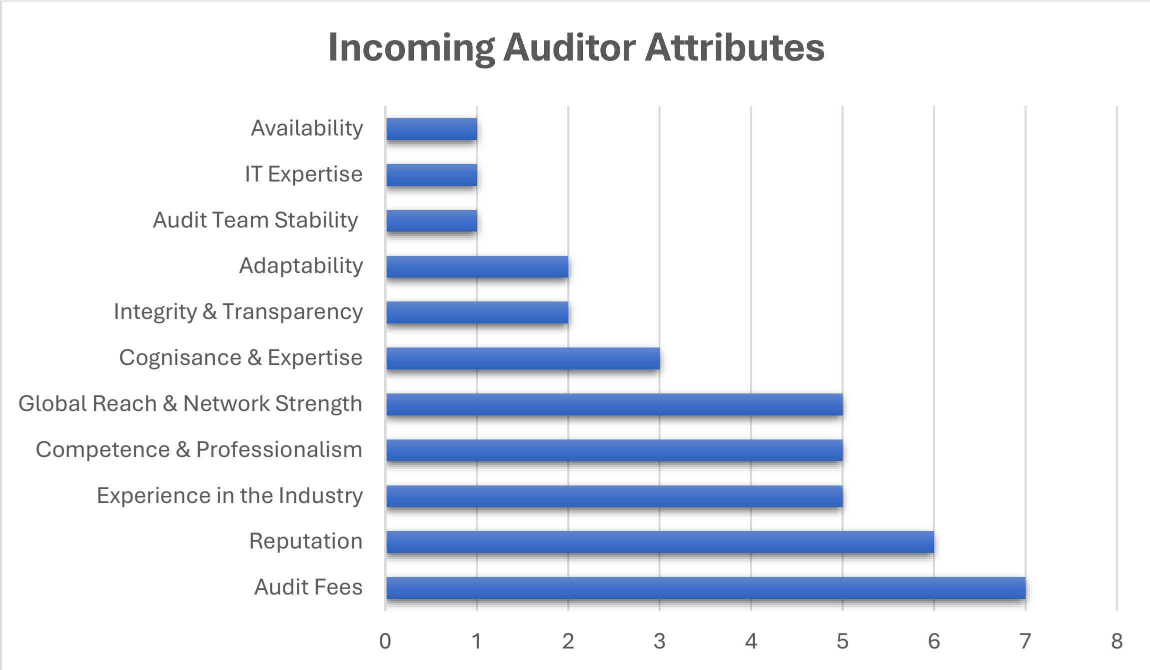

Figure 4.4: Incoming Auditor Attributes

Furthermore, a significant majority of 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. Other respondents$_{(4/15)}$ exhibited indifference between a Big-Four audit firm and a mid-tier audit firm, opting to tender to both. Lastly, two respondents$_{(2/15)}$ stated that they will exclusively choose a mid-tier firm.

Furthermore, 47%$_{(7/15)}$ of respondents would be willing to rotate back to their original auditor at the subsequent rotation, while only 6%$_{(1/15)}$ favoured selecting a new auditor, "*as there is no point in going back to the previous ones*". The remaining 47%$_{(7/15)}$ exhibited a more cautious approach, intending to base their decision on the resulting rapport established with the incoming auditor and on the subsequent offers presented.

PLC representatives were also consulted for their recommendations to policy makers[13]. Five respondents$_{(5/15)}$ asserted that policymakers should mandate and regulate the handover of audit files between incoming and outgoing EAs, to ensure seamless knowledge transfer and minimise disruptions during rotations. Other suggestions to policymakers include enforcing written documentation that clients must maintain to facilitate rotations, providing clearer guidelines and mandating joint audits with the incoming auditor only for the final audit of the outgoing auditor. While some recommended removing MAFR and replacing it with increased supervision by the Accountancy Board, others suggested shortening the minimum ten-year period, deeming it excessively long. These recommendations underscore the desire for more structured processes and oversight, to improve the efficacy of audit rotations.

4.3 EAs' Perspectives on MAFR

During the initial phase of the interview, EAs were queried regarding their involvement in audit engagements subject to MAFR[14], to get an understanding of the extent to which this regulation has been implemented in Malta. The majority$_{(8/10)}$ of EAs interviewed 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. The remaining two respondents$_{(2/10)}$ have undergone voluntary rotation only thus far.

4.3.1 Focal Views on MAFR

To ascertain the general perspectives of EAs on MAFR, respondents were questioned on their overall perception on MAFR as positive, negative or neutral[15]. The findings revealed a predominant positive sentiment towards MAFR among the majority$_{(7/10)}$ of EAs. Such outlook was attributed to factors such as its role in the enhancement of competition, transparency, credibility, independence, audit

[13] Vide Q16 in Appendix 3.2
[14] Vide Q3 in Appendix 3.3
[15] Vide Q15 in Appendix 3.3

quality and scepticism, the formation of a level playing field with increased opportunities, the injection of fresh perspectives and the prevention of fraud, misstatements and familiarity threats. Conversely, one mid-tier auditor$_{(1/10)}$ expressed an overall negative perspective on MAFR, citing concerns that mid-tier audit firms typically have a limited number of PLC engagements and MAFR will lead to the loss of these clients after the prescribed ten-year period. Two respondents$_{(2/10)}$ adopted a neutral stance on MAFR, acknowledging its positive implications for the auditing profession but recognising its negative impact on business. They noted the benefits for incoming auditors but also highlighted the challenges faced by outgoing auditors. AUD001 commented that:

> *"it gives us the opportunity to possibly win new engagements but obviously on the other hand you have to let go. So, it is a win lose situation."*

Furthermore, EAs were prompted to express their perspectives on the benefits and challenges of MAFR as a regulatory requirement[16]. Generally, EAs provided more insights into the benefits of MAFR compared to its challenges, further highlighting their favourable perception of the regulation. The most significant advantages highlighted include the infusion of a fresh perspective, the opportunity to acquire new clients and the reinforcement of independence. The primary challenges identified are the loss of client relationships and associated revenue, as well as the loss of accumulated client knowledge and the necessity to rebuild such knowledge from scratch. These points are depicted below in Figures 4.4 and 4.5 respectively.

[16] Vide Q4 in Appendix 3.3

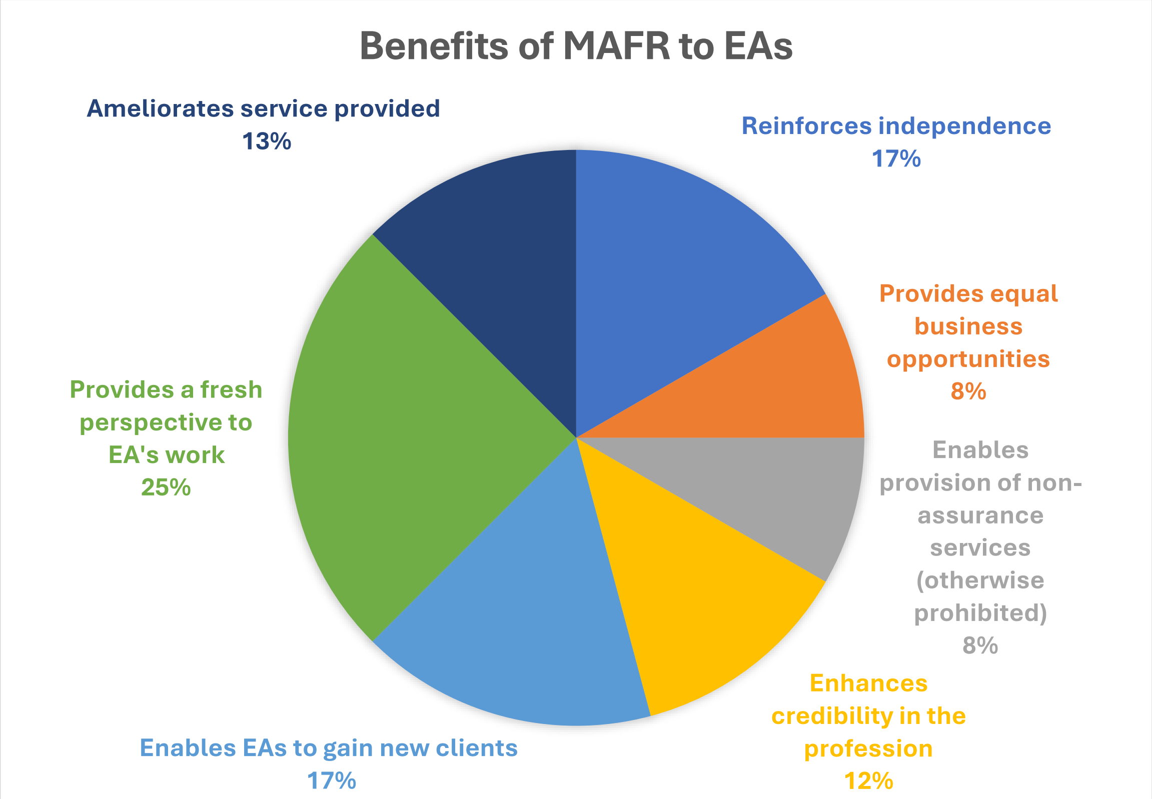

Figure 4.5: The Benefits of MAFR to EAs

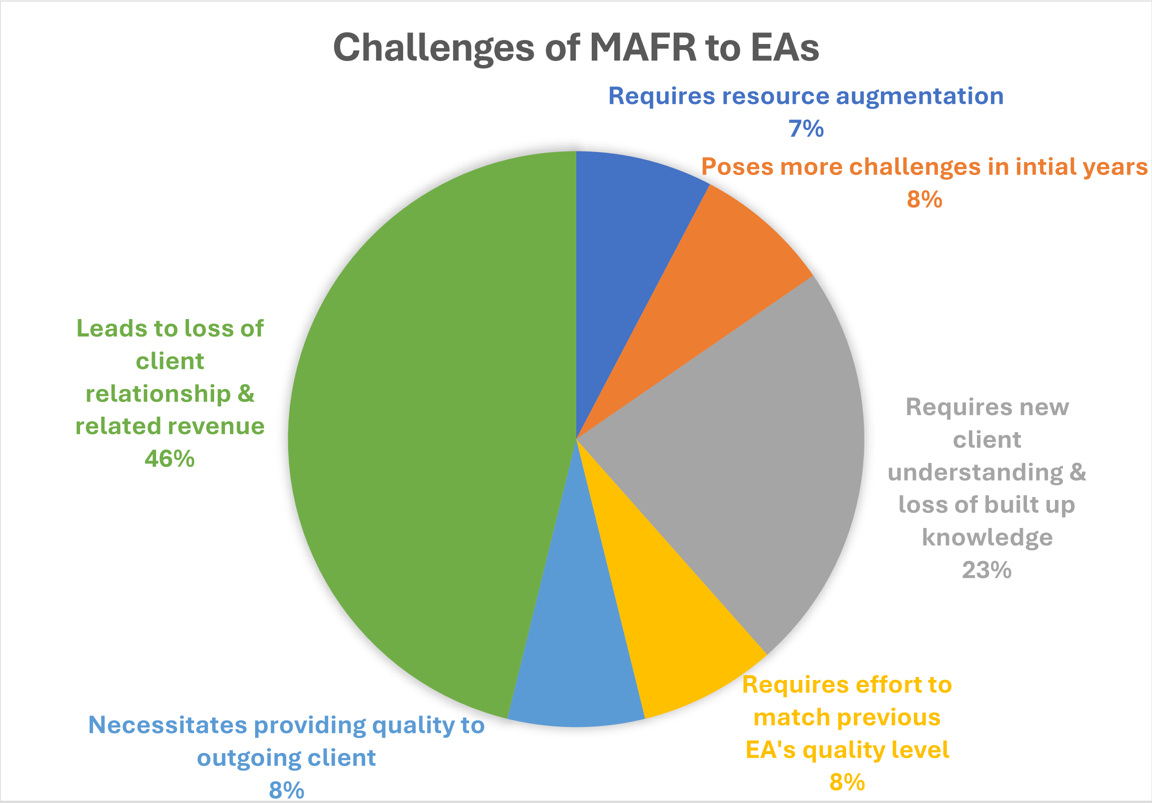

Figure 4.6: The Challenges of MAFR to EAs

4.3.2 Implications of MAFR

EAs were requested to provide insights on the impact of MAFR on their clients, by evaluating the advantages derived from the fresh perspective offered to clients, in contrast to the additional costs incurred by clients[17]. 50%(5/10) of EAs emphasised that MAFR's benefits to clients, in terms of the introduction of diverse perspectives and ideas, outweigh its associated costs. They highlighted that MAFR diminishes familiarity, thereby reducing complacency. Moreover, starting afresh rather than revisiting existing processes allows for the identification of new weaknesses. AUD004 additionally noted that while lower-level staff who interact with EAs regularly may be less inclined to support the rotation, top management and the audit committee "*all appreciate the fresh look at things… because it provides certain new challenges to the company.*" Only one mid-tier auditor(1/10) expressed that the costs of the rotation surpass its benefits to their clients. This interviewee highlighted the increased workload resulting from commencing afresh, noting that these costs are subsequently passed on to clients. Additionally, the respondent emphasised additional costs associated with client staff adapting to the new auditor's methodology and re-explaining company processes and operations. The remaining four EAs(4/10) were not able to conclude whether the fresh perspective entails more costs than benefits for the client, asserting that this depends on whether the new auditor's fees align with market rates or are competitively reduced. One EA further noted that although the provision of a fresh perspective is important, it could also be achieved through partner rotation only.

EAs were also asked regarding the effect that MAFR has on client-auditor relationships[18].[19] Four EAs(4/10) noted that MAFR upholds professionalism in such relationships. Similarly, two respondents(2/10) expressed that auditors would be inclined to continue delivering high-quality service to clients. AUD001 explained that:

> *"the last thing you want is a new auditor coming in and finding issues that were not perhaps picked up … you will probably want to make*

[17] Vide Q5 in Appendix 3.3
[18] Vide Q6 in Appendix 3.3
[19] A total of fourteen responses were obtained as some respondents provided multiple responses

> *sure you tick all the boxes, make sure you did the right thing, so as not to have surprises when the new auditor comes in."*

Furthermore, three $EAs_{(3/10)}$ stated that the auditor's role in such relationships is replaced by another role stemming from non-assurance services, otherwise prohibited. They also noted that just as distinct relationships are formed with outgoing clients, new client-auditor relationships must be established with incoming clients. Other noteworthy impacts on the client-auditor relationship include the communication challenges arising between parties and the auditor's effort and investment in the relationship. Conversely, two $respondents_{(2/10)}$ stated that there is no effect on such relationships.

Respondents were also asked whether newly acquired clients from MAFR exhibit any resistance to cooperating or sharing information[20]. All $EAs_{(10/10)}$ concurred that there should be no change in these aspects. It was emphasised that clients comprehend the mandatory nature of the rotation and their duty to cooperate. However, complexities may arise when requesting information that was previously not asked for and clients may attempt to conceal certain grey areas based on their experience with the previous auditor. Two $EAs_{(2/10)}$ remarked that rather than client resistance, they faced resistance from the client's previous auditor during the handover process.

Moreover, EAs were queried on their views regarding MAFR's effect on continuity of knowledge and expertise[21]. All $EAs_{(10/10)}$ concurred that for incoming clients it is necessary to understand and construct from scratch new knowledge about their functions, processes and operations. Furthermore, all accumulated knowledge on clients rotating outwards is lost. Particularly, AUD006 reflected on the loss of cumulative knowledge and experience and the absence of a prior year audit file:

> *"In recurring audits, we refer to the CAKE, the cumulative audit knowledge and experience. So, this CAKE is really helpful in auditing a client because you know what to expect, you know where the issues may be, knowledge of the industry and the specific client. So that is affected for sure."*

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[20] Vide Q7 in Appendix 3.3
[21] Vide Q8 in Appendix 3.3

Three respondents$_{(3/10)}$ further highlighted that the rebuilding of such "*CAKE*" makes the initial two years of an audit particularly challenging. Another two respondents$_{(2/10)}$ commented that for certain complex client specific items, EAs must restart consultations and communication with external authorities and develop new expertise. Conversely, two respondents$_{(2/10)}$ stated that auditor expertise is unaffected by rotation.

4.3.3 Feasibility and Necessity of MAFR

EAs were asked to remark on the current feasibility of MAFR in the local context[22], making reference to a 2012 local study highlighting its impracticality. Interestingly, opinions on this matter were divided, with six respondents$_{(6/10)}$ considering MAFR feasible, while the remaining four$_{(4/10)}$ deemed it unfeasible. However, 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 view. The majority of Big-Four EAs noted an expansion in the size of audit firms in Malta and that they have more than sufficient skills and resources to serve large clients. In fact, AUD003 commented that:

> *"Big-Four firms have grown a lot… if you compare the size of Big-Four firms here in Malta between 2012 and today, most of them would have doubled in size, so I do not think having resources is an issue."*

On the contrary, mid-tier EAs emphasised the resource constraints they encounter, hindering their ability to cater for such large clients. AUD007 remarked that:

> *"it is not always feasible to just shift the bigger clients out of Big-Four … smaller and mid-tier firms have a little bit of lack in skill set and resources."*

Respondents were further questioned on their perception of MAFR's necessity compared to audit partner rotation[23]. Despite the mixed views on feasibility, the majority$_{(8/10)}$ of respondents stated that MAFR is indeed necessary. Six of such respondents emphasised that firm rotation makes a significant difference in the audit, while the other two respondents deemed it necessary only for the public

[22] Vide Q12 in Appendix 3.3
[23] Vide Q14 in Appendix 3.3

perception. Only one respondent$_{(1/10)}$ considered MAFR to be unnecessary and another respondent$_{(1/10)}$ remained neutral.

4.3.4 Adaptation to MAFR

EAs were asked about their strategies for adapting to the MAFR regulation[24]. The predominant responses included adapting to new client needs (24%), ensuring the adequacy of resources (18%) and enhancing proficiency in offering non-assurance services (18%). Moreover, respondents highlighted the importance of assisting and preparing clients for rotation (12%), diversifying client portfolios (12%), enhancing expertise (12%) and keeping abreast with regulations (6%).

4.4 The Impact of MAFR on Audit Factors and other aspects

The questions discussed in this section[25] were posed to both PLCs and EAs, encompassing their perspectives and insights on such matters.

4.4.1 The effects of MAFR on Audit Factors

4.4.1.1 Audit Quality

More than half (56%)$_{(14/25)}$ of the respondents indicated that MAFR has no significant impact on audit quality, while 32%$_{(8/25)}$ perceived a positive effect and 12%$_{(3/25)}$ acknowledged both positive and negative effects. The detailed perspectives are presented in Figure 4.7.

[24] Vide Q16 in Appendix 3.3
[25] Vide Q10-11 in Appendix 3.2 and Q9-11, 13 in Appendix 3.3

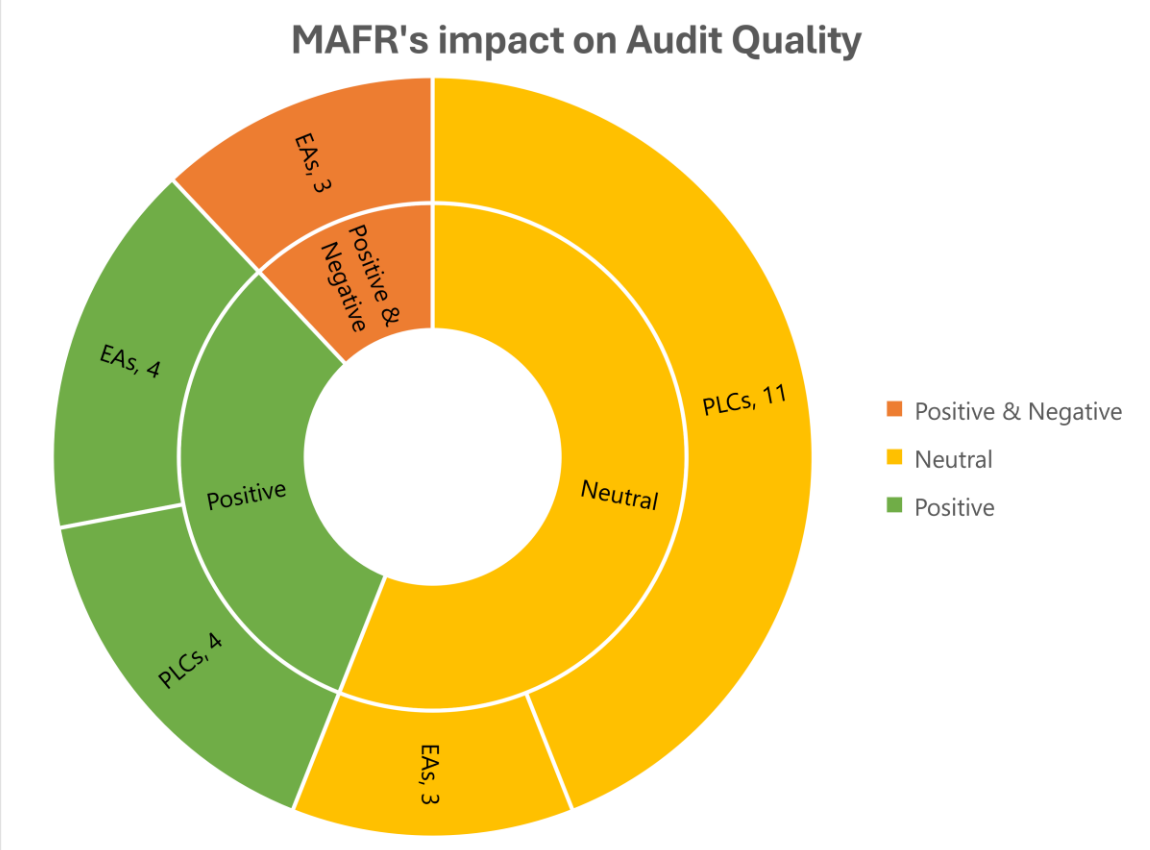

Figure 4.7: MAFR's impact on Audit Quality

Most PLCs, along with some EAs, asserted that MAFR has no impact on audit quality. PLCs asserted that the quality of audit services should remain consistent regardless of MAFR, acknowledging the possibility of lower audit quality at the onset of the rotation, which eventually neutralises. EAs stated that while the initial years of rotation may require more effort to retain the same level of audit quality, they observed no significant long-term changes.

A number of PLCs and EAs argued that MAFR has a positive effect on audit quality. PLCs highlighted that audit quality will improve, with audit files being kept up to scratch in view of the possible scrutiny by the successor auditor, who will thoroughly recheck their work. EAs also echoed this sentiment. They further noted the value of fresh perspectives brought by new auditors, which could lead to innovative methodologies and outside-the-box thinking, ultimately resulting in improved audit quality.

Only a number of EAs articulated both positive and negative effects of MAFR on audit quality. On the one hand, they reasoned that a deep client understanding, resulting from the auditors repeatedly carrying out the same audit, bolsters audit quality, whereas on the other hand, fresh perspectives from new auditors may also enhance it. Furthermore, they acknowledged that in transitions from mid-tier to Big-Four firms, audit quality is enhanced due to greater resources, whereas vice-versa, quality will not easily be matched.

4.4.1.2 Auditor Independence

Similarly, 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. More in-depth details are presented in Figure 4.8 below.

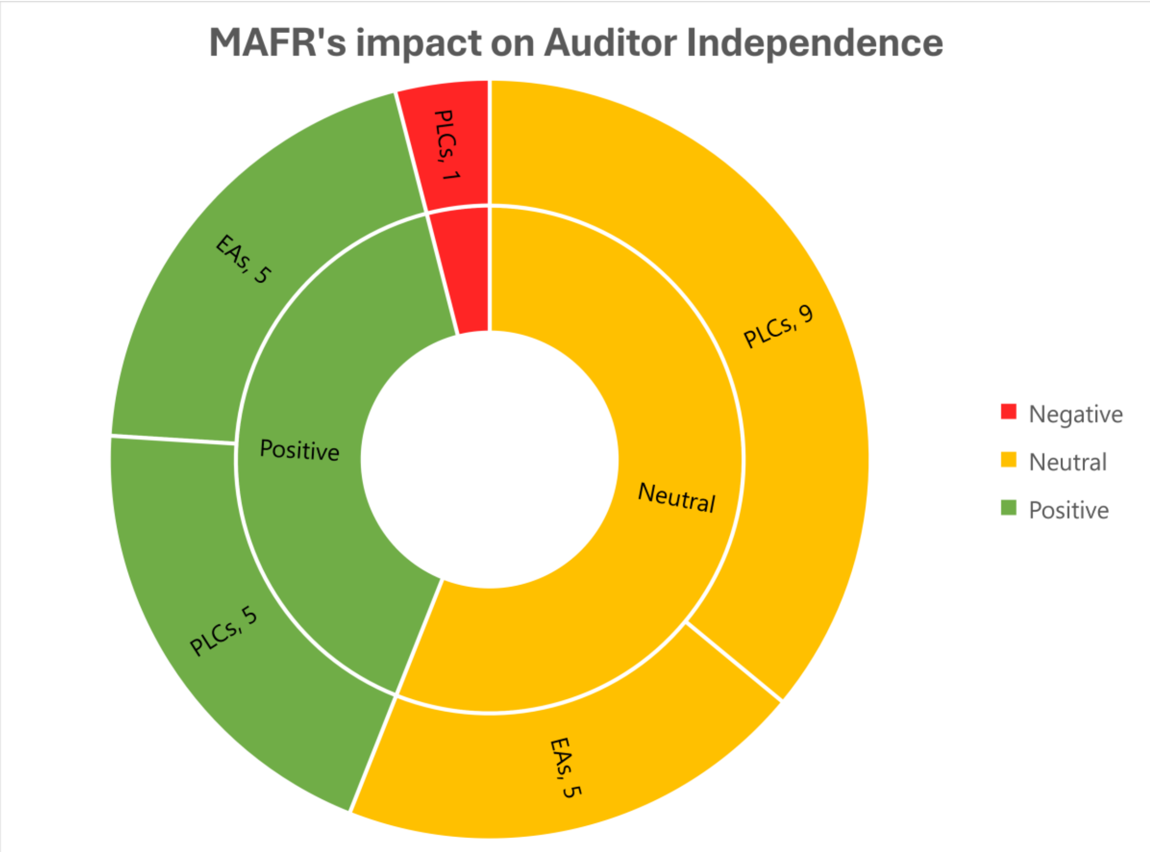

Figure 4.8: MAFR's impact on Auditor Independence

The majority of PLCs and half of EAs stated that MAFR is unlikely to have a significant impact on auditor independence. PLCs reasoned that independence should inherently be present and it is the duty of auditors regardless of rotation requirements. EAs argued that independence is rigorously assessed both before accepting an engagement and during the audit. They emphasised that threats to independence can arise irrespective of MAFR and that independence is primarily upheld by factors such as the rotation of partners and associates, adherence to professionalism and the inherent duty of auditors to maintain independence, rather than being directly affected by MAFR.

Some PLCs and half of EAs contended that MAFR positively impacts auditor independence. PLCs highlighted that the primary objective of MAFR is to enhance independence by mitigating familiarity. They argued 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. Additionally, they noted that MAFR improves the public perception of independence. EAs echoed similar sentiments, emphasising that MAFR enhances the public perception of independence and reduces familiarity. They pointed out that while partner rotation alone may not address familiarity issues adequately, MAFR effectively reduces such familiarity, thus bolstering independence.

Only one PLC stated that auditor independence will be reduced due to MAFR, referencing the self-review threat. They pointed out the possibility of a conflict of interest emerging if the new EA were to audit a non-assurance service previously rendered.

4.4.1.3 Auditor Professional Scepticism

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. Further elaboration is provided in Figure 4.9.

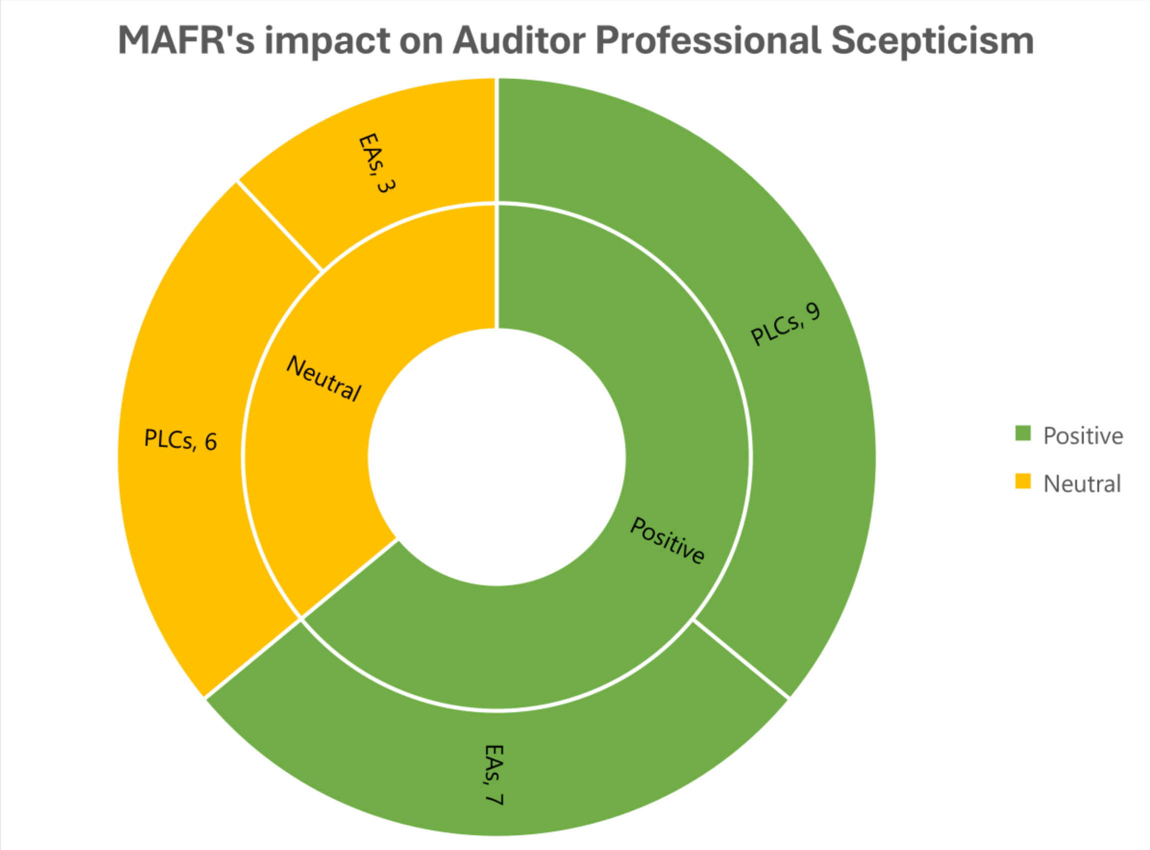

Figure 4.9: MAFR's impact on Auditor Professional Scepticism

The prevailing view among both PLCs and EAs was that MAFR positively impacted professional scepticism. PLCs argued that MAFR enhances the public perception of scepticism and manifests through fresh ideas. However, they noted that this is contingent on EAs investing sufficient time in the audit. EAs highlighted that MAFR compels EAs to ensure that estimates and projections are rigorously checked and reduces complacency that may arise from familiarity. They also noted that fresh perspectives tend to be more sceptical and new eyes challenge assumptions more rigorously, contributing to overall improvement in professional scepticism.

Some PLCs and EAs adopted a neutral stance on the issue. Both argued that auditors should always maintain a level of scepticism, regardless of MAFR.

4.4.2 The effects of MAFR on other aspects

4.4.2.1 Transparency of Financial Information

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. Additional insights can be found in Figure 4.10 below.

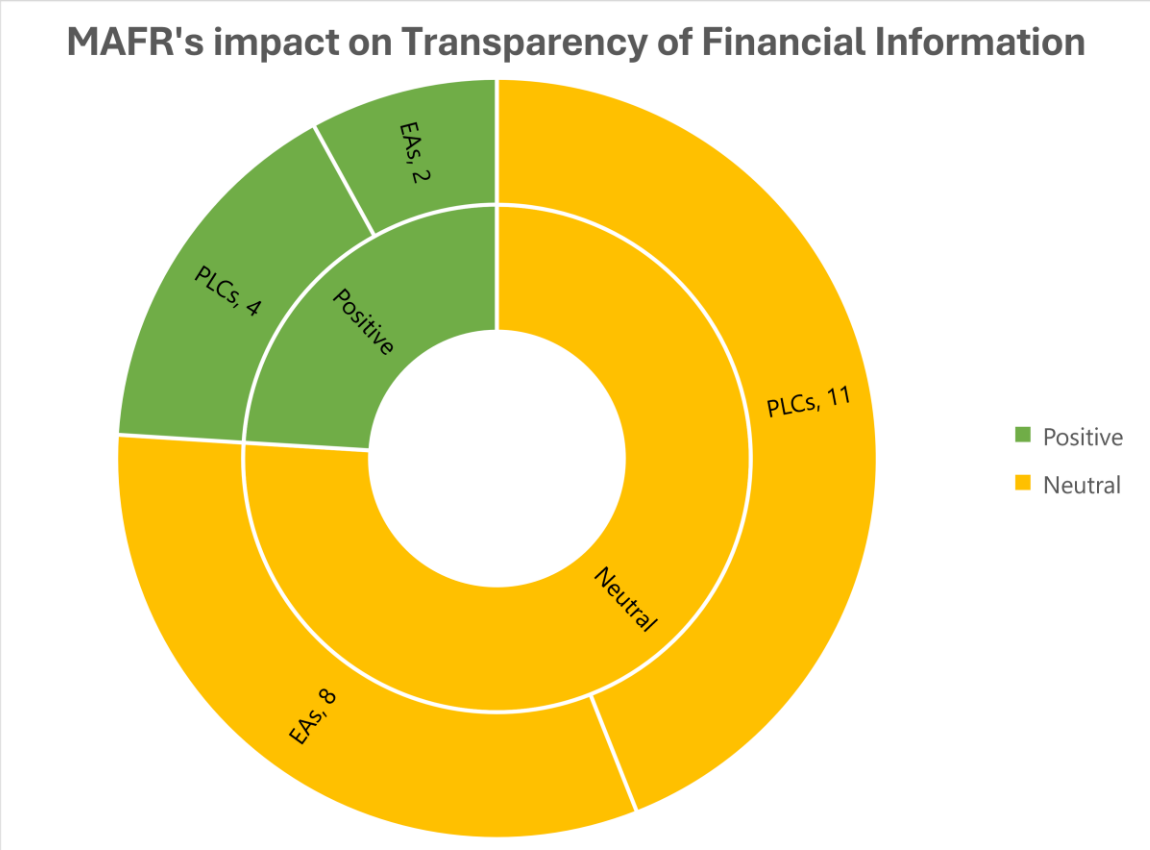

Figure 4.10: MAFR's impact on Transparency of Financial Information

The majority of PLCs and EAs asserted that MAFR does not significantly affect the transparency of financial information. PLCs argued that transparency primarily falls under the responsibility of the Board of Directors, emphasising that PLCs disclose information as required to meet regulatory standards like the International Financial Reporting Standards (IFRS). They also asserted that the transparency of financial information hinges on compliance with these standards. Similarly, EAs contended that any auditor can ascertain compliance with IFRS, suggesting that transparency should remain consistent regardless of auditor rotation.

In contrast, a minority of PLCs and EAs perceived MAFR as enhancing the transparency of financial information. PLCs suggested that MAFR improves the perception of transparency and instils greater confidence in users. However, one respondent added that this is contingent on the new auditor dedicating sufficient time to the audit. 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. They argued that MAFR enhances credibility and provides more comfort to users, ultimately contributing to greater transparency in financial reporting.

4.4.2.2 Supervision and Coordination of audits

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 detailed viewpoints are illustrated in Figure 4.11.

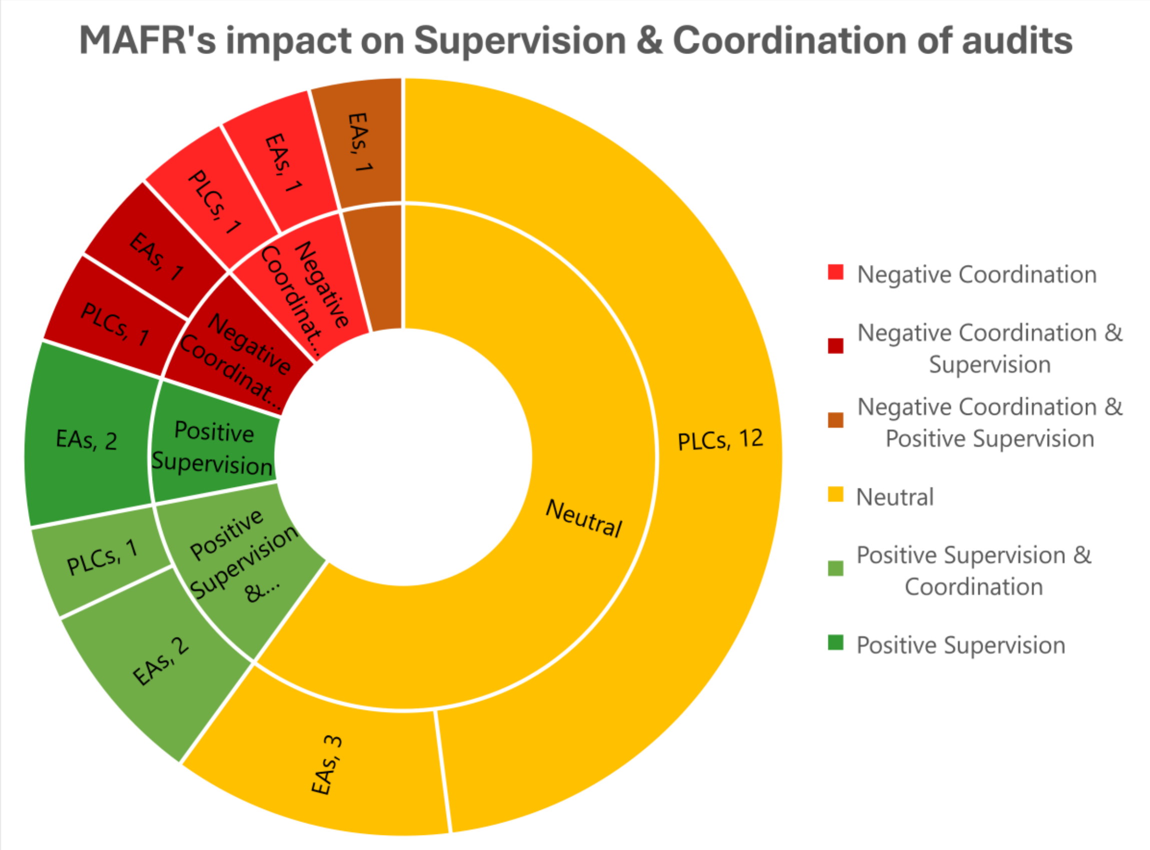

Figure 4.11: MAFR's impact on Supervision and Coordination of audits

The prevailing opinion, shared by PLCs and some EAs, was that MAFR has no discernible effect on the supervision and coordination of audits. PLCs 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, auditors may not supervise or coordinate the same audit in consecutive years.

Conversely, two EAs noted a positive effect on audit supervision in terms of regulatory oversight and in checking that audits are being carried out effectively. One EA pointed out the difficulty in planning resources for coordination while acknowledging the positive aspect of regulatory oversight for supervision.

One EA and one PLC 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 and PLC highlighted the initial challenges in coordination, requiring more effort until the team becomes accustomed to the client.

4.4.2.3 Audit Fees

Nearly half of the respondents (48%)(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. Further details may be referred to in Figure 4.12 below.

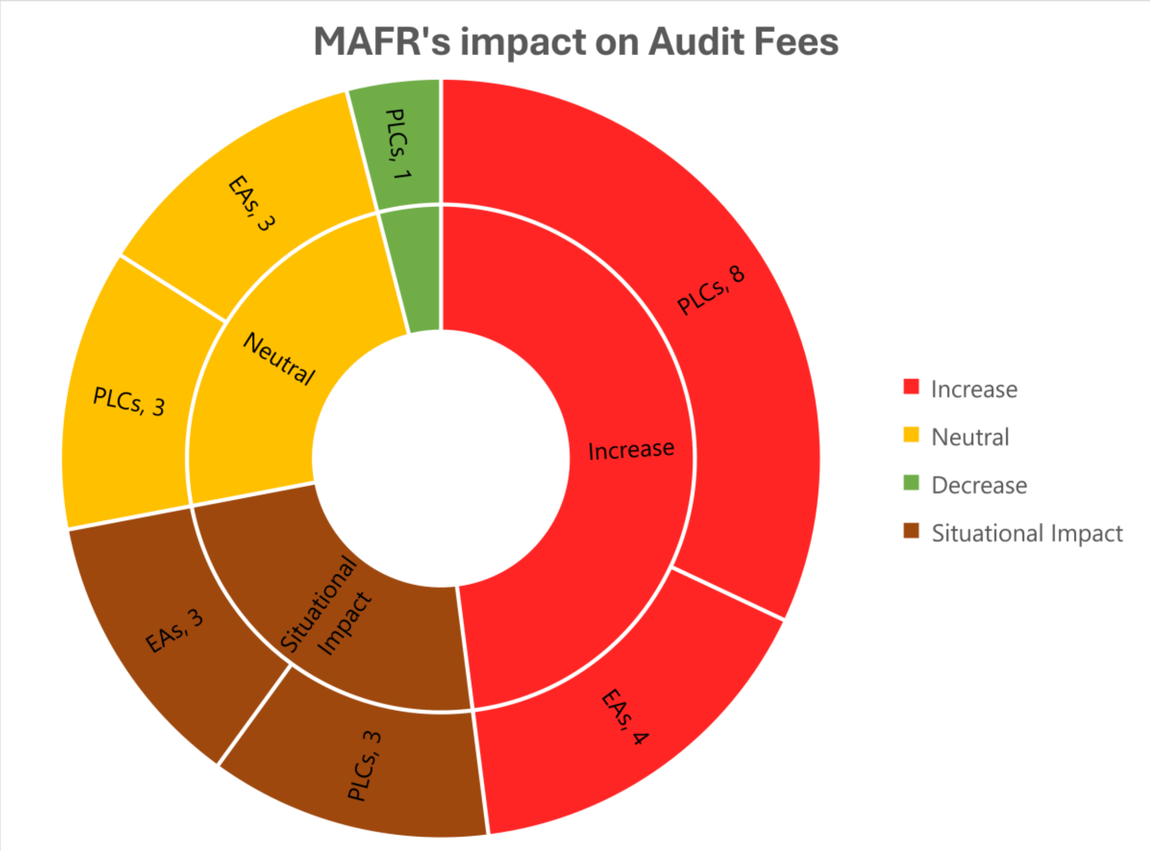

Figure 4.12: MAFR's impact on Audit Fees

The prevailing sentiment among the majority of PLCs and some EAs suggested that audit fees are likely to rise under MAFR. PLCs based this expectation on their past experiences, noting that in long-standing relationships, auditors may be hesitant to increase fees, but with rotation, fees tend to align with market rates. They also noted that EAs might take advantage of MAFR and increase their audit fees, knowing that PLCs must rotate mandatorily. EAs echoed this view, citing the opportunity for fee revision upon rotation. They emphasised that audits now entail additional work compared to a decade ago, particularly in the first year, due to advancements in information systems.

Some PLCs and EAs suggested that the impact of MAFR on fees hinges on specific circumstances. PLCs opined that EAs may either reduce audit fees amidst heightened competition or seize the opportunity to raise fees. Furthermore, PLCs noted that while fees typically increase over time, they are also influenced by competition and professional development. 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. EAs also noted that mid-tier audit firms may charge less than their Big-Four counterparts.

Some PLCs and EAs contended that MAFR will have no significant impact on audit fees. PLCs 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 asserted that there would be a decrease in audit fees, attributing it to competition in the market, as EAs attempt to regain clients for the subsequent ten-year period in tendering.

4.4.2.4 Competition

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. Additional insights are provided in Figure 4.13.

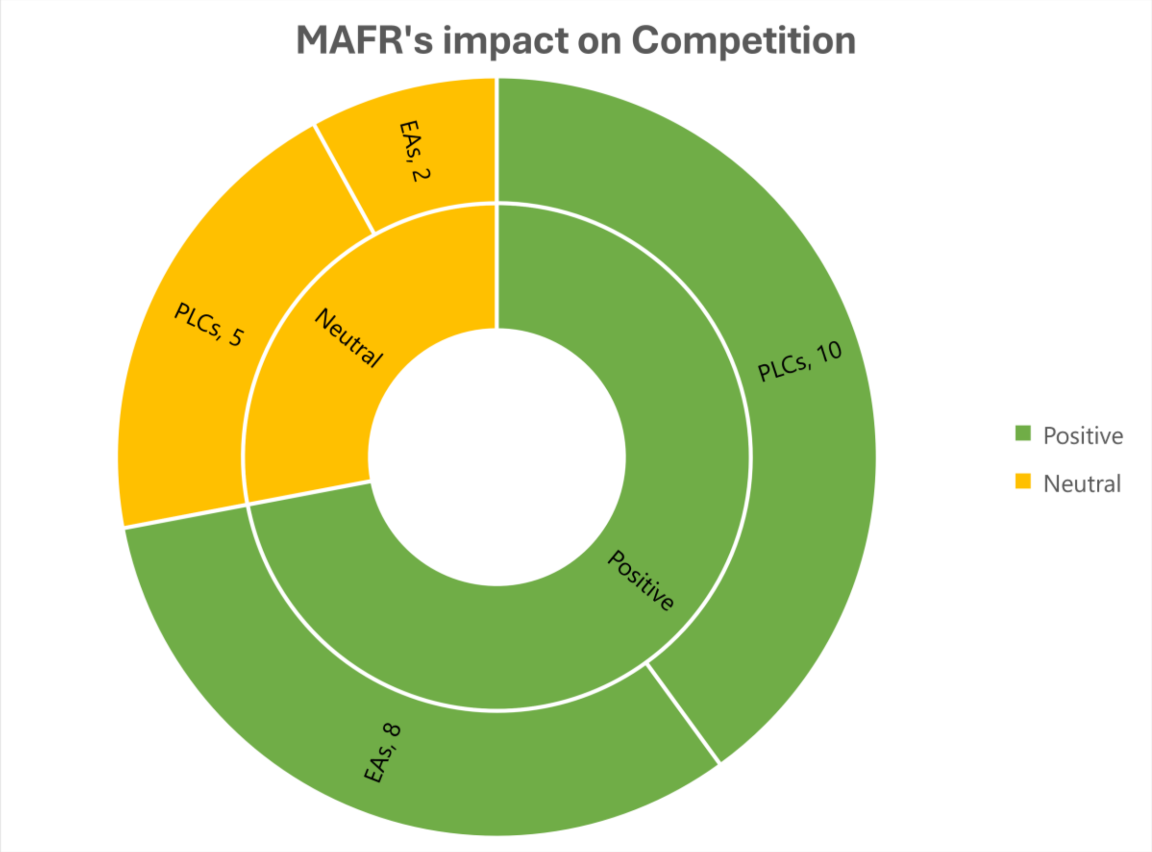

Figure 4.13: MAFR's impact on Competition

Most PLCs and EAs suggested that MAFR enhances audit market competition. PLCs emphasised the mandatory increase in the number of companies changing EAs, leading to a healthier mix of competition among audit firms. EAs generally concurred, noting that the primary objective of MAFR is to ameliorate competition, thereby expanding opportunities for audit firms. Among the EAs who advocated heightened competition, five anticipated increased competition between Big-Four and mid-tier firms, while three anticipated heightened competition specifically among Big-Four firms.

A minority viewpoint among both PLCs and EAs suggested that MAFR will have little to no impact on competition. One PLCs 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 PLCs 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.

4.5 Conclusion

This chapter presented the qualitative findings gathered from the interviews conducted. The following chapter provides an in-depth analysis and discussion of these findings in the context of the study's research objectives.

Chapter 5

Discussion of Findings

5.1 Introduction

This chapter provides an in-depth discussion of the research findings outlined in Chapter Four, in the context of the literature review presented in Chapter Two. As illustrated in Figure 5.1, Section 5.2 discusses the views of PLCs on MAFR, addressing the first research objective. Section 5.3, then, examines the views of EAs on MAFR, addressing the second research objective. The merits and demerits of MAFR are then analysed in Section 5.4. Subsequently, Section 5.5 delves into the implications of MAFR, addressing the third study objective. Additionally, Section 5.6 offers insights on the implementation of MAFR in Malta, particularly within the framework of the EU Audit Reform objectives. Finally, Section 5.7 concludes this chapter.

5.1 Introduction

5.2 MAFR as perceived by PLCs

5.2.1 Do PLCs favour MAFR?
5.2.2 Is MAFR deemed essential by PLCs?
5.2.3 How do PLCs adapt to MAFR?
5.2.4 How can policymakers facilitate MAFR implementation for PLCs?

5.3 MAFR as perceived by EAs

5.3.1 Is MAFR favoured by EAs?
5.3.2 How do EAs perceive the value of MAFR for their clients?
5.3.3 Do EAs consider MAFR as feasible and necessary?
5.3.4 What strategies can EAs employ to effectively adapt to MAFR?

5.4 The merits and demerits of MAFR

5.4.1 What advantages are attributed to the implementation of MAFR?
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5.5 The perceived implications of MAFR

5.5.1 How is the client-auditor relationship affected by MAFR?
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5.5.3 Which audit factors are affected by MAFR?
5.5.3.1 Audit Quality
5.5.3.2 Auditor Independence
5.5.3.3 Auditor Professional Scepticism
5.5.4 What other aspects does MAFR affect?

5.6 Concluding Remarks on MAFR implementation in Malta

5.6.1 Are the objectives of the EU Audit Reform being achieved in Malta?

5.7 Conclusion

Figure 5.1: Overview of Chapter 5

5.2 MAFR as perceived by PLCs

5.2.1 Do PLCs favour MAFR?

The overall perspective of PLCs on MAFR reflects a nuanced stance as evidenced by both the literature and the findings of this study. The findings suggest a predominantly positive perception of MAFR among PLCs, while also acknowledging its drawbacks[26]. This positive perception aligns with existing literature, exemplified by studies like Orlik (2011) and KPMG (2022). However, such a positive perception stands in contrast to other international research. For instance, findings by Fontaine et al. (2016) portrayed PLCs as adamantly opposing MAFR. Similarly, local study by Gerada (2012), indicated a majority opposition towards MAFR among Maltese PLCs. Evidently, the local sentiment appears to have changed over time. Furthermore, this evolving perspective may be influenced by the practical experience of undergoing MAFR, challenging the preconceived ideas about its impacts.

5.2.2 Is MAFR deemed essential by PLCs?

The findings of this study reveal a mixed perspective among PLCs regarding the necessity of MAFR[27]. While literature favours audit partner rotation over MAFR, citing benefits in client knowledge retention and client-auditor relationship preservation (Fontaine et al. 2016), respondents' views are divided, with half deeming it necessary and half opining that audit partner rotation only suffices. However, it is notable that some respondents precisely echoed the aforementioned argument put forward by Fontaine et al. (2016).

Furthermore, Gerada (2012) had contended that PLCs generally resist voluntary audit firm rotation, unless faced with a conflict of interest. Over a decade later, this sentiment still holds true, as PLCs indicate a willingness to change auditors only in cases of dissatisfaction with auditor performance[28]. This observation is noteworthy, particularly in light of the fact that although some respondents

[26] Vide Section 4.2.1
[27] Vide Section 4.2.3
[28] Vide Section 4.2.3

advocate for the necessity of MAFR, they exhibit reluctance to voluntarily adopt it.

5.2.3 How do PLCs adapt to MAFR?

In adapting to MAFR, Maltese PLCs demonstrate a clear inclination towards undergoing audit tendering[29]. This strategy affords PLCs the flexibility to either retain their current EA and extend their tenure (provided that it has not already been extended) or otherwise select a new EA if they offer more favourable services. On the one hand, some respondents favour audit tendering for the former reason, being that it enables the extension of the audit tenure to possibly twenty years. This aligns with the extensive audit firm tenures[30] observed in certain companies and the reluctance towards voluntary audit firm rotation[31]. On the other hand, audit tendering is favoured by some respondents as it enables PLCs to evaluate their options before committing to the same EA for another decade. This aligns with the varied opinions on reverting to the previous EA post-rotation[32], emphasising the importance of exploring alternatives.

Moreover, Maltese PLCs display limited interest in pursuing joint audits[33]. This is a notable departure from practices observed in foreign jurisdictions like France, where joint audits are commonly embraced by PLCs (Dattin 2017). Such contrast may indicate differences in the dynamics of audit environments across different countries.

Furthermore, whether rotating voluntarily or due to MAFR, there is a prevalent preference among PLCs for transitioning to a Big-Four audit firm[34]. 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.

[29] Vide Section 4.2.4
[30] Vide Section 4.2
[31] Vide Section 5.2.2
[32] Vide Section 4.2.4
[33] Vide Section 4.2.4
[34] Vide Section 4.2.4

5.2.4 How can policymakers facilitate MAFR implementation for PLCs?

Policymakers can play a crucial role in supporting PLCs to navigate the challenges associated with the implementation of MAFR through the enforcement of additional regulations[35]. Respondents suggested two key approaches to address the challenges associated with transitions between EAs. Firstly, policymakers could mandate and oversee the handover of audit files between incoming and outgoing audit firms. This measure is also proposed by Jong et al. (2020), as it would ensure the effective transfer of essential information, thus maintaining continuity of knowledge. This, in turn, would mitigate disruptions that may arise during transitions between audit firms, by warranting that the incoming auditor has access to all relevant information from the previous audit cycles. Such a measure may be truly helpful as some incoming EAs have indeed experienced resistance from the client's previous auditor during the handover process. Secondly, policymakers could require clients to maintain written documentation detailing current operations and past records, which would facilitate the transition process by providing crucial information to incoming audit firms. These two propositions enable the new EA to quickly familiarise themselves with the client's operations and financial reporting practices, thereby facilitating the audit process and potentially lowering audit fees associated with additional work to gather client understanding.

Moreover, mandating joint audits with the incoming auditor for the final audit engagement of the outgoing auditor can further enhance continuity in the audit process. This approach emphasises the collaboration of both EAs and enables the incoming auditor to gain valuable insights into the client's business operations and audit history. As highlighted by Dattin (2017), such a 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.

[35] Vide Section 4.2.4

Some respondents also suggested that the minimum ten-year rotation period be shortened, considering it excessively lengthy. This sentiment aligns with the conclusions drawn by Orlik (2011), in which a rotation period of three years was suggested.

5.3 MAFR as perceived by EAs

5.3.1 Is MAFR favoured by EAs?

The prevailing sentiment among EAs towards MAFR demonstrates a predominantly positive outlook, as evidenced by both the findings of this study and existing literature. The findings indicate a notable inclination among EAs towards viewing MAFR favourably[36], with several factors contributing to this optimistic perspective, such as the perceived enhancement of audit quality and independence. This is commensurate with international research conducted by Fahti and Rashed (2021), Jong et al. (2020) and Şeker and Türel (2023). Additionally, EAs attribute their positive outlook to various other effects associated with MAFR, including its perceived positive impact on competition and opportunities within the audit market, transparency, credibility, auditor scepticism and fresh perspectives.

However, a noteworthy departure from the former local perspective of EAs is observed when comparing research findings to those of Gerada (2012), as previously EAs held a stance adamantly opposing MAFR. The shift in EAs' perception towards a more favourable view of MAFR could be attributed to the non-materialisation of the anticipated negative effects associated with MAFR.

5.3.2 How do EAs perceive the value of MAFR for their clients?

The majority of EAs recognise that the implementation of MAFR offers PLCs the benefit of a fresh perspective, albeit with associated additional costs[37]. This fresh outlook, as highlighted by McLaren (1958) and Polychronidou et al. (2020), aids

[36] Vide Section 4.3.1
[37] Vide Section 4.3.2

PLCs in uncovering errors and overlooked areas in audits. Some EAs view this advantage as outweighing the costs for their clients, as it fosters a proactive approach to identifying weaknesses in processes and reduces complacency. Moreover, such a fresh viewpoint is perceived as highly valued by top management and audit committees, as it signals a commitment to rigorous audit practices and contributes to the overall improvement of the company. However, this appreciation may not be universal, especially among lower-level staff who interact regularly with EAs, as they may find the process of changing auditors burdensome and disruptive to their workflow.

On the other hand, the primary disadvantage of MAFR for EAs' clients, as identified by Fontaine et al. (2016), Jong et al. (2020) and Polychronidou et al. (2020), is the incurrence of additional costs and uncertainty associated with switching EAs. EAs acknowledge such costs, particularly in terms of increased fees passed on to clients due to increased audit workload. Additionally, costs may relate to client staff adapting to the new auditor's methodologies and the necessity of re-explaining company processes and operations.

Determining whether the benefits of a fresh perspective outweigh these costs for clients poses a challenge. Such evaluation often hinges on whether the fees charged by the new EA align with market rates or are competitively reduced. As noted by McLaren (1958), the practical dilemma is whether the fresh perspective is justified by its cost, meaning, if the audit fees are revised upwards, the fresh outlook may not be perceived as worthwhile anymore. Furthermore, while the provision of a fresh perspective is deemed important, questions arise as to whether this could be achieved through partner rotation alone, without the need for full audit firm rotation.

5.3.3 Do EAs consider MAFR as feasible and necessary?

The feasibility of MAFR has been a topic of debate, as indicated in the literature and confirmed by this study's findings. Gerada (2012) highlighted concerns among EAs 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. The findings of this study reflected a divergence of opinions on this matter[38]. While Big-Four EAs viewed MAFR as feasible, citing their abundant skills and resources to cater effectively to large clients, mid-tier EAs expressed scepticism regarding its feasibility due to resource constraints. Consequently, mid-tier EAs agreed with Gerada's assertion, as they face challenges in servicing large clients, whilst Big-Four EAs contested Gerada's findings, stating that MAFR is indeed viable.

Despite varying opinions on feasibility, the majority of both Big-Four and mid-tier EAs consider MAFR necessary in the local context[39], echoing findings from Anis (2014) and Şeker and Türel (2023). These studies assert that EAs perceive MAFR as crucial for enhancing audit effectiveness, particularly in terms of objectivity and independence. However, this stance contrasts with Gerada's (2012) study, where fewer than 15% of EAs supported MAFR's implementation in Malta. As suggested by Jong et al. (2020), this shift in perspective may stem from EAs' direct experience with the implementation of MAFR, leading them to perceive it as less detrimental than initially anticipated. Furthermore, this stance contradicts Harber and Maroun's (2020) findings, where EAs deemed audit partner rotation sufficient, raising doubts about the necessity of full audit firm rotation.

5.3.4 What strategies can EAs employ to effectively adapt to MAFR?

EAs may adopt proactive strategies in navigating the challenges brought about by this regulatory change[40]. As emphasised by EAs, adopting a client-centric approach is paramount to address new client needs and form strong client relationships. Additionally, EAs should concentrate their efforts on resource management to ensure that they have adequate resources to effectively serve the new clients introduced by MAFR. This not only includes manpower, but also technology and other necessary resources to conduct audits.

[38] Vide Section 4.3.3
[39] Vide Section 4.3.3
[40] Vide Section 4.3.4

Diversification of services is another key strategy, with a particular focus on enhancing proficiency in offering non-assurance services. This diversification into alternative revenue streams serves as a buffer against potential adverse financial effects of MAFR on EA businesses. Furthermore, EAs should diversify their client portfolios to mitigate risks associated with over-reliance on individual clients. By expanding their client base beyond PLCs, EAs can spread their risk and enhance their resilience to regulatory changes like MAFR.

Lastly, EAs should stay abreast of regulatory developments, such as MAFR, to be prepared to adapt to the evolving regulatory landscape.

5.4 The merits and demerits of MAFR

5.4.1 What advantages are attributed to the implementation of MAFR?

Both PLCs and EAs identified numerous benefits stemming from the implementation of MAFR. In line with McLaren (1958) and Polychronidou et al. (2020), several respondents from both groups perceive MAFR as providing a fresh perspective to audits[41], 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), who argue that MAFR leads to overall improvements in audit quality. Similarly, Hoyle (1978) asserts the effectiveness of MAFR in refining audit approaches.

Moreover, some respondents believe that MAFR reinforces independence and reduces familiarity[42], with the latter serving to strengthen the former. This observation also finds support in the works of Hoyle (1978), Petty and Cuganesan (1996) and Polychronidou et al. (2020), all of whom contend that MAFR enhances audit independence and objectivity. Ultimately, as acknowledged by EAs, such benefits contribute to credibility in the audit profession.

[41] Vide Section 4.2.1; Section 4.3.1
[42] Vide Section 4.2.1; Section 4.3.1

PLCs further appreciate the benefit of increased professional scepticism[43], consistent with the assertions of Hoyle (1978) and note MAFR's role in holding auditors accountable. This finding is 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 found to be another significant benefit[44], 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[45]. 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 offer other non-assurance services to their clients[46]. However, this is contingent upon the establishment of trust in prior relationships so that clients feel confident in entrusting EAs with future engagements. Notably, non-assurance services often yield higher margins and profits for audit firms compared to audit engagements. Therefore, in such scenarios, not only are relationships maintained through alternative channels, but audit firms also benefit from increased profitability.

5.4.2 What are the key disadvantages associated with MAFR?

PLCs and EAs have both identified several challenges associated with the implementation of MAFR. One primary drawback noted by both parties is the loss of accumulated client knowledge[47]. PLCs 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 research from Fontaine et al. (2016), Harber and Maroun (2020), Jong et al. (2020) and Polychronidou et al. (2020), which highlight the increased costs and

[43] Vide Section 4.2.1
[44] Vide Section 4.2.1
[45] Vide Section 4.3.1
[46] Vide Section 4.3.1
[47] Vide Section 4.2.1; Section 4.3.1

inefficiencies associated with gaining an understanding of the client under MAFR. Furthermore, PLCs raise concerns about reduced audit efficiency stemming from such lack of knowledge[48]. EAs further corroborate this view by stating that the initial years of a new audit present more challenges to new auditors due to limited understanding of clients' businesses[49]. Such additional challenges may take the form of errors in first-year audits (Jong et al. 2020) and lead to a deterioration in the quality of financial reporting (Kim et al. 2015).

Additionally, PLCs emphasise further inconveniences, as they find the process of changing auditors to be time-consuming and resource intensive[50]. Another concern noted by PLCs is the creation of a potential conflict of interest in the case that the newly appointed EA had previously provided non-assurance services to the company[51]. This could result in a self-review threat as the new auditor reviews their own work from the preceding year. Thus, such a case would result in additional costs to subcontract an additional EA to review the results of such non-assurance work.

EAs also remark on the loss of client relationships and associated revenue as major disadvantages of MAFR[52]. 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. However, such costs are not always recoverable from new clients, adversely impacting the profitability of engagements due to the financial burden incurred during the transition period. 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[53].

Lastly, the overarching findings indicate that both PLCs and EAs are absorbing the costs associated with MAFR[54]. This stands in contrast with the predictions

[48] Vide Section 4.2.1
[49] Vide Section 4.3.1
[50] Vide Section 4.2.1
[51] Vide Section 4.2.1
[52] Vide Section 4.3.1
[53] Vide Section 4.3.1
[54] Vide Section 4.2.1; Section 4.3.1

made by PLCs and EAs in Gerada's (2012) study. According to such literature, PLCs anticipated bearing the majority of the supplementary costs stemming from MAFR, while EAs expected to absorb such additional costs themselves, rather than passing them on to their clients. However, Gerada (2012) had rightly concluded that MAFR would increase costs for both parties.

5.5 The perceived implications of MAFR

5.5.1 How is the client-auditor relationship affected by MAFR?

Contrary to Fontaine et al. (2016), several PLCs and EAs perceive no impact of MAFR on their relationship[55]. However, others acknowledge significant changes[56]. For instance, both respondent groups note increased accountability in the latter stages of the client-auditor relationship. With the inevitability of a change in auditors, EAs become more diligent in ensuring thorough and error-free audits, to avoid scrutiny by the next auditor. In view of this, EAs further strive to deliver high-quality service to clients and attribute MAFR to upholding professionalism in such relationships. This observation aligns with Gerada's (2012) findings. 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 negative publicity resulting from the failure to detect errors by the previous firm.

Furthermore, both PLCs and EAs note that EAs tend to prioritise client loyalty, driven by a newfound sense of appreciation of their clients. Recognising the value of longstanding relationships, auditors actively strive to either win back former clients after rotation or retain them by offering alternative services. The latter signifies a transformation in the client-auditor relationship, shifting towards a client-advisor dynamic.

[55] Vide Section 4.2.2; Section 4.3.2
[56] Vide Section 4.2.2; Section 4.3.2

Both respondent groups also emphasise the importance of establishing new client-auditor relationships with incoming clients by building trust, which takes time to develop. Such relationships will face numerous communication challenges in the initial years. Notably, EAs must invest more effort into ensuring the success of these new relationships to ensure their continuity, especially considering that PLCs can simply replace their auditors if they are dissatisfied.

5.5.2 Is the continuity of knowledge and expertise impacted by MAFR?

Both PLCs and EAs acknowledge the detrimental impact of MAFR, particularly concerning the loss of accumulated knowledge[57], a sentiment supported by Fontaine et al. (2016). This challenge is particularly noticeable during the initial years of an audit, adding complexities for both parties involved. Literature by 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. EAs echoed these concerns, expressing difficulties in understanding and constructing new knowledge about client businesses, as well as the need to develop new expertise. However, PLCs identified potential benefits arising from this challenge, such as the emergence of new insights during the accumulation of fresh knowledge.

It is anticipated that the aforementioned challenge subsides over time, as EAs remarked that new clients are cooperative and willing to share information[58]. Clients understand the obligatory nature of the rotation and their responsibility to collaborate. Moreover, they acknowledge that assisting EAs in understanding their business will ultimately benefit them by facilitating the audit process and expediting its completion.

[57] Vide Section 4.2.2; Section 4.3.2
[58] Vide Section 4.3.2

5.5.3 Which audit factors are affected by MAFR?

5.5.3.1 Audit Quality

Gerada's (2012) findings had anticipated that MAFR would reinforce audit quality, yet current prevailing views are mixed. PLCs generally perceive MAFR as having no significant impact on audit quality[59], contending that all auditors are expected to deliver a high-quality service regardless of rotation. This sentiment substantiates studies by Aschauer and Quick (2018), DeFond and Francis (2005) and Stefaniak et al. (2009), which indicate a lack of substantial correlation between MAFR and audit quality.

Conversely, EAs' views on the relationship between MAFR and audit quality vary. While it is challenging to draw a definitive conclusion from their responses, a notable proportion of EAs recognise the potential positive effect of MAFR on audit quality. They argue that MAFR prompts auditors to maintain meticulous audit files in anticipation of scrutiny by successor auditors, thereby fostering a heightened level of diligence and attention to detail in audits. Moreover, the introduction of fresh perspectives by new auditors is seen as a contributing factor to improved audit quality. These 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).

On the contrary, a few EAs argue that the deep understanding of clients' businesses, often attained over years of engagement, plays a crucial role in enhancing audit quality. Such understanding, however, tends to erode following audit firm rotation, leading to the assertion that MAFR potentially diminishes audit quality. This argument 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.

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[59] Vide Section 4.4.1.1

5.5.3.2 Auditor Independence

Opinions regarding the effect of MAFR on auditor independence are diverse[60], partially contradicting Gerada's (2012) forecasts of MAFR reinforcing auditor independence. PLCs, echoing sentiments of Aschauer and Quick (2018) and Dattin (2017), contend that auditor independence is not affected by MAFR, as independence is an inherent professional duty of auditors, unaffected by rotation requirements. Moreover, independence is primarily upheld by other factors, such as the rotation of partners, as suggested by Harber and Maroun (2020).

In contrast, EAs hold varied perspectives on the matter. While some agree with PLCs that MAFR has no significant effect on auditor independence, others perceive a positive impact. It is argued that MAFR enhances independence by mitigating familiarity between auditors and clients. This viewpoint substantiates research by Fathi and Rashed (2021), Kim et al. (2015), Petty and Cuganesan (1996) and Polychronidou et al. (2020). Moreover, it is implied that while partner rotation alone may not address familiarity issues adequately, MAFR effectively reduces such familiarity. In the absence of EA rotation, familiarity in the client-auditor relationship may increase the likelihood of overlooking discrepancies and placing undue trust in client contentions (Hoyle 1978). Additionally, it is argued that MAFR improves the public perception of independence, as noted by O'Leary (1996).

5.5.3.3 Auditor Professional Scepticism

Evidence from research and literature converges to suggest that MAFR positively impacts auditor professional scepticism[61]. Both PLCs and EAs share this viewpoint, aligning with findings from studies conducted by Fathi and Rashed (2021), Harber and Maroun (2020) and Jong et al. (2020). MAFR introduces fresh perspectives that prompt EAs to engage in more rigorous challenging of assumptions, thereby mitigating complacency that may arise from prolonged familiarity with clients. This resonates with Hoyle's (1978) assertion that extended tenures may compromise auditor objectivity and professional scepticism.

[60] Vide Section 4.4.1.2
[61] Vide Section 4.4.1.3

Additionally, Gerada's (2012) forecast regarding the heightened awareness of EAs on the scrutiny of their work which leads to more diligence, is corroborated in this instance. In fact, EAs emphasise the rigorous examination of estimates and projections to ensure thoroughness and accuracy, reinforcing the positive influence of MAFR on professional scepticism.

5.5.4 What other aspects does MAFR affect?

This study concludes that MAFR has limited influence on the transparency of financial information, implying no significant effect on the quality of financial reporting[62]. Respondents attribute the responsibility for maintaining transparency to the Board of Directors, highlighting their role in ensuring compliance with financial reporting standards. Additionally, regardless of rotation, auditors can verify compliance with these standards, substantiating the perspectives presented by Blouin et al. (2007). However, this view contrasts with findings by Kim et al. (2015), who suggested a possible decline in the quality of financial reporting attributable to MAFR. They argued that this decline stems from the limited understanding of clients by new EAs, which is crucial for identifying specific risk factors in financial statements.

Furthermore, the findings suggest that MAFR does not significantly impact the supervision of audits, by either audit partners or regulatory authorities[63]. Notably, even without rotation, auditors may not necessarily supervise or coordinate the same audit in consecutive years. Moreover, the inherent difficulties in supervision and coordination persist regardless of rotation, owing to the constant rotation of audit teams. However, challenges in audit coordination in the initial years were noted by some respondents. For instance, newly rotated EAs necessitate more effort and thought into resource planning, until the audit team becomes acclimated to the client. This observation substantiates findings by Aschauer and Quick (2018), indicating difficulties for EAs in establishing multiyear audit plans.

[62] Vide Section 4.4.2.1
[63] Vide Section 4.4.2.2

Additionally, this study revealed mixed views regarding MAFR's impact on audit fees[64], with a predominant sentiment suggesting a probable increase in such fees, consistent with the findings by Jong et al. (2020), but contrary to those of Ewelt-Knauer et al. (2013). Respondents reported experiencing fee increases upon rotation, attributing this trend to the opportunity for EAs to raise their fees, particularly given the mandatory nature of rotation for PLCs. Moreover, audits now involve more extensive work, especially in the initial year following rotation, resulting in increased audit fees. 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. However, a minority of respondents view no significant impact on audit fees, aligning with the conclusions drawn by Salehi et al. (2022).

Lastly, the findings of this study imply that MAFR generally fosters competition[65], consistent with prior research by Hoyle (1978), McLaren (1958) and Polychronidou et al. (2020), which highlight a broader distribution of audit engagements among a wider range of practitioners. However, despite such a view, PLCs 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, as previously mentioned. This preference aligns with the observations made 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 towards favouring mid-tier audit firms may stem from perceived deficiencies in specialised expertise among these firms, as highlighted by Petty and Cuganesan (1996).

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

[64] Vide Section 4.4.2.3
[65] Vide Section 4.4.2.4

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.

5.6 Concluding Remarks on MAFR implementation in Malta

The findings reveal a significant response to MAFR in Malta, as evidenced by both PLCs and EAs[66]. A considerable proportion of PLCs have either undergone rotation or are actively preparing for imminent rotation, signalling a substantial acclimation to this regulation. It is noteworthy that among the PLCs preparing for rotation, many have never undergone auditor rotation in the past. This indicates a notable shift driven by regulatory exigencies, highlighting the significant adjustment these PLCs are making in response to regulatory demands. Similarly, the majority of audit firms have experienced mandatory rotation, with only a minority having experienced voluntary rotation only thus far. These findings offer valuable insights into the extent and ramifications 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.

5.6.1 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[67], 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.

[66] Vide Section 4.2; Section 4.3
[67] Vide Section 4.4.1.1

Similarly, the objective focused on improving auditor independence[68] 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[69] 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[70]. However, as aforementioned, 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 within the local context.

5.7 Conclusion

In this chapter, the key research findings were discussed, as responses were analysed and compared with local and international research. The subsequent chapter concludes the dissertation by summarising the findings, providing recommendations and pinpointing areas for further research.

[68] Vide Section 4.4.1.2
[69] Vide Section 4.4.1.3
[70] Vide Section 4.4.2.4

Chapter 6

Summary, Conclusions & Recommendations

6.1 Introduction

This chapter concludes the research study. As illustrated in Figure 6.1 below, Section 6.2 summarises the findings and the scope of this research. The key conclusions are subsequently presented in Section 6.3. Furthermore, Sections 6.4 and 6.5 provide recommendations and areas for further research respectively. Finally, Section 6.6 sets out the concluding remarks.

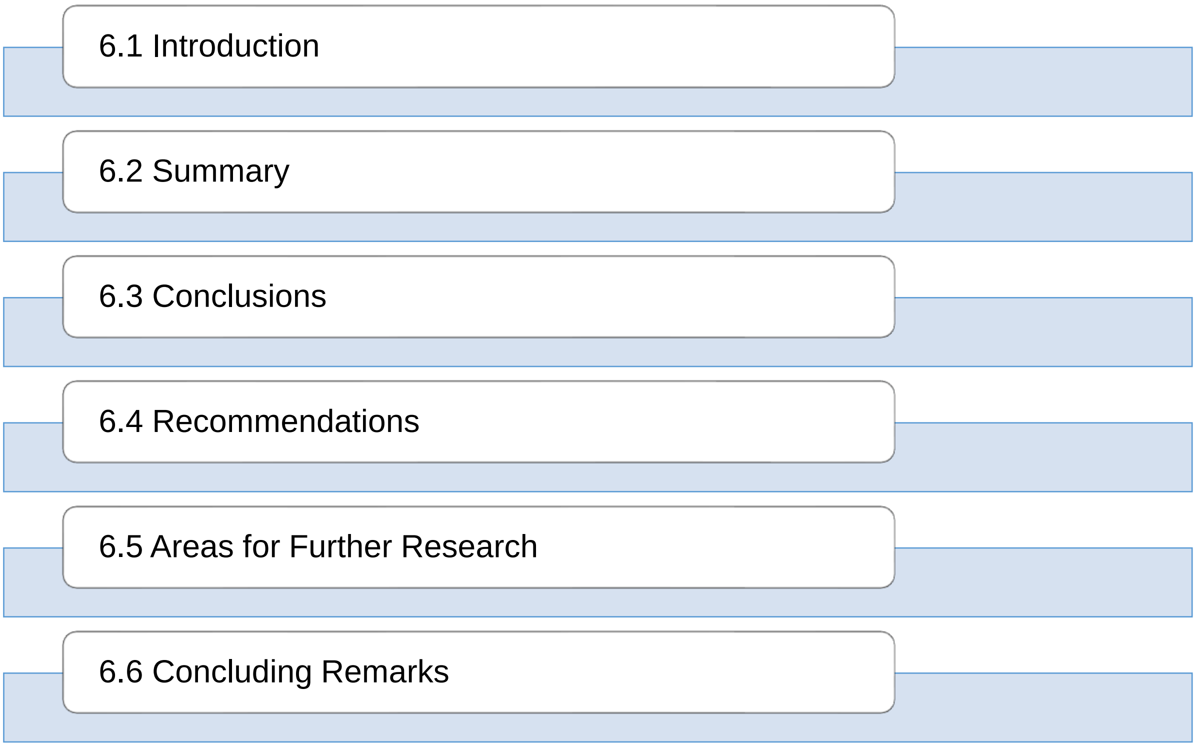

Figure 6.1: Overview of Chapter 6

6.2 Summary

This study sought to ascertain the perceptions of both PLCs and EAs regarding MAFR and to discern the implications resulting from its implementation within the local context. This research was driven by a noticeable gap in local literature concerning this topic, as well as an interest in evaluating the extent to which the objectives set forth by the EU Audit Reform[71] are perceived to be achieved in Malta through the implementation of MAFR.

A qualitative methodology involving twenty-five semi-structured interviews was employed to achieve all three objectives of this study. EA participants included four Partners, one Director, three Senior Managers and two Managers. On the other hand, PLC respondents comprised eight CFOs, two Financial Controllers, two Heads of Finance, one Head of Audit, one Finance Manager and one Audit Committee Member.

The qualitative findings derived from both groups of participants were subsequently analysed, compared and contrasted against each other. They were also contextualised against existing literature to highlight any consistencies or disparities with prevailing studies. The ensuing section delineates the findings and their relationship to the study's research objectives.

6.3 Conclusions

The first objective of this study aimed to examine the perspectives of Maltese listed PLCs on MAFR and to comprehend their perceptions of the impacts brought about by this regulatory measure. This study concludes that Maltese PLCs exhibit a predominantly favourable view of MAFR, although they also recognise certain drawbacks associated with its implementation. A shift in perspective is observed since local PLCs previously expressed opposition towards MAFR, as highlighted in Gerada's (2012) study. Such shift suggests that practical experiences with the regulation have challenged and influenced PLCs' initial perceptions of MAFR. Furthermore, PLCs hold varied opinions regarding the necessity of MAFR, with some advocating for it, while others favouring audit partner rotation as a standalone measure. While some PLCs recognise its necessity and benefits, not all would have voluntarily adopted this measure had it not been mandatory. Additionally, the implementation of MAFR has prompted

[71] Vide Section 2.2.1

PLCs 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.

Regarding the effects of MAFR, PLCs perceive an increased sense of accountability and appreciation in the latter stages of client-auditor relationships. Additionally, certain relationships transform into client-advisor relationships due to MAFR. However, concerns are raised regarding the disruption to the continuity of knowledge and expertise due to MAFR, presenting challenges for PLCs in the initial years of new audits as they are required to re-explain their unique aspects to EAs. Nonetheless, some PLCs perceive this challenge as an opportunity for novel insights to emerge during the acquisition of fresh knowledge. Finally, PLCs generally believe that the quality of audit services remains unaffected by MAFR, highlighting the importance of auditors' duty to consistently provide high-quality services, irrespective of regulatory requirements.

The second objective of this study sought to explore the perspectives of EAs on MAFR and evaluate their perceived impacts of it. Similar to the case of PLCs, the study reveals a significant shift in EAs' attitudes towards MAFR, with a notable transition from previous opposition to a more positive view. This change in perception could be attributed to the non-materialisation of anticipated negative effects associated with MAFR. Furthermore, EAs perceive MAFR as advantageous for their clients, particularly in providing fresh perspectives, despite the additional costs incurred. Typically, these innovative viewpoints are appreciated by top management and audit committees but not by lower-level staff. Moreover, Big-Four EAs regard MAFR as feasible locally due to their ample skills and resources to cater effectively 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 prior perspectives outlined in the aforementioned study. Nonetheless, both Big-Four and mid-tier EAs consider MAFR indispensable for the local scenario, notwithstanding resource constraints.

In terms of the impacts of MAFR, EAs express heightened accountability, diligence and a stronger commitment to delivering a high-quality service in the later stages of client-auditor relationships, motivated by the need to avoid scrutiny by subsequent EAs. Thus, MAFR upholds professionalism in such relationships. Additionally, EAs also aim to offer non-assurance services to clients rotating outwards to maintain relationships and revenues. Simultaneously, they seek out new clients and establish new client-auditor relationships to replace prior audit revenue streams. Moreover, since MAFR disrupts the continuity of knowledge and expertise, EAs invest additional efforts during the initial years of new audits to make up for such loss and also strive to enhance their levels of expertise.

The third objective was to discern and assess the audit factors affected by MAFR. The study concludes that PLCs perceive MAFR as having no significant impact on audit quality and auditor independence, contending that such aspects are inherent to audits and should not be affected by rotation. However, EAs hold a more nuanced stance, partially concurring with PLCs, while also attributing a positive influence on both quality and independence to MAFR. In fact, some suggest that the resulting increased diligence and fresh perspectives enhance audit quality and that MAFR mitigates familiarity. Furthermore, both PLCs and EAs observe a positive correlation between MAFR and auditor professional scepticism. It is argued that MAFR introduces fresh perspectives which prompt EAs to scrutinise assumptions more rigorously and conduct more thorough examinations of estimates and projections.

Additionally, both groups of respondents perceive no significant impact of MAFR on the transparency of financial information and supervision and coordination of audits. Financial reporting standards are viewed as more crucial in ensuring transparency of financial information than audits. Furthermore, inherent difficulties in supervision and coordination persist regardless of rotation.

Conversely, both respondent groups observe increased audit fees and competition. Audit fees tend to rise due to EAs' newfound flexibility in fee revision and due to increased workload, which is ultimately billed to clients. Additionally, competition is intensified primarily among the Big-Four firms, as mid-tier firms still encounter hurdles in acquiring new PLC clients due to resource constraints and PLCs' 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.

6.4 Recommendations

In view of the findings, the researcher proposes the following recommendations:

A. Facilitating client knowledge transfer

Given the challenges faced by both PLCs and EAs regarding the disruption of knowledge continuity during EA transitions, additional regulations should be considered to facilitate the sharing of client information between auditors. Such regulations would also address the resistance of preceding EAs to provide information to new EAs. Structured mechanisms for sharing client knowledge could be developed to mitigate such loss during rotations. This might include mandating the handover of audit files between incoming and outgoing EAs or even requiring joint audits on final engagements. PLCs can also contribute by maintaining updated documentation of operations and records to aid incoming EAs. These recommendations would expedite the acclimation of new EAs to clients' operations and financial reporting practices, accelerating the audit process. Additionally, they empower PLCs to negotiate lower audit fees by reducing the workload associated with gaining client understanding. Moreover, the proposal for a final joint audit would instil greater confidence in stakeholders, leveraging the combined expertise and oversight of multiple EAs.

B. Shortening rotation periods

Some PLCs expressed concerns about the lengthy ten-year rotation period, especially considering the possibility of extension to twenty years through audit tendering. Thus, it is recommended to shorten the rotation period to ten years or less, without the option of extension. This adjustment would further mitigate the threat of familiarity, encourage rotation between Big-Four and mid-tier EAs and enhance EA accountability.

C. Promoting mid-tier firm inclusion in PLC audits

To diversify the audit market and reduce the dominance of Big-Four firms, efforts should be made to promote the inclusion of mid-tier firms in PLC audits. Policies or incentives could be implemented to encourage PLCs to consider mid-tier EAs during tendering processes. Mandating that requests for quotes are sent to a minimum of two mid-tier EAs could be one such measure. Nonetheless, for mid-tier EAs to be able to take on such engagements, they must address their resource constraints, as highlighted below.

D. Enhancing EAs' resource management

Recognising the resource limitations in implementing MAFR faced by EAs, particularly mid-tier firms, EAs should ensure that they have adequate human and other resources to cater to new PLCs. Essentially, EAs should engage in effective resource management to meet the demands of increased audit engagements resulting from mandatory rotation.

6.5 Areas for Further Research

While this study has provided a comprehensive examination of MAFR perceptions and implications, it is important to note that it is not exhaustive. Consequently, the research has identified the following areas that warrant further investigation:

A. Stakeholder Perspectives on MAFR

This study primarily focuses on the views of PLCs and EAs regarding MAFR. However, expanding research to include current perspectives of other stakeholders on this regulatory measure, such as regulatory authorities, would provide additional valuable insights. Specifically, such a study could analyse shifts in the perspectives of regulatory bodies like the Ministry for Finance and the Accountancy Board[72]. Furthermore, including other stakeholders such as lenders, creditors and investors would provide a more comprehensive understanding of MAFR's implications.

B. A comparative analysis of MAFR implementation across the EU

Exploring the implications of MAFR across various jurisdictions within the EU through a comparative study would offer valuable insights into the diverse regulatory landscapes and their impact on MAFR implementation, effects and perceptions. Furthermore, examining the impact of MAFR variations, such as shorter rotation periods, would decipher the effectiveness of different regulatory approaches. Additionally, understanding how MAFR influences audit quality, auditor independence and market competition in different EU countries, can inform policymakers and practitioners about potential areas for improvement and harmonisation of audit regulations across the EU. While Chapter Two[73] and Chapter Five[74] briefly touch upon this, deeper exploration is warranted to fully grasp the nuances of MAFR across different contexts.

C. Quantitative analysis of MAFR implications

Adopting a statistical approach to assess the implications of MAFR offers a distinct dimension to understanding its effects, supplementing the qualitative analyses of perceptions conducted in this study. Comparing the findings of a quantitative analysis with those of this study can yield insights into the consistency and robustness of observed effects, such as those related to audit quality. For instance, researchers could employ statistical methods to examine audit quality indicators, for example discretionary accruals or the likelihood of issuing a going concern opinion, before and after MAFR implementation. Such a study enables researchers to determine whether MAFR has produced discernible impacts on audit quality, thus enhancing our understanding of its efficacy in achieving regulatory objectives.

[72] Vide Section 2.2.1
[73] Vide Section 2.4.1.2
[74] Vide Section 5.2.3; Section 5.6.1

6.6 Concluding Remarks

In conclusion, the MAFR regulation has brought about a significant shift within the local audit landscape, particularly impacting PIEs like PLCs. This study has shed light on the converging perspectives of PLCs and EAs on MAFR, unveiling a shared recognition of certain positive impacts, albeit accompanied with the incurrence of additional costs. Furthermore, both parties espouse the belief that MAFR not only enhances but, at times, fundamentally transforms client-auditor relationships. Nevertheless, disruptions to continuity of knowledge and expertise are acknowledged, presenting challenges that must be navigated.

While the primary objectives of this regulation were to enhance auditor independence, audit quality and competition within the audit sector, not all PLCs and EAs fully acknowledge these intended effects. In fact, the only positive outcomes noted primarily revolve around the augmentation of professional scepticism and competition within the Big-Four market.

Lastly, embracing change and fostering collaboration are imperative in adapting to this regulatory measure. The insights garnered from this study highlight the acceptance and appreciation 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*."

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Appendices

Appendix 1.1 - Maltese Listed Public Limited Companies

This Appendix contains a list of the Maltese Listed PLCs as at 10th September 2023, obtained from the MSE website. Such list is divided into equity listed PLCs and other listed PLCs. These companies were taken into account for data collection purposes.

Equity Listed PLCs:

1. APS Bank p.l.c.
2. AX Real Estate p.l.c.
3. Bank of Valletta p.l.c.
4. BMIT Technologies p.l.c.
5. FIMBank p.l.c.
6. GO p.l.c.
7. Grand Harbour Marina p.l.c.
8. Harvest Technology p.l.c.
9. Hili Properties p.l.c.
10. HSBC Bank Malta p.l.c.
11. International Hotel Investments p.l.c.
12. LifeStar Holding p.l.c.
13. LifeStar Insurance p.l.c.
14. Lombard Bank Malta p.l.c.
15. Loqus Holdings p.l.c.
16. Main Street Complex p.l.c.
17. Malita Investments p.l.c.
18. Malta International Airport p.l.c.
19. MaltaPost p.l.c.
20. Malta Properties Company p.l.c.
21. Mapfre Middlesea p.l.c.
22. MedservRegis p.l.c.
23. MIDI p.l.c.

24. M&Z p.l.c.
25. PG p.l.c.
26. Plaza Centres p.l.c.
27. RS2 Software p.l.c.
28. Santumas Shareholdings p.l.c.
29. Simonds Farsons Cisk p.l.c.
30. The Convenience Shop (Holding) p.l.c.
31. Tigne Mall p.l.c.
32. Trident Estates p.l.c.
33. VBL p.l.c

Other Listed PLCs:

1. 1923 Investments p.l.c.
2. 6PM Holdings p.l.c.
3. AX Group p.l.c.
4. AX Investments p.l.c.
5. Best Deal Properties p.l.c.
6. BNF Bank p.l.c.
7. Bortex Group Finance p.l.c.
8. Browns Pharma Holdings p.l.c.
9. CPHCL Finance p.l.c.
10. Dino Fino Finance p.l.c.
11. Dizz Finance p.l.c.
12. Eden Finance p.l.c.
13. Endo Finance p.l.c.
14. Exalco Finance p.l.c.
15. G3 Finance p.l.c.
16. Gap Group p.l.c.
17. Hal Mann Vella Group p.l.c.
18. Hili Finance Company p.l.c.
19. Hudson Malta p.l.c.
20. IZI Finance p.l.c.
21. Izola Bank p.l.c.

22. JD Capital p.l.c.
23. Mariner Finance p.l.c.
24. MeDirect Bank (Malta) p.l.c.
25. Mediterranean Investments Holding p.l.c.
26. Mediterranean Maritime Hub Finance p.l.c.
27. Melite Finance p.l.c.
28. Mercury Projects Finance p.l.c.
29. Merkanti Holding p.l.c.
30. Mizzi Organisation Finance p.l.c.
31. Multitude Bank p.l.c.
32. Phoenicia Finance Company p.l.c.
33. Premier Capital p.l.c.
34. SD Finance p.l.c.
35. Shoreline Mall p.l.c.
36. Smartcare Finance p.l.c.
37. SP Finance p.l.c.
38. St. Anthony Co. p.l.c.
39. Stivala Group Finance p.l.c.
40. Together Gaming Solutions p.l.c.
41. TUM Finance p.l.c.
42. Tumas Investments p.l.c.
43. Virtu Finance p.l.c.
44. Von der Heyden Group Finance p.l.c.

Appendix 3.1 - Interviewees' Job Position and Tenure

The following tables display the interviewees' job positions and tenures in such positions for PLC representatives and EAs respectively.

Reference	Job Position	Tenure (years)
AUD001	Chief Financial Officer	3
AUD002	Chief Financial Officer	8
AUD003	Chief Financial Officer	4
AUD004	Group Finance Manager	3
AUD005	Chief Financial Officer	3
AUD006	Chief Financial Officer	8
AUD007	Audit Committee Member	9
AUD008	Head of Finance	4
AUD009	Chief Financial Officer	11
AUD010	Financial Controller	4
AUD011	Head of Finance	15
AUD012	Chief Financial Officer	8
AUD013	Chief Financial Officer	8
AUD014	Head of Audit	2
AUD015	Financial Controller	13

Table A3-1: Interview Participants' Details – PLC Representatives

Reference	Job Position	Tenure (years)
AUD001	Audit Partner	4
AUD002	Audit Senior Manager	6
AUD003	Audit Senior Manager	8
AUD004	Audit Partner	2
AUD005	Audit Partner	10
AUD006	Audit Manager	7
AUD007	Audit Manager	2
AUD008	Audit Director	7
AUD009	Audit Senior Manager	3
AUD010	Audit Partner	5

Table A3-2: Interview Participants' Details – EAs

Appendix 3.2 - Interview Schedule for PLC Representatives

This Appendix presents the interview schedules utilised for conducting semi-structured interviews with PLC representatives of Maltese Listed PLCs.

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 you 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?

Appendix 3.3 - Interview Schedule for EAs

This Appendix presents the interview schedules utilised for conducting semi-structured interviews with EAs, including both Big-Four and mid-tier 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 PLCs?
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?

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

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?