

Paper#: K125

Do Audit Partners' Market Shares in an Industry Still Capture Audit Partner Industry Expertise in a Mandatory Audit Partner Rotation Regime? Evidence from the Banking Industry in Taiwan

Wuchun Chi*

Department of Accounting, National Chengchi University, Taipei, Taiwan
wchi@nccu.edu.tw

Hsiumei Liao

Department of Accounting, Ming Chuan University, Taipei, Taiwan
lsm@mail.mcu.edu.tw

Hong Xie

Von Allmen School of Accountancy, University of Kentucky, Lexington, KY 40506
hongxie98@uky.edu

ABSTRACT

Prior studies commonly use audit partners' market shares in an industry as a proxy for audit partner industry expertise and show that audit partners' market shares are positively associated with audit quality and audit fee premium. However, these studies are conducted in a voluntary audit partner rotation regime where the length of the client-partner relationship is not limited. An audit partner's market share is determined by the market force and competition—expert partners attract more clients and keep the clients longer. Thus, in a voluntary rotation regime, a partner's market share naturally reflects his industry expertise. However, in a mandatory partner rotation regime, a partner's market share can be increased or decreased due to rotating into or out of an industry. We hypothesize and find that mandatory audit partner rotation weakens the link between a partner's market share and his industry expertise. While we find that an audit partner's market share is positively associated with audit quality in the voluntary partner rotation regime in Taiwan in the banking industry, such a positive relation disappears in the mandatory partner rotation regime. We conclude that mandatory audit partner rotation decouples the link between an audit partner's market share in an industry and his industry expertise and thus reduces the usefulness of market share as a proxy for industry expertise. We caution researchers against using audit partners' market shares as a proxy for audit partner industry expertise in a mandatory audit partner rotation regime.

Keywords: earnings quality, auditor expertise, mandatory partner-rotation, client-specific tenure, industry-specific market share