

## **FAR Practitioners Papers Series**

Francis, J., N. Golshan, and N. Hallman. 2022. "Does Distance Matter? An Investigation of Partners who Audit Distant Clients and the Effects on Audit Quality." *Contemporary Accounting Research*. Volume 39 (2): 947-981. DOI: 10.1111/1911-3846.12744

### **Research question**

Is audit quality affected by a partner's proximity to the client?

### **Research findings**

Together, the evidence suggests that clients have greater discretion over reporting when partners are more distant, and this discretion results in lower quality (audited) earnings.

The joint effects of audit partner rotation and industry specialization have led to around 35 percent of U.S. listed firms being audited by a non-local partner. While clients generally prefer a local-office-based partner, the researchers find that the likelihood of having a non-local partner increases for large clients, for clients with complex accounting issues, and for clients in cities with relatively fewer audit partners per capita.

Why does partner location matter? The authors argue that greater information asymmetry exists for non-local partners that can harm quality. Specifically, more distant audit partners will know less about their clients, and more distant partners will know less about the daily work of the audit team (which is typically from an office near the client).

Lower quality audits when partners are non-local are evidenced by: (1) more frequent client restatements; (2) larger unexpected (abnormal) accruals in client financial statements; and (3) more aggressive earnings management behavior to meet or beat analysts' earnings forecasts.

### **Academic implications**

The results show the importance of geographical location in understanding audit quality and adds to a growing academic literature on the economics of geography.

### **Practitioner implications**

Non-local audit partners are a fact of life given partner rotation rules and industry specialization. What audit firms need to do is develop tools and provide resources to help manage the inherent information asymmetries facing non-local partners.