

Exploring a South African Solution to an International Concern over Auditor Independence:

The South African Audit Profession's Opinions with Regard to Mandatory Audit Firm Rotation

by

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Abstract

The provision of assurance services, most notably the audit function, is an activity of public protection that requires a high degree of independence between the auditor and the audit client to ensure audit quality is achieved. Internationally, especially in the European Union, there is a legislated move towards mandatory audit firm rotation (MAFR) to ensure auditor independence. South Africa is currently faced with the decision of whether to change legislation and follow suit.

Using a qualitative and descriptive methodology, through the use of semi-structured and open interviews with experienced South African audit partners, the direct and indirect effects of mandatory firm rotation on the audit profession was explored. This study will therefore present the opinions of the regulator and a small group of experienced audit partners, most being regional or national managing partners, from audit firms that perform public interest entity audits. Of particular interest will be the opinions of the respondents around (1) the state of independence in South Africa, (2) whether mandatory audit firm rotation will increase audit quality, (3) whether there are better alternatives to mandatory audit firm rotation, and (4) what the perceived direct and indirect effects of mandatory rotation will be within the South African legal and regulatory context. A particular emphasis is also placed on the argument from the national audit regulator that mandatory audit firm rotation, in addition to strengthening independence, will also reduce market concentration (promote competition) in the South African audit industry, as well as promote black economic transformation.

The results show significant disagreement by the audit practitioners against the arguments in favour of mandatory audit firm rotation, with most claiming that it will not achieve an increase in audit quality and will produce many unintended consequences that will in their opinion actually reduce audit quality. There is a significant amount of agreement amongst the audit partners on the key issues and no partner interviewed is fully in favour of changing legislation to require MAFR. A number of alternative means for improving audit quality are suggested, which in the opinion of many of the partners, will be less damaging to audit quality and the audit profession.

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Chapter 1: Introduction

The provision of assurance services, most notably the audit function, is an activity of public protection. In the eyes of the public, especially the investing public and all stakeholders of the company, the audit function provides the much needed stamp of credibility and assurance as to the fair presentation of the company's financial reporting. As clearly stated in both the International Standards of Auditing, notably ISA 200 (Overall Objectives of the Independent Auditor) and ISQC 1 (the quality control standard), as well as the professional conduct codes that govern assurance services, the auditor must act at all times with the required independence, objectivity and professional scepticism that is required for the purposes of providing an audit opinion on the fair presentation of the company's financial statements (ISA 200, para. 14 and 15, International Federation of Accountants (IFAC), 2009).

Auditor independence is important because it has an impact on audit quality. DeAngelo (1981), as quoted by many recent studies on audit quality, suggests that audit quality can be defined as the probability that:

- (a) The auditor will uncover a breach of statutory or regulatory requirement and
- (b) Report the breach to the appropriate parties.

If auditors do not remain independent, they might be less likely to report irregularities or insist that financial statements be prepared to their satisfaction, thus, impairing audit quality (Carey and Simnett, 2006). This potentially lessens the credibility of the financial reporting process.

The number of studies on the topic of auditor independence that have been performed to date (Bowlin, Hobson, & Piercey, 2014; Carey & Simnett, 2006; Daniels & Booker, 2011; Tepalagul & Lin, 2015), is understandable given its importance to the quality of the audit. If auditors, due to a lack of independence from the client, acquiesce to the financial reporting decisions of client management, they might be less likely to report irregularities uncovered

during the audit, through the various reporting channels available. The most notable reporting channel is via the auditor's opinion and the audit report in which that opinion is contained, and therefore a lack of independence could impair the quality of the audit report provided to the public and stakeholders of the company.

Recent research by Tepalagul and Lin (2015) provides a useful four dimensional approach with which to assess the impact of auditor independence on audit quality, namely, (a) client importance, (b) non-audit services, (c) auditor tenure, and (d) client affiliation with audit firms. This categorisation of the four main threats to auditor independence is useful for further research and theory and will be used in this paper, as shown diagrammatically in Figure 1.

The audit profession in most international jurisdictions is a profitable and competitive enterprise as well as a necessary public practice. Therefore, like any business, the auditors have profit incentives to yield to client pressure to retain their business, especially the business of their most significant clients, which in turn compromises auditor independence (Tepalagul and Lin, 2015). Added to this potential compromise of independence is the reality that many audit clients require non-assurance services from their auditors, which are often more lucrative than the audit fee (Tepalagul and Lin, 2015), possibly resulting again in compromised independence in the audit engagement (Tepalagul and Lin, 2015). These threats to independence are explained at length in the IFAC Code of Professional Conduct whereby numerous guidelines are provided to enable the auditor to manage these conflicts of interest. Long auditor-client tenure and client affiliation with audit firms create familiarity between the parties as relationships form. The IFAC Code of Professional Conduct describes a familiarity threat, as well as a self-interest threat to independence due to longer tenures (Section 290:151, International Federation of Accountants (IFAC), 2006). The profits from non-audit services, provided by the audit firms, create self-interest threats to independence. These various threats may threaten auditor independence and audit quality.

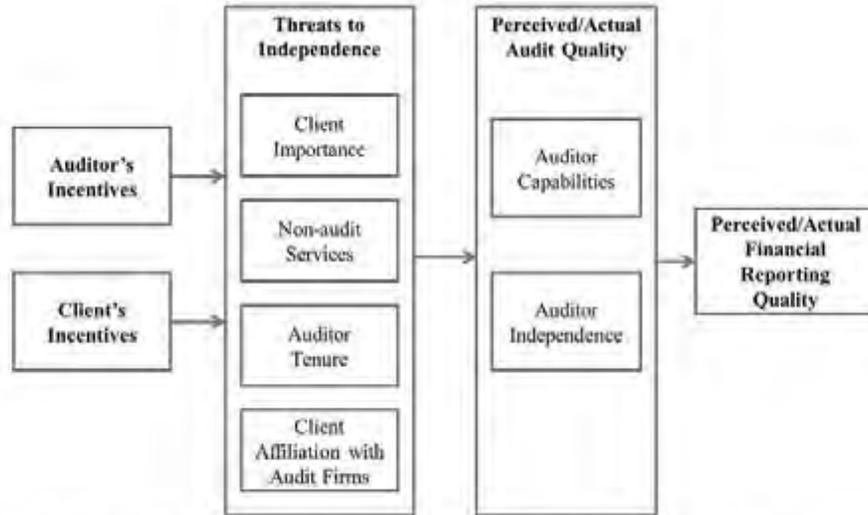


Figure 1. A framework for assessing the impact of auditor independence on audit quality.

Source: Tepalagul and Lin (2015)

As can also be seen from Figure 1, audit quality, which results in quality financial reporting of companies, is a function of the capabilities and the independence of the auditor. However, the threats to auditor independence negatively impact on this quality.

The purpose of this study is to examine the opinions of experienced audit practitioners with regards to legislated audit firm rotation, considering that the South African audit regulator (IRBA) views mandatory rotation as a possible partial solution to the threats of familiarity to auditor independence. The views of the audit profession, which acts as an important stakeholder in the pursuit of quality financial reporting, need to be understood in order to explore the possible direct and indirect consequences of changing legislation in favour of firm rotation. The response by audit practitioners to key questions around the need for, and the effects of, audit firm rotation, will be useful to academics in performing further research in this area, as well as to regulators, most notably the IRBA. Open-ended interviews will be the means of collecting the opinions of audit practitioners. Regulators and others have suggested that long auditor tenures may compromise auditor independence and be associated with increased likelihood of audit failures, and have implemented mandatory auditor rotation as one possible solution. In some jurisdictions, most notably the European Union, regulators have proceeded one significant step further and implemented a system of mandatory audit firm rotation (MAFR).

The structure of this thesis is as follows. Chapter 2 summarises the current state of auditor rotation regulations internationally as well as in South Africa, followed by a review of the academic literature regarding auditor independence and the effects of auditor rotation and full audit firm rotation. Chapter 3 describes the qualitative methodology employed to understand the perceptions of experienced practising registered auditors with regards to audit firm rotation in a South African context. The means by which the data was collected (open ended interviews) and how it was analysed is described. Chapter 4 presents the findings of the research, describing the breadth of the themes and issues raised by the registered auditors interviewed and presenting these findings in a thematic and organised manner. Chapter 5 provides a brief summary and conclusion of the findings, including areas for further research around audit firm rotation in a South African context.

Chapter 2: Literature Review

The following literature review will begin by briefly describing the recent legislative developments around auditor tenure and rotation, as well as the current requirements in key international jurisdictions such as the United States (US), Europe and the United Kingdom (UK). The comparison will then be made with the South African legislative framework. Following this, a review of academic literature regarding auditor independence and auditor rotation will be performed with particular emphasis on the issue of auditor rotation.

Auditor rotation has been enforced in many countries as a primary means to ensure auditor independence and thereby promote audit quality (Cameran, Vincenzo, & Merlotti, 2005). However, since the major financial corporate failures that have occurred in recent years, there has been considerable interest in mandatory audit firm rotation (MAFR), not simply audit partner rotation, as a means to protect auditor independence. A few examples of such corporate collapses are Enron (2001), WorldCom (2001), Parmalat (2003), African Bank (South Africa 2015), Banco Espírito Santo (Portugal 2014) and the financial institutions at the centre of the 2008/9 financial crisis, such as AIG and Lehman Brothers. These are just a few examples among many whereby the quality of the audit function as a means to prevent or detect corporate fraud and gross mismanagement has been challenged (Laurion, Lawrence, & Ryans, 2015). Examples such as these have resulted in the questioning of auditor rotation, beyond academic circles, into a broader number of regulator and government institutions, such as the European Union Commission, the American Institute of Certified Public Accountants and the U.S. Securities and Exchange Commission (Cameran et al., 2005). Given the significance of threats to auditor independence, as discussed above and illustrated in Figure 1, a better solution to ensuring auditor independence and audit quality is being sought, with many believing that MAFR is perhaps that solution. According to Jackson, Moldrich, & Roebuck (2008) there is a need to determine whether the current international regulations of auditor rotation are enough to restore public confidence in the audit profession, or whether further regulatory changes, such as a system of MAFR are desirable. There has also been a call for further research on this topic by both the international standard setters and academics (Jackson et al., 2008).

The literature review will therefore lead beyond auditor independence and auditor rotation into the few studies and findings that have been documented regarding mandatory audit firm rotation itself (MAFR), which is the focus area of this study.

International Developments

In recent years, most notably since the collapse of Enron in 2001, regulators have expressed concerns about auditor independence and taken actions to mitigate those concerns (Laurion et al., 2015). These include the passage of the 2002 Sarbanes–Oxley (SOX) Act, also known as the "Public Company Accounting Reform and Investor Protection Act", which is United States (US) legislation that, among many other requirements, prohibits the auditor (in a US context) from providing most non-audit services to its clients. More specifically, SOX imposes a one-year "cooling-off period" for former auditors taking employment at their previous audit clients and requires audit partners to rotate every five years. In terms of SOX, the US also shifted from a seven-year rotation with a two-year cooling-off period (before SOX), to a stricter five-year rotation and five-year cooling-off period for audit engagements. More specifically the requirement is to rotate (1) the partner having primary responsibility for the audit and (2) the partner responsible for reviewing the audit, every five years. The audit committee is required to ensure that the requisite rotation actually takes place (Tepalagul and Lin, 2015).

In the European Union (EU), regulations have also recently changed. The European Parliament in 2014 voted in favour of Directive 2014/56/EU, amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (European Commission, 2015). These new rules force European companies to hire new audit firms at 10- to 24-year intervals, depending on certain criteria, bringing mandatory audit firm rotation into one of the world's most significant economic regions (KPMG, 2014). More specifically, public interest entities have to appoint a new firm of auditors every 10 years. However, member states have the option to extend this maximum period to 20 years (24 if there is a joint audit) provided the audit is subject to a public tendering carried out after 10 years. These new rules require European-listed companies, banks and financial institutions to appoint a

new audit firm every 10 years, though this can be extended if companies put their audit contract up for bid at the decade mark or appoint another audit firm to do a joint-audit. The rules also prohibit certain non-audit consulting services and cap the amount of additional fees auditors can charge their clients (to 70%). The laws are expected to apply from mid-June 2016 (KPMG, 2014).

It is expected that the United Kingdom (UK) will also implement mandatory firm rotation in the near future. Currently, UK companies are required to re-tender, or explain why they have decided not to re-tender, every 10 years. There has recently been a change in UK regulations in this regard. In 2012, the Financial Reporting Council (FRC) introduced a provision in the UK Corporate Governance Code for FTSE 350 companies to consider tendering their audit appointment every 10 years, on a comply or explain basis. The Competition and Markets Authority (CMA) finished its long running investigation of the UK large company statutory audit market in October 2013 and concluded that tendering of the audit appointment should be mandatory for FTSE 350 companies at least every 10 years. The ruling is now effective from June 2016 (Agnew, 2016). In addition to the mandatory tender after 10 years, it is expected that UK companies will have to appoint a new auditor every 20 years (PWC, 2014).

As can be seen in the comparison between the US regulations of auditor rotation and the recently adopted EU and the UK audit firm rotation regulations, there is a difference between auditor rotation (i.e. the audit engagement partner) and audit firm rotation, although sometimes the terms are used too loosely and the distinction is lost. Auditor rotation, as in the US and South Africa, refers to the mandatory rotation of the engagement audit partner after a prescribed five years. Under auditor rotation the audit firm retains the client, providing a different audit partner to the engagement. There is then a “cooling-off” period (five years in the US, two years in South Africa) whereby the rotated audit partner must wait until being allowed to be reappointed as engagement partner on that client. However, audit firm rotation, as is now being adopted in 2016 by the EU, is a step further than this. It requires a change of the audit firm, not simply the audit partner. The audit firm effectively loses the business of the audit client, regardless of whether or not the partners in the firm are suitable and capable of performing the audit. The EU has adopted this in an

attempt to further mitigate the threats (particularly familiarity) to auditor independence, thereby protecting audit quality (KPMG, 2014).

Other than the more significant recent examples of the UK and the EU, other countries such as Brazil, India, Italy, Spain, Singapore and South Korea have required, and some still do require, audit firm rotation (MAFR) after a maximum specified period (Cameran et al., 2005). As mentioned, the US is a notable exception against this international trend and the European Union therefore remains the largest economic jurisdiction to apply MAFR rules.

To follow, a brief description of the current state of legislation in South Africa is provided.

The context in South Africa

Currently South Africa does not legislate the mandatory audit firm rotation (MAFR) laws as have been implemented in the EU, but rather follows a system similar to the US, with auditor rotation (i.e. individual audit partner) required every five years. This includes a cooling-off period of two years, as prescribed by section 92 of the Companies Act, 2008 (Act No. 71 of 2008). The profession in South Africa also places a large degree of reliance on the professions ethical standards in order to internally assess (or self-assess) threats to its independence as auditor. These standards are contained in the International Standards on Auditing (ISAs), as well as the Code of Ethics for Professional Accountants issued by the International Federation of Accountants (the IFAC Code). In terms of this code, the engagement audit partner on a publically listed entity should rotate off the client after no longer than seven years (Section 290:154, International Federation of Accountants (IFAC), 2006). These are internationally recognised standards for which the auditor can assess their independence from the audit client.

In South Africa there is also regulation and guidance provided to the audit committee of public interest entities to assess the independence of the auditor. This is legislated in the South African Companies Act, 2008 (Act No. 71 of 2008). Guidance is also provided to audit committees in the King Report on Governance (King III), which is the South African standard on issues of corporate governance, soon to be replaced with the King IV Report. As an

example, the Companies Act requires the audit committee to formally assess the independence of the auditor. However, legislation, standards and regulations of the Johannesburg Stock Exchange (JSE) have all stopped short of requiring mandatory audit firm tendering or audit firm rotation as is now being implemented in the EU and the UK.

Impact of Mandatory Audit Firm Rotation

The following is a review of the literature on the effects of auditor tenure on audit quality, followed by the specific impact of audit firm rotation on audit quality. More studies have been performed on audit tenure in comparison to full audit firm rotation (MAFR), owing to the relatively recent move of jurisdictions such as the European Union and the UK towards MAFR. Literature around other aspects of auditor independence is then discussed, namely auditor-client preferences and the division between company management and the audit committee.

Lastly the literature regarding the perceptions of audit practitioners with respect to partner rotation, including their perceived direct and indirect effects of such rotation is reviewed.

The Effect of Audit Tenure on Audit Quality

A study by Tepalagul and Lin (2015) consisted of a comprehensive review of academic research pertaining to auditor independence and audit quality. Through a review of published articles during the period 1976-2013 in nine leading journals related to auditing, most studies concluded that long auditor tenure does not impair independence (Tepalagul & Lin, 2015). However, according to Tepalagul and Lin (2015) there are two opposing views on the effects of auditor tenure on audit quality. One states that as the auditor-client relationship lengthens, the auditor may develop a close relationship with the client and become more likely to act in favour of management, thus reducing audit quality. This is the typical familiarity threat argument for auditor rotation, as described in Section 290 of the IFAC Code (IFAC, 2006). Therefore, this view supports some form of regular audit partner or audit firm rotation. Controlling the time by which an auditor is engaged with the client (auditor tenure) is a means to reduce the familiarity threat and promote independence of mind and action by the auditor. The other view was that as auditor tenure lengthens, auditors increase their understanding of their clients' business and improve their expertise, resulting in higher audit quality (Tepalagul & Lin, 2015). For example, client-specific

experience, a proxy for expertise, was found to enhance the auditors' ability to respond to fraud indicators (Brazel, Carpenter, & Jenkins, 2010). These two views provide conflicting results on whether or not to pursue MAFR, as one argues the possible benefits of auditor tenure, and the other the possible cost.

A Belgium study by Knechel and Vanstraelen (2007) that used a sample of stressed bankrupt and non-bankrupt companies, found that auditors do not become less independent over time nor do they become better at predicting bankruptcy. According to Knechel and Vanstraelen (2007), the evidence for tenure either increasing or decreasing audit quality is weak.

Other researchers again produce conflicting findings on the association between auditor tenure and auditor behaviour. In a study of audits of US public schools, Deis and Giroux (1992) report that quality-control findings decrease as auditor tenure lengthens. Using data for audit partner tenure in Australia for a period where partner rotation was not mandatory, the relationship between audit quality and long audit partner tenure was investigated by Carey and Simnett (2006). The three measures (proxies) of audit quality examined were 1) the auditor's propensity to issue a going concern opinion for distressed companies, 2) the direction and amount of abnormal working capital accruals, and 3) just beating (missing) earnings benchmarks. For long tenure observations the results showed a lower propensity to issue a going concern opinion and some evidence of just beating (missing) earnings benchmarks, consistent with deterioration in audit quality associated with long audit partner tenure (Carey and Simnett, 2006).

Further conflicting results were identified by Johnson, Khurana, & Kenneth Reynolds (2002) who examined whether the length of the relationship between a company and an audit firm (audit firm tenure) is associated with financial reporting quality. Johnson et al. (2002) categorised auditor-client relationships into periods of short, medium and long tenures. Using two proxies for financial reporting quality, based on accounting accruals, and a sample of large audit firm clients matched on industry and size, Johnson et al. (2002) found that relative to medium audit firm tenures of four to eight years, short audit firm tenures of two to three years are associated with lower-quality financial reporting. Again, in contrast to the

shorter periods, Johnson et al. (2002) found no evidence of reduced financial reporting quality for longer audit firm tenures of nine or more years.

A US study on the raising of going concern (financial distress) uncertainties by auditors suggests that audit failures are more likely in the early years of the auditor-client relationship (Geiger & Raghunandan, 2002). The results were consistent with the position that auditors may be more influenced by their newly obtained clients in the earlier years of the engagement. Therefore this does not support that auditor rotation be made mandatory or that long tenure reduces audit quality.

Bamber and Iyer (2007) used a theory-based measure for the extent to which auditors identify with a client, which was then used to directly measure auditors' attachment to the client and consequently the threat of this attachment to auditors' objectivity. The responses of 252 practising auditors were obtained, providing support for the predictions of Bamber and Iyer (2007). Specifically, Bamber and Iyer (2007) found that auditors do identify with their clients and that auditors who identify more with a client are more likely to agree with the client preferred position on an audit and financial reporting matter. However, more experienced auditors and auditors who exhibit higher levels of professional identification are less likely to acquiesce to the client's position. Differing incentives were identified for the partner in comparison to the firm. The incentive of the individual audit partner may conflict with that of the audit firm so that long partner tenure increases the likelihood of the auditor acquiescing to the client's preferences, whereas audit firm tenure is associated with the decreased likelihood of auditor concessions (Bamber & Iyer, 2007). By looking at the differing incentives of the firm as a whole, compared to that of the individual partner in the firm, the results implies that, unlike an audit partner, an audit firm may have stronger reputational incentives to remain independent. Therefore, rotating the firm in a system of MAFR, as opposed to the partner, may not be the best means to achieve independence and audit quality.

An investigation into the effects of audit partner rotation among US publicly listed companies by Laurion et al. (2015) used a sample of US partner rotations and non-rotations, revealed that partner rotations result in substantial increases in material restatements

(124.8%) and total valuation allowances and reserves (0.8% of assets). This suggests that US partner rotations do provide a fresh look at the audit engagement.

Researchers have also explored the impact of partner rotation on auditor effort and audit quality. There is empirical evidence that the effort provided by the auditor, or invested by the auditor into the engagement, increases following a rotation of the audit partner. Bedard and Johnstone (2010) showed evidence that planned engagement effort increases following partner rotation, suggesting that new partners apply themselves and their resources more to gain client knowledge in the first year on the engagement. This suggests that new partners work harder to reduce the information asymmetry that they face in directing a first-time audit (Bedard & Johnstone, 2010). In this way, a “fresh set of eyes” is a benefit to the audit and would be a positive aspect of partner or firm rotation (Bedard & Johnstone, 2010).

In conclusion, there are mixed results around the effect that partner rotation has on independence and audit quality. However, as noted by Tepalagul and Lin (2015), most studies conclude that audit tenure does not impair independence, even though there does appear to be benefits to partner rotation, such as a more conservative and diligent approach to the audit by the incoming partner.

The Effect of Audit Firm Rotation on Audit Quality

Recent studies have mostly concerned themselves with audit partner (auditor) rotation (Bowlin et al., 2014; Daugherty et al., 2012; Laurion et al., 2015; Tepalagul & Lin, 2015), rather than audit firm rotation. According to the South African Independent Regulatory Board for Auditors (IRBA), since the audit failures associated with Enron, larger corporates in South Africa and major financial institutions across the globe, the independence of auditors and regulators have become a focal point for governments and oversight structures (IRBA, 2015a). It is for this reason that the recent European Union legislation concentrates on improving independence rotation of audit firms after a fixed period of 20 years; a cap on the amount of fees for non-audit services at 70 per cent of the audit fee; and encouragement for companies to adopt joint audits (Hay, 2015). Investors and the public are also

demanding more information and transparency and have become more aware of their rights to be protected (IRBA, 2015a). However, there is very little research on the effectiveness and consequences of audit firm rotation specifically. According to Hay (2015) the rotation of audit firms is a difficult area to research because there are so few practical situations where it has been enforced. As a result, “there is no clear evidence about whether it is effective” (Hay, 2015). According to Bédard and Compernelle, the authors of chapter 20 of “The Routledge Companion to Auditing” (2014), as quoted by Hay (2015), “academic research has been unable to provide clear answers about the consequences of mandatory audit firm rotation”.

Two leading studies that have been performed in this area of mandatory audit firm rotation (MAFR), namely 1) Jackson, Moldrich, and Roebuck (2008) and 2) Ruiz-Barbadillo, Gómez-Aguilar, and Carrera (2009) are not in favour of pursuing mandatory audit firm rotation.

Jackson et al. (2008) investigated the effect of mandatory audit firm rotation in Australia on audit quality. Two measures of audit quality were used; 1) the propensity to issue a going-concern report and 2) the level of discretionary accruals. The main finding was that audit quality increases with audit firm tenure, when proxied by the propensity to issue a going-concern opinion, and is unaffected when proxied by the level of discretionary expenses. Given the additional costs associated with switching auditors as described by Jackson et al. (2008), it was concluded that there are minimal, if any, benefits of mandatory audit firm rotation (Jackson et al., 2008). However, only actual audit quality was examined and while the results suggest that actual audit quality is associated with the length of audit firm tenure, the perception of audit quality by market participants was not addressed. Perception of audit quality is important, as described in the International Federation of Accountants (IFAC) Code of Ethics for auditors (section 290:8), as the need for the auditor to have independence in both mind and in appearance to a third party (International Federation of Accountants (IFAC), 2006). The audit opinion provides assurance to the market and the public of the credibility of the financial statements, as explained in the International Standards on Auditing, and therefore this independence of the auditor in the eyes of the market is necessary. According to ISA 200, the audit enhances “the degree of

confidence of intended users in the financial statements”(ISA 200:3, International Federation of Accountants (IFAC), 2009).

Ruiz-Barbadillo et al. (2009) suggested that auditors’ incentives to protect their reputation has a positive impact on the likelihood of them reporting going concern uncertainties. In addition, auditors’ incentives to retain existing clients did not impact on their decisions in both the mandatory rotation (1991-1994) and post-mandatory rotation (1995-2000) periods in Spain.

The research of Jackson et al. (2008) and Ruiz-Barbadillo et al. (2009), both provide evidence against pursuing mandatory firm rotation.

A study on audit perception with regard to audit firm rotation was performed by Daniels and Booker (2011), exploring loan officers’ perceptions of auditor independence and audit quality in circumstances with and without firm rotation. Loan officer responses indicated that these officers do perceive an increase in auditor independence when the company follows an audit firm rotation policy. However, the length of auditor tenure within rotation failed to significantly change loan officers’ perceptions of independence.

In conclusion, the studies in the previous section regarding auditor tenure showed mixed results. However, the few studies shown in this section that focus on the effects of audit firm rotation, rather than partner rotation and auditor tenure, indicate that firm rotation does not improve actual audit quality. These findings are not in favour of audit firm rotation. However, the research around firm rotation is sparse and does not sufficiently consider the impact of such rotation on the credibility of financial statements and perceptions of audit quality by the users of these financial statements. From a South African perspective there is also the need, as communicated by the South African regulator (IRBA), to consider the effect of audit firm rotation on market competition in the audit industry (market concentration) and national transformation objectives (IRBA, 2015a). No studies to date have addressed mandatory audit firm rotation in this South African context.

Auditor-client preferences

Experimental research by Dopuch, King and Schwartz (2001) was designed to assess whether mandatory rotation and/or retention of auditors increases auditors' independence by reducing their willingness to issue reports biased in favour of management. Auditors' reporting was compared across regulations of mandatory rotation, or mandatory retention, including scenarios whereby neither was required. The findings of Dopuch et al. (2001) showed that within the regulations that required rotation only, or both rotation and retention, there was decreased auditor willingness to issue biased reports, relative to the other regimes in which rotation was not imposed. Therefore client-preferred reporting by auditors was concluded to be less likely under mandatory rotation (Dopuch et al., 2001).

Regarding firm rotation specifically, an experimental study by Wang and Tuttle (2009), building on the findings of Dopuch et al. (2001), but incorporating negotiation theories, investigated the process differences in auditor-client negotiations under conditions with and without mandatory audit firm rotation. As is the nature of auditing, where there are uncertainties requiring a significant use of professional judgement and estimates in applying the financial reporting standards, differing opinions regarding asset values, accounting estimates and application of accounting standards are likely to arise between management and the auditor (Wang and Tuttle, 2009). Management have the incentive to apply accounting standards and provide estimates in such a manner so as to increase asset values and reported profit, in comparison to auditors. Negotiation is therefore often required between management and the auditor in settling occasional disagreements of opinion around financial reporting issues and identified audit misstatements where adjustments are proposed by the auditor.

Wang and Tuttle (2009) also acknowledged that different incentives exist for managers and auditors and therefore, these differing incentives can lead client managers and auditors to prefer different values within the range of acceptable possibilities. Hence, auditor-client negotiation is a natural process of reconciling these differences in incentive-induced preferences. The results suggested that under mandatory firm rotation, negotiation results are closer to the preference of the auditor than that of the client. This implies that with

mandatory rotation, auditors adopt less co-operative negotiation strategies (Wang & Tuttle, 2009).

Hatfield, Jackson, and Vandervelde (2011) contributed to the debate around auditor and audit firm rotation through analysing the effects of prior auditor involvement and client pressure on proposed audit adjustments. The results revealed that auditors who have no involvement in waiving a prior period audit adjustment propose current period audit adjustments that are significantly larger than auditors who have involvement in waiving a prior period audit adjustment (Hatfield et al., 2011). The results of Hatfield et al. (2011) have implications for the consideration of auditor rotation, including firm rotation. The “no prior involvement” condition in the study mirrors the situation in which there is either audit partner rotation or audit firm rotation, and the “prior involvement” condition mirrors the situation in which there is a recurring audit firm or audit team. The results suggest that either form of rotation will likely increase the magnitude of proposed audit adjustments. This is a similar conclusion to Laurion et al. (2015).

The management-audit committee divide

Related to the auditor-client preference, as discussed above, an issue at the heart of auditor independence debates is the concern that the auditor may advocate for management, rather than view the market, the shareholders or the public as the real client (Buffet and Clark, 2006). Ghafran and O’Sullivan (2013) performed an extensive review that synthesized recent empirical research around the audit committee’s role in corporate governance. Much of the findings of Ghafran and O’Sullivan (2013) fall in support of regulatory strengthening of audit committee experience and its involvement in governance of companies. The review of evidence by Ghafran and O’Sullivan (2013) supports the idea that larger and more independent audit committees as well as those with financial expertise are more likely to seek a higher level of external audit coverage and assurance, as well as the purchase of lower levels of non-audit services from auditors, thereby seeking to preserve the independence of the external audit process. Smaller, less experienced and less independent audit committees are susceptible to poor oversight of the external audit process. There seems to be a consensus that more independent audit committees and those with greater accounting or financial expertise have a positive impact on the quality of financial

statements (Ghafran and O'Sullivan, 2013). This is in spite of the fact that, even in large corporate environments with larger and more independent audit committees, management does still have some influence over the auditor (Bedard and Johnstone, 2010).

Case-study based research by Fiolleau et al. (2013), using a large US public company, explored the validity of the divide between audit committee and management as it relates to the auditor decision. The listed company analysed was perceived to have a good quality and regulatory-compliant audit committee by Fiolleau et al. (2013). The dominant view in both academic literature (Bedard & Johnstone, 2010; Cohen, Krishnamoorthy, & Wright, 2010; Fiolleau et al., 2013; Ghafran & O'Sullivan, 2013) and the auditing profession, including regulation, is that the audit committee "owns" the auditor appointment process and has primary responsibility in assessing the independence and suitability of the auditor before making the appointment decision. As an example, in South Africa these obligations of the audit committee to assess auditor independence are prescribed in the Companies Act, 2008 (Act No. 71 of 2008). An alternative view, counter to the intention of the governance structures and policies, is that regulatory reforms such as the Sarbanes-Oxley Act in the United States, leave in place power relations whereby management is the dominant party who hires both the auditor and the directors on the audit committee. Due to management becoming the dominant party, the audit committee's actions are likely to be ceremonial rather than substantive (Cohen et al., 2010). Fiolleau et al. (2013) investigated how the audit committee interprets and executes its legislative mandate in appointing an independent external auditor and the role of management in these responsibilities. The findings of Fiolleau et al. (2013) was a limited involvement of the audit committee in the appointment process and decision. The audit committee abdicated its information gathering and decision-making responsibilities to management, serving rather as a witness to management's selection process and decision. The audit firm that offered the least senior level expertise and the lowest fee obtained the engagement, despite management and the audit committee stating that the price was not a primary criterion or motivation for the decision. Fiolleau et al. (2013) argued that all auditors seek to convey more to the potential client than just technical expertise, as they need to differentiate themselves from competitors. Therefore, since auditors were focused on winning the client and were willing to cut fees, move partners to the client's head office city, and curtail quality control. The

attitude of the auditors was to secure the appointment as a matter of priority and urgency, concerning themselves later about whatever issues might arise in the future (Fiolleau et al., 2013). In the research pre and post the US Sarbanes–Oxley Act of 2002 (SOX), Cohen et al. (2010) found that the independence of the audit committees had improved considerably, but not sufficiently. Many auditors surveyed reported that in their post-SOX experience, management continues to be the dominant player in auditor appointment and dismissal decisions, and only about half of the auditors felt audit committees play an important role in resolving auditor disputes with management (Cohen et al., 2010).

These results, which show a tendency of the audit committee to represent the wishes of management, rather than provide an independent oversight, and its resultant effect on the behaviour of the external auditor who is attempting to secure appointment, raise some concern over the effectiveness of existing and proposed changes to auditing regulations attempting to govern auditor independence. The intention of regulations may not be met due to these incentives and decision making realities. Instead of strengthening independence and providing a “fresh look”, the auditor change process is dominated by management, not the audit committee, and is characterised by gestures from prospective auditors to win client favour, rather than submit a professional and work-related tender proposal. These influences could render any proposed (or existing) audit partner/firm rotation regulations ineffective because regulations do not appropriately consider the management-audit committee dependence (Fiolleau et al., 2013). According to the findings of Fiolleau et al. (2013), researchers often attribute the inefficacy of regulatory reforms to the political power of the audit industry for adopting clever tactics to displace blame on individuals or other parties. Therefore, Fiolleau et al. (2013) suggest that client-management power, rather than audit industry politics, may be an important factor in undermining regulatory reforms.

Research on interaction between external auditor and audit committee by Bédard and Compennolle (2014) shows that management still has some influence over the auditor, even when the audit committee is formally responsible (Hay, Knechel, & Willekens, 2014). These findings by Fiolleau et al. (2013), Cohen et al. (2010) and Bédard and Compennolle (2014), coupled with previously reported evidence that new auditors are not only more vulnerable

to fraud (Treadway, 1987) but also to errors in early years (Johnson et al., 2002), should be considered in any move towards more strict auditor/firm rotation regulations.

Audit Partner Perceptions

After performing a survey of auditor perception, Shockley (1981) found that auditors do not regard tenure exceeding five years as reducing independence. Daugherty et al. (2012), in the wake of the US Sarbanes–Oxley Act of 2002 (SOX), used structured interviews and surveys of practising audit partners in order to examine US audit partner perceptions with regard to mandatory partner rotation and cooling-off periods. The survey also considered how recently enacted, more stringent rules, may negatively impact auditors’ quality of life to the detriment of audit quality. Daugherty et al. (2012) developed the following model of the direct and indirect effects of auditor rotation, as shown in Figure 2:

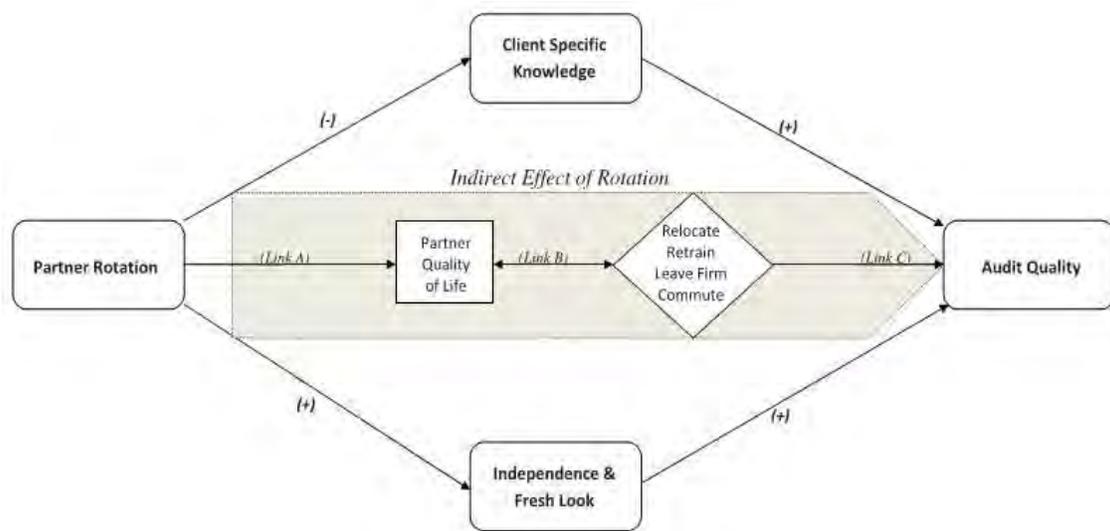


Figure 2. Model of Direct and Indirect Effects of Mandatory Rotation on Audit Quality

Source: Daugherty et al. (2012)

In Figure 2, auditor rotation is associated with increases in independence and a “fresh look” at the client, hence the positive (+) symbol, but can decrease the client specific knowledge of the business being audited, hence negative (-) symbol. There are also indirect negative effects of rotating audit partners, namely a decrease in quality of life of the audit partner and having to relocate, retrain, leave the audit firm or have to commute further to work.

Daugherty et al. (2012) sought to test the direct and indirect effects of audit partner rotation through examining the opinions and perceptions of practising audit partners. Opinions were gathered around the impact of partner rotation on client-specific knowledge, independence, quality of life and the decision to relocate geographically for work as a result of auditor rotation. Seven audit partners from across the US and from firms of varying sizes were interviewed using semi-structured interviews. In order to test the theoretical model developed, a field survey was created and distributed to 370 practising partners from 14 firms, representing approximately 40 distinct practice office locations of varying size. Results suggested that auditor rotation can increase partners' workloads and the likelihood of them needing to relocate for work. Additionally, results suggest that in response to accelerated rotation (and an extended cooling-off period), partners would prefer to learn a new industry, rather than relocate. Importantly, partners perceive audit quality suffers from retraining, but not from relocating. Thus, the results suggest an indirect, negative impact, and unintended consequence of accelerated rotation/extended cooling-off periods on audit quality (Daugherty et al., 2012).

Another study focusing on audit partner perceptions and experiences was performed by Cohen et al. (2010). Using semi-structured interviews with 30 experienced audit partners and audit managers, from large tier audit firms, auditors reported that the corporate governance environment had improved considerably in the post-SOX era. Audit committees were substantially more active, diligent, knowledgeable, and powerful. However, in some instances Cohen et al. (2010) found that governance was still rather symbolic. Management continued to be seen as a major corporate governance decision maker and therefore the dominant player in the audit committee versus management roles as far as auditor appointment was concerned. As such, management was often the driving force behind auditor appointments and terminations. Some auditors reported that audit committees play a passive role in helping resolve disagreements with management (Cohen et al., 2010).

The above two studies of partner perceptions follow a similar methodology to that applied in this study. The Daugherty et al. (2012) findings reveal perceived direct and indirect consequences in the audit profession from mandatory audit partner rotation. The Cohen et al. (2010) findings reveal perceptions of a lack of independence and quality in the

functioning of the audit committees. Both of these US-based studies have an application to MAFR debate, especially if similar sentiment is expressed by South African audit practitioners. These two studies are based on the perceptions of audit practitioners themselves and reveal some of the pushback from the audit profession against changing auditor rotation legislation and attempting to improve auditor independence by further regulating auditors, when the problems are believed to lie elsewhere. A survey of the audit profession performed by the Institute of Chartered Accountants Australia, as well as a collection of the arguments for and against mandatory audit firm rotation, produced similar arguments against changing legislation in Australia in favour of mandatory audit firm rotation. The report produced raised the concern that there would likely be significant unintended consequences to the auditing profession, and that the underlying causes of poor audit quality or auditor independence which may lie on the audit committee-management side of the engagement, would be unaddressed by such legislation (Institute of Chartered Accountants Australia, 2015).

Conclusion

There is a move towards mandatory audit firm rotation in many developed economies, with the most significant and recent change in that direction being the European Union in 2014, with the United Kingdom soon to follow suit. Smaller countries such as Brazil, India, Italy, Spain, Singapore and South Korea have required audit firm rotation for some time now. The United States, at least for the moment has decided to remain with a system of partner rotation only, on a rotation period of five years, similar to that currently in place in South Africa.

The literature reviewed presents mixed results regarding the impact of audit tenure on audit quality and auditor independence, with most studies however indicating that independence is not impaired as auditor tenure increases. Many studies however do show that incoming auditors are more conservative and diligent, making greater adjustments to the financial statements than the outgoing auditors.

Audit partners in the United States have expressed concerns around the direct and indirect effects on the profession of audit partner rotation, but this study did not consider audit firm rotation. United States audit partners also express concern around the proper functioning of the audit committees as necessary partners in maintaining the auditor-client relationship. Little research has been performed specifically on the link between firm rotation and audit quality, mostly because the move towards firm rotation regulations is very recent and therefore the impact of such regulations is yet to be seen. The studies that have analysed audit firm rotation in countries that have adopted it, such as Australia and Spain, are not in favour of audit firm rotation and do not show clear links to the improvement of auditor independence or audit quality.

The indirect and unintended consequences of a move to mandatory firm rotation has not been studied, nor the perceptions of the various stakeholders involved in the audit process. In addition, no studies appears to have been published in a South African context around mandatory firm rotation.

If the debate around MAFR has already been performed in Europe, the United Kingdom, the United States as well as other developed economies, an important question to answer at the outset, is “what is unique about the South African environment that justifies the need for South African-specific research regarding MAFR?”

The following considerations are relevant to answering this question:

1. The results of the 2014/15 Public Inspections Report around ethical compliance in South African audit firms (refer to **Appendix 2**) indicate a specific South African problem whereby independence of the auditor may be the underlying cause.
2. The South African legislative environment, namely the Companies Act 71 of 2008, as well as accepted principles of corporate governance, are different from other countries.
3. Black economic empowerment (transformation / affirmative action initiatives) is a specific priority in the economy, acknowledged by both business and government as an ethical and urgent national priority. South Africa’s history of Apartheid and its impact on the economy and society today has resulted in a widespread desire to

“level the playing field” and redress the inequalities of Apartheid by giving previously disadvantaged groups of South African citizens’ economic privileges previously not available to them. This has significant impact on the MAFR debate in South Africa.

4. The South African national audit regulator (IRBA) has three main reasons for pursuing the question of MAFR, only one being to improve public protection through improved audit quality (refer to **Appendix 2**). Many other countries have considered MAFR from a pure audit quality perspective.

Chapter 3: Research Methodology

This section describes the rationale for the application of specific procedures or techniques used to identify, select, and analyse information applied to understanding the research problem. The purpose is firstly to answer the question of how the data was collected or generated; and secondly, how it was analysed.

This is a descriptive study that employs a qualitative research methodology. Qualitative studies aim to explain the ways in which people come to understand and account for issues, event and behaviours in their lives. Therefore the data gathered covers the perceptions, opinions and reasoning of the participants based on their unique experiences of areas related to the topic studied.

In order to explore the perceptions and opinions of the South African audit practitioners regarding the proposed move towards mandatory audit firm rotation (MAFR), away from the current system of five year partner rotation, the first step employed, which is the purpose of this research, is to conduct semi-structured interviews with experienced partners across a number of audit firms nationally. The purpose of these semi-structured interviews study is to document the breadth of issues around MAFR from an audit practitioner perspective, so as to produce an appropriate and well balanced national field survey to be distributed to audit partners around South Africa, which is considered to be step two in the research (refer to Further Research in the Conclusion section).

A semi-structured interview is a qualitative method of inquiry that combines a pre-determined set of open-ended questions (questions that prompt discussion), with the opportunity for the researcher to explore particular themes or responses further. This type of interview does not limit respondents to a set of pre-determined answers, unlike a structured questionnaire for example (Dearnley, 2005).

The purpose of the semi-structured interviews is to understand the breadth of issues and opinions around adopting MAFR in South Africa, as well as opinions regarding possible alternatives to, and unintended consequences of, MAFR. Therefore this study aims to

document the breadth of the issues and opinions using a small sample of audit partners so as to allow the second natural step in the research, which is produce and implement a comprehensive and appropriate field survey of the audit profession. This survey is to be sent more broadly to the profession where the intention will be to receive responses from a much larger sample of audit practitioners, i.e. audit partners around the country. Note that the second step is not the purpose of this thesis, but rather an important area for further research based on this study.

This methodology of using semi-structured interviews to inform a much larger field survey study is similar to that performed by Daugherty, Dickins, Hatfield, and Higgs (2012) in their study entitled “An Examination of Partner Perceptions of Partner Rotation: Direct and Indirect Consequences to Audit Quality”. As opposed to the unstructured interview, semi-structured interviews are often the sole data source for a qualitative research projects and are usually scheduled in advance at a designated time and location outside of everyday events (DiCicco-Bloom and Crabtree, 2006). Such interviews are generally organised around a set of predetermined open-ended questions, with other questions emerging from the dialogue between interviewer and interviewee(s). Semi-structured in-depth interviews are the most widely used interviewing format for qualitative research and can occur either with an individual or in groups (DiCicco-Bloom and Crabtree, 2006). The open nature of the questions encourages depth and vitality in the responses by the interviewees and allows new concepts to emerge over the course of the interviews (Dearnley, 2005).

Key expert opinions

Before selecting and interviewing the audit partners the input into the debate by three select expert individuals was sought, namely:

- The Chief Executive Officer of the South African Independent Regulatory Board for Auditors (IRBA)
- The Chairperson for the past five years of the International Auditing and Assurance Standards Board (IAASB) Consultative Advisory Group (CAG) and Chair of the Financial Reporting Investigation Panel on the Johannesburg Stock Exchange (JSE).
- The Chairman of the King Committee on Corporate Governance.

The reason for interviewing these three select individuals (refer to **Appendix 2**), was to understand the perspectives of other key decision makers and areas of expertise in the auditor independence debate. The CEO of the South African national audit regulator (IRBA) provided insight from a regulatory and protection of public interest perspective. The Chairman of the King Committee on Corporate Governance provided insight from the perspective of those charged with governance in the companies themselves (i.e. the board of directors and audit committees). A South African representative at the International Auditing and Assurance Standards Board (IAASB), provided insight and perspective from recent international developments and discussions with regards to auditor independence, as well as a financial reporting considerations.

These three interviews stand apart from the interviews of the audit partners and served to inform the researcher of the broader South African and international issues surrounding MAFR. The results of these discussions and the information gathered can be found in **Appendix 2** and played a key role in the development of the semi-structured interview questions and understanding of the key issues by the researcher. Together with the literature review, this is vitally important to the researcher for partaking in the interviews appropriately and facilitating and guiding discussion. As is more fully discussed in **Appendix 2**, many opinions, themes and priorities were raised as issues to which response and opinion is required from the South African audit profession. Therefore the open-ended interviews included these questions and perspectives which were expressed as relevant for the audit partners to respond to, such as:

- Will MAFR strengthen auditor independence and so protect the public and investors?
- Will MAFR address market concentration of audit services and create a more competitive environment?
- Will MAFR promote transformation by creating more opportunities for small and mid-tier audit firms to enter certain markets?
- Are small and mid-tier audit firms competent to audit the larger public interest entities?

(Refer to **Appendix 2**)

The population and the selection

The purpose of this study, with respect to the issue of mandatory audit firm rotation (MAFR) in South Africa, is to understand the perceptions and opinions of the audit practitioners. Therefore the population to be analysed is considered to be the “audit partners”, otherwise called “audit directors”, from the official list of Johannesburg Stock Exchange (JSE) accredited audit firms. Smaller, non-accredited audit firm practitioners have not been considered based on the reasoning that if MAFR is implemented in South Africa it would only apply to public interest entities, which the smaller audit practices do not service with assurance work. This is similar with international practice and implementation of MAFR. In terms of South African legislation, an audit partner (or audit firm) refers to an individual (or firm) registered as an auditor with the Independent Regulatory Board for Auditors (IRBA). An individual must apply the IRBA for registration as an auditor and must meet the prescribed minimum requirements as determined by the Auditing Profession Act, 2005 and by the IRBA (Auditing Profession Act, 2005). If registered in this manner then the individual is considered a “registered auditor” and is allowed by law to perform audit assurance services in public practice as prescribed by the above Act and in compliance with the auditing professions ethical and professional standards.

This study employs a purposive sampling technique, also known as judgemental, selective or subjective sampling. Purposive sampling is a type of non-probability sampling which focuses on sampling techniques where the units that are investigated are based on the judgement of the researcher, rather than on statistical techniques (Tongco, 2007). Purposive sampling technique is most effective when one needs to study a certain domain which contains knowledgeable experts. According to Tongco (2007), in choosing a sampling method for informant selection, the question the researcher is interested in answering is of utmost importance and it is especially important to be clear on informant qualifications when using purposive sampling.

Fourteen experienced practising “registered auditors” (audit partners) were selected from nine different audit firms in order to perform the interview (refer to table below). According to the book entitled “The Long Interview” by McCracken (1988), as cited in DiCicco-Bloom and Crabtree (2006), in-depth interviews are used to discover shared understandings of a

particular group and the sample of interviewees should be fairly homogenous and share critical similarities related to the research question. This selection of audit partners is therefore the homogenous group that share critical experience related to the research question. The selection is also considered to be fairly representative of the population of registered auditors in South Africa, especially considering that the audit partners selected were involved in the senior leadership of their respective audit practices and were considered sufficiently experienced as audit practitioners, having worked for many years in the capacity of audit partner.

The commonly agreed and recognised distinction between the audit firms (Marx, 2009; Rapoport, 2016) has been used in this study and is as follows:

- “Big four” audit firms refer to the largest four accounting and audit firms globally, namely Deloitte, PricewaterhouseCoopers (PwC), Ernst & Young (EY) and KPMG. These four firms are also referred to as “large-tier” firms (ICAEW, 2016).
- The non-big four firms are either mid-tier or small-tier firms depending on their respective global size, global presence and capabilities as an audit firm in terms of resources (ICAEW, 2016; Rapoport, 2016).

The researcher and the participants in this study used these terms in the interview discussions.

The following is a description of the fourteen practitioners interviewed:

- All the partners were considered senior and highly experienced, ranging between seven and thirty-three years as a practising audit partner. The average number of years as a practising registered auditor of all interviewees is 22 years.
- Seven of the partners were either a regional or a national managing partner in the firm and therefore in key leadership and strategic roles within their respective firms. The remainder were senior partners who also held significant leadership responsibilities and portfolios within their respective firms or network of firms.
- The audit firms were selected from Johannesburg and Cape Town offices of the network firms.

- Of the fourteen partners, two were women.
- The two largest black audit firms in South Africa, namely SizweNtsalubaGobodo Inc. and Nkonki Inc. were represented. These two firms are the largest “black-owned” audit firms in South Africa and have grown to considerable size to rival the traditional “mid-tier” firms.
- Five partners were from the “big four” international audit firms.
- The remaining partners were from the “mid-tier” audit firms (including the “black-owned” medium size firms) who also perform audit services of public interest entities.

The below table shows a further description of the audit partners (participants/respondents) interviewed, including the number assigned for the purposes of analysing the results of the interviews, i.e. “Audit Partner 1”; “Audit Partner 2” etc.:

Designation of Participant in Analysis of Results	"Big four" or "Mid-tier" or "Black-owned Mid-tier" firm	Position	Years as Practising Audit Partner
<i>Audit Partner 1</i>	Big four	Senior partner	25
<i>Audit Partner 2</i>	Big four	Managing Partner	20
<i>Audit Partner 3</i>	Big four	Senior partner	25
<i>Audit Partner 4</i>	Big four	Senior partner	9
<i>Audit Partner 5</i>	Big four	Senior partner	23
<i>Audit Partner 6</i>	Black-owned Mid-tier	Managing Partner	22
<i>Audit Partner 7</i>	Black-owned Mid-tier	Managing Partner	23
<i>Audit Partner 8</i>	Black-owned Mid-tier	Senior partner	29
<i>Audit Partner 9</i>	Mid-tier	Managing Partner	32
<i>Audit Partner 10</i>	Mid-tier	Managing Partner	17
<i>Audit Partner 11</i>	Mid-tier	Senior partner	16
<i>Audit Partner 12</i>	Mid-tier	Managing Partner	33
<i>Audit Partner 13</i>	Mid-tier	Managing Partner	28
<i>Audit Partner 14</i>	Mid-tier	Senior partner	7

Interview process and methodology

Each interview was held in person with the respective participants and lasted between one and two hours, the discussion audio being electronically recorded with the express permission of each participant. Each participant is held on audio record as giving permission to record the interview, on the condition that all personal names, firm names and client names mentioned in the discussion will not be made publically available or mentioned in any output produced by the researcher for public use.

A standard set of open-ended questions was used to guide the discussion (refer to **Appendix 1**). These questions were compiled based on the results of the literature review and the interviews of the three key individual experts (refer above). All electronically recorded audio data from the interviews was collected and then transcribed after the meeting to be used for the data analysis.

According to Leedy and Ormrod (2010), qualitative data analysis ideally occurs concurrently with data collection so that the researcher can generate an emerging understanding about research questions, which in turn informs both the sampling and the questions being asked. This was certainly the case within this study as the interviews process was being conducted, as new opinions documented fed into and shaped the subsequent discussions with interviewees. This iterative process of data collection and analysis eventually leads to a point in the data collection where no new categories or themes emerge, referred to as saturation, signalling that data collection is complete (DiCicco-Bloom and Crabtree, 2006). Saturation is believed to have been reached in these interviews in the sense that no new themes or categories surrounding the question of MAFR emerged in the last interviews, indicating that the sample of fourteen practitioners was sufficient for the purpose of the study.

In the analysis of the data from the interviews a grounded theory approach will be implemented. Grounded theory is an inductive, theory discovery methodology that allows the researcher to develop a theoretical account of the general features of a topic while simultaneously grounding the account in empirical observations or data (Martin and Turner, 1986). This is a research methodology which operates almost in a reverse fashion from

research in the positivist/empiricist tradition employing an inductive, theory discovery methodology that allows the researcher to develop a theoretical account of the general features of a topic while simultaneously grounding the account in empirical observations or data (Martin & Turner, 1986). Unlike positivist research, a study using grounded theory is likely to begin with a question, or set of questions, or even just with the collection of qualitative data. As the researcher then reviews the data, repeated ideas, concepts or elements become apparent, and are grouped into codes, concepts and categories. These categories may become the basis for new theory.

Therefore the analysis of the data from the interviews will be categorised and discussed within a framework of the key themes that were either (1) formed based on the open-ended interview questions themselves, or (2) brought into the discussion by the interviewees. The order to which these themes are presented is a reflection of the chronological sequence of the discussions as well as the inherent importance of the issue as expressed by the interviewees. In order to ensure the reliability (accuracy) of the transcribing process the researcher performed a check of the transcription by listening to each audio interview with the transcription document in hand.

The transcribed data was then used in order to identify common, recurrent, or emergent themes around the issue of MAFR in South Africa. It is also important to analyse patterns amongst themes, such as noting similar traits among the partners who express similar opinions on issues and themes. For example, the inherent traits of audit firm size is a significant categorisation of traits, as well as whether the audit partner represents a black-owned, mid-tier or large-tier audit firm. A less significant trait may be common experiences such as exposure to acting on audit committees or professional bodies.

Regarding the potential for researcher bias, the researcher is in a neutral role as an academic with no inherent personal or financial interest in the outcome of legislation in South Africa regarding MAFR; hence bias is not a significant risk in the study. The questions posed and the responses to them were documented objectively.

The results of the analysis will therefore be a presentation of themes around the partners' views of MAFR and issues related to MAFR. It is important to note that, as mentioned above, the purpose of this research is to produce a national field survey, and the open-end interview methodology is employed to understand the breadth of the concerns and opinions of the audit profession. Therefore, the fourteen partners are not intended to be "representative" of the population and there is no need to quantitatively present the findings. The purpose is to present the breadth of the issues, not the extent to which the population agree or disagree with any particular viewpoint expressed. Quantitative findings that can be considered "representative of the population", namely the South African audit profession, will be intention the national field survey study that is intended to follow this research (refer to areas for further research).

The interview sheet used to facilitate the semi-structured interviews is shown in **Appendix 1**.

Chapter 4: Presentation and Analysis of Results

This section presents and discusses the findings of the study based upon the methodology applied to gather information.

The results are presented and analysed according to the following key themes identified by the researcher upon review of the complete data collected, being the transcripts that document the discussion of the interviews. The order to which these themes are presented is a rough reflection of the chronological sequence of the discussions as well as the inherent importance of the issues as expressed by the interviewees.

The following significant themes and categories were identified and are used to present the analysis of results:

1. The need for improved auditor independence
2. Public perception of independence
3. Competing objectives
4. The role of the audit committee
 - a. The experience, composition and competency of the audit committee
 - b. Regulation vs. audit committee judgement
5. Unintended consequences
 - a. Loss of knowledge and experience
 - b. The distraction of requiring to source new business
 - c. Unmanageable costs
 - d. A move away from assurance services
 - e. Audit fee low-balling
6. Possible alternatives to MAFR
 - a. Mandatory audit tendering
 - b. Combined (joint) audits
 - c. Audit manager rotation
7. Addressing market concentration
8. Transformation considerations
9. The problem of over regulation

1. The need for improved auditor independence

There was some degree of mixed response with regard to whether or not South African auditors were appropriately independent, however most (11/14) were of the opinion that independence was not a concern in reality, especially for public interest entities where a partner rotation is mandatory every five years. More than half of the audit partners were of the opinion that, considering the requirement to rotate the audit partner every five years (for public interest audits), MAFR is not likely to bring a further improvement to auditor independence.

There were no partners, of the fourteen interviewed, who were fully in favour of MAFR in South Africa. Nearly all (13/14) were against it on the grounds that it would not achieve improved auditor independence and that there were too many significant negative consequences, as will be discussed below. Only one partner was tentatively in favour of MAFR but stressed the need to balance the trade-off between (1) gained institutional knowledge and experience of the client and (2) the familiarity threat with management that develops over time. In this partner's opinion, if MAFR is required after too short a period such as five years, then audit quality will suffer from an auditor lack of knowledge and experience with the client. However, too long a period will result in familiarity threats to independence, as they believe is a problem currently in practice in South Africa.

After expressing that independence in their experience was not a real concern, i.e. that the degree of auditor independence in their audits was sufficient, one audit partner expressed a qualification, namely that there will always be the situation whereby the client is the one paying the audit fee to the audit firm. This was the case whether or not MAFR was implemented and would always result in some degree of conflict of interest. This unavoidable threat to independence, i.e. the importance of the client to the auditor, simply because the auditor is reliant on the client for the payment of significant audit fees (Tepalagul & Lin, 2015), will always provide a degree of risk to auditor independence, and realistically cannot be removed so long as the client pays for audit services. The international code of ethics also explains that when the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the

dependence on that client and concern about losing the client creates a self-interest or intimidation threat to the auditor's independence (IFAC, 2006, section 290). However, this partner agreed with most of the respondents that independence was not actually a significant problem in reality i.e. the threats to auditor independence in practice are managed appropriately. *(Refer to Quote 1, Appendix 3)*

Only one respondent was of the opinion that MAFR would improve independence, stating that from a purely theoretical perspective, MAFR would increase independence. However, the respondent did not believe that an increase in auditor independence was required in practice i.e. they believed that the degree of auditor independence in practice was sufficient. *(Refer to Quote 2, Appendix 3)*

This comment was in the context of smaller companies, as opposed to large listed entities. The partner felt that, as a mid-tier firm partner, there are many medium size businesses that are considered public interest entities in South Africa but are relatively small private companies. These businesses are often family owned and management (who are the owners) will often rely on the professional advice of their auditors and over time will develop a good relationship with the partners at the audit firm. The partner who expressed this also made the point that the public interest score, as it is currently contained in the Regulations to the Companies Act 71 of 2008, results in too many smaller businesses being labelled as public interest entities. However, this partner's point was that regulation like MAFR would force a greater degree of independence but that would lead to other unintended consequences on the profession and on audit quality. Nearly all partners interviewed expressed a strong concern that the implementation of MAFR will not improve audit quality, even if it may improve auditor independence. The concerns expressed were in regard to the unintended consequences and effects of MAFR, as is discussed further below.

All the audit partners expressed concern at the outset of the interviews that forcing MAFR on South Africa would result in significant unintended consequences. This will be discussed more fully in the following sections.

2. Public perception of independence

Most audit partners (11/14) agreed that there is a significant difference between the public perception of independence and the reality of auditor independence, with the public's perception being significantly worse (i.e. perception of an independence or audit quality problem) than what was in reality the case (in their opinion). These partners are all in favour of pursuing means of addressing public misconceptions about the audit function and about auditor independence before making a decision on MAFR. In their opinion the regulator (IRBA) should look at means of addressing the perception problem before looking to change legislation in the profession. A number of partners illustrated this point with the example of how in their experience of discussing their work with company stakeholders and the general public, it is not uncommon for people to express their understanding that it is the auditors role to guarantee the accuracy of the financial statements and to detect all forms of fraud and mismanagement. These experiences are evidence that the public does indeed misunderstand the role and value added by the auditor to the credibility of the audited financial statements. In the opinion of these partners who expressed these experiences, MAFR should not be adopted in response to public perception per se, but instead other more effective and perhaps less damaging methods (to audit quality and the profession) should be pursued by both the IRBA and the profession to educate public understanding of the limitations of the audit function. *(Refer to Quotes 3 and 4, Appendix 3)*

A number of partners raised the point that there is a high degree of adherence to ethical standards at both a professional level and at a firm level, to which the audit practitioners need to adhere to. In their opinions they find that the partners take this very seriously. In addition, the fact that South African audit partners are required by local regulations to place their personal name on the audit report and sign, together with the firm name, was raised as a further reason for the partner to guard his or her independence. The international audit standards do not require the name of the engagement partner on the signed audit report. *(Refer to Quote 5, Appendix 3)*

3. Competing objectives

Some partners, especially the representatives of black-owned emerging audit firms, as well as non-big four audit firms, were of the opinion that MAFR or maybe an alternative such as combined audits, would improve competition (i.e. reduce market concentration) and transformation in the audit industry. In response to this argument other partners pointed out that the IRBA needs to be clear as to what exactly any change in regulation is trying to achieve. Is the IRBA attempting to improve audit quality or are there other priorities driving the agenda, such as market concentration and transformation objectives? More than one partner was sceptical that the IRBA claims that MAFR or any alternative to MAFR is primarily being considered to improve audit quality in the interest of public protection. In reality they believed that there were these alternative objectives around transformation and competition being pursued as well. In their opinion there were better ways to achieve the other objectives, rather than imposing such significant additional regulation on the industry, and that any discussion on MAFR (or an alternative) should only be considered if it did indeed improve audit quality. These partners were adamant that by pursuing other objectives (in addition to audit quality) in the decision around MAFR could actually result in a loss of audit quality.

4. The role of the audit committee

All the audit partners agree that the audit engagement and the choice of the auditor, as well as any non-assurance services required, is a decision of both the audit committee, being those charged with governance by the shareholders, as well as the auditors themselves. The audit committee, whose existence is a legislative requirement in South Africa for a public interest entity (refer to section 94 of the Companies Act 71 of 2008), is ultimately responsible for the recommendation for the nomination and the replacement of the auditor, subject to approval by the shareholders. The decision of whether or not to ask the auditors for non-assurance services and whether or not to place the audit out for tender, is ultimately in the hands of the audit committee, being those charged with governance by the shareholders.

a. The experience, composition and competency of the audit committee

All the partners interviewed agreed with the reasoning that the best means of improving auditor independence is actually to improve the quality of corporate governance in the audit clients, rather than through MAFR. Improving the quality of the non-executives on the audit committees, possibly through education and promotion of King III Report principles of corporate governance (soon to be replaced by King IV), was believed to be a means of having a greater impact on auditor independence and audit quality.

Some partners had experience as audit committee members, as well as in their capacity as audit partners, and they expressed that the Audit Committees that they have served on over the years and continue to serve on currently, take auditor independence very seriously. Other partners expressed some mixed experiences regarding the experience and effectiveness of audit committees. South Africa is very highly rated in terms of its standards of corporate governance, namely the World Economic Forum Global Competitiveness Reports (GCR), including the latest 2015-2016 Report (World Economic Forum, 2015). Referring to this fact, many partners stated that, in their experience, often both sides of the audit engagement, the auditor and the audit committee, take independence matters very seriously. *(Refer to Quote 6, Appendix 3)*

Providing examples of strong audit committee action, some partners illustrated that, in their view, when the opposite is the case, i.e. weak governance by the audit committee, this is when there is the greatest potential for independence of the auditor and audit quality to be compromised. Weak audit committees resulted in threats to auditor independence and this should be acknowledged by the IRBA before regulatory changes such as MAFR impose change on the auditors only.

A few audit partners were of the opinion that in their experience there is actually a deficiency in the functioning of the audit committee and this deficiency needs to be addressed before MAFR, or any other audit regulation, is considered. An interesting dissenting view came from a mid-tier firm partner who expressed the occasional failure of audit committees, although the person was in favour of strengthening corporate

governance as a better approach than MAFR. In their experience there is a tendency sometimes for audit committees, and audit committee chairpersons, to firstly favour certain audit firms or secondly, not consider the need to replace auditors periodically to remove the familiarity threats. *(Refer to Quote 10, Appendix 3)*

One partner, with extensive experience as both an audit committee member and chairperson, as well as auditor, expressed a concern that in their experience the audit committee's independence from management can negatively affect their quality as a committee, especially as it related to managing external audit as required by the codes of corporate governance and the Companies Act. Too often management is handling issues that are clearly the mandate of the audit committee and the audit committee acts as the "rubber stamp", simply ratifying management's decision in these issues. *(Refer to Quote 11, Appendix 3)*

Referring to certain key issues that are the responsibility of the audit committee to manage, this partner made the point that sometimes key issues that should be the jurisdiction of the audit committee were dealt with by management and decided upon, before reaching the audit committee. A number of respondents expressed this concern around management involving themselves in audit committee matters. As it pertains to auditor independence, the problem expressed was that the audit committee receives the result of management decisions regarding key audit issues, such as an audit misstatement uncovered by the auditor, issues around terms of the appointment of the auditor, or non-assurance services to be provided by the auditor. The decision making should however happen the other way around i.e. the audit committee consults with the auditor, makes the relevant decisions, and then notifies management. In this partner's view, sometimes the audit committee is even guilty of actively requiring the auditor to settle a key issue with management, rather than being the key player in the decision. The specific example given was the audit committee requiring management to approve the audit fee and if they had done so, the committee would simply "rubber stamp" the agreement. Any debate around the audit fee becomes one that is between auditor and client management, with the audit committee willingly sitting on the side-line, in direct contravention to corporate governance codes of best practice. *(Refer to Quotes 12 and 13, Appendix 3)*

The respondents often provided examples from past experience, such as one partner describing a situation whereby he/she was a member of an audit committee and management simply told them that the audit was going out for tender. Management then went so far as to provide the audit committee with the short list of firms that had tendered for the role. If this reality presents itself in a company, and if it is tolerated by the audit committee, the result is clearly an ineffective audit committee and poor corporate governance practice. In addition, as this partner points out, if this is the way decisions are made in the company regarding the audit function, the auditors now need to manage their relationship with management. Managing the relationship with management and thereby impairing auditor independence is seen as a necessary means to retain the audit work, since management are effectively performing the role of the audit committee and the non-executives. Therefore this relationship with management creates a clear conflict of interest for the auditor and impairs their independence. It was expressed that if management do not like the auditors or feel that they are too expensive or raising too many audit adjustments, then management can either put the audit out for tender. And this reality is the case regardless of whether there is audit partner or audit firm rotation. The problem exists in both legislated environments, whether there is MAFR or not. Either way there is a lack of independence that will reduce audit quality significantly. It was expressed that this is the problem that the regulator (IRBA) should be looking to address, and MAFR is not the solution. Rather, in the opinion of some of the partners, measures to educate non-executives, and strengthen the corporate governance, will have the greatest impact on auditor independence. Another suggested solution to this was better informed and more active shareholders who ensure the independence of the audit committee board members (non-executives) and who appoint auditors based on this independent recommendation from the audit committee, as is the intention of the Companies Act and the King III Report on governance.

Many respondents expressed similar concerns of a lack of professionalism, knowledge of role and independence in the operations of the audit committee. The partners had experienced many strong and independent audit committees, but unfortunately the “rubber stamp” system is a problem in more than a few companies. (*Refer to Quote 14, Appendix 3*)

Some of the audit partners expressed the opinion that the weakness in corporate governance lies not in its principles, as South Africa has some of the best governance principles and structures in the world. All the partners were well aware of the findings of the Global Competitiveness Reports (GCR) in this regard. Rather, the problem lies in its execution in some companies, and of most concern was the need to strengthen the role of the non-executive director. The quality of the non-executive directors needed to be improved in the opinion of many respondents, especially their understanding of King III corporate governance principles, and their degree of independence from the company. *(Refer to Quote 7, Appendix 3)*

There was a generally expressed concern around the quality and independence of company non-executive directors was specifically identified by other partners. In South Africa, and certainly on exchange listed companies, it is the non-executive directors who comprise the audit committees. Frustration was expressed that the reality of their experience is that non-executive directors are sometimes not being appointed because the shareholders really believe that they should be, or that the audit committee really believes that they are the right firm for the job. The appointment is made because the CEO and CFO believe they should be, and this in their opinion is a major problem in South Africa and likely globally. This is a problem that they believe is not being acknowledged and needs to be addressed. *(Refer to Quote 15, Appendix 3)*

Whereas all the audit partners interviewed were of the opinion that auditor independence can better be established and strengthened through proper corporate governance at the audit client, this should not be construed as though they believe that corporate governance practices in South Africa are weak. On the contrary, a number of audit partners (as above) referred to the GCRs issued every year by the World Economic Forum which rate South Africa's "strength of auditing and reporting standards" 1st out of 140 countries researched, the "efficacy of corporate boards" 3rd and "strength of investor protection" 14th, based on the 2016 Report (World Economic Forum, 2015). Together with the general recognition that the South African King III Report on Corporate Governance is one on the best governance codes available, it was the opinion of many that the discussion around MAFR should take

into account that South Africa is in a strong position from a governance and auditing standards perspective, relative to other developed and developing countries. One partner made the point that, considering the strength of South Africa's corporate governance and auditing standards, as externally verified, they seriously question the assumption that MAFR would actually improve audit quality. The IRBA needs to answer this question: Will it really improve audit quality? If it cannot be convincingly shown to improve audit quality then it should not be pursued. *(Refer to Quote 8, Appendix 3)*

b. Regulation vs. audit committee judgement

A common concern raised was that MAFR would have the effect of removing the need for much important discussion and decision-making by the audit committees and therefore take away their role as the ultimate "auditor gatekeeper" and assessor of the audit function within the company. Currently the audit committee must, in terms of the Companies Act 71 of 2008, approve non-assurance services required of the auditor and formally assess the independence and suitability of the auditor to the company. The feeling was that MAFR would take this important judgement and control away from the audit committee and replace it with simple rotation regulation. The audit committee would no longer have the incentive to take auditor independence and auditor suitability (to the company) seriously. The audit committee would no longer apply its collective mind to the issue of auditor independence, certainly not to the degree expected in terms of corporate governance principles outlined in the King III Report, because it would be believed that the issue was dealt with by regulation, not by the audit committee. Why should the committee concern itself with threats to auditor independence, especially in light of non-assurance services and familiarity through relationships with management, when the firm would be replaced as a matter of legislation in due course? It was felt (by many partners) that mandatory rotation would artificially limit the freedom of those charged with governance to appoint the audit firm which best meets the needs of the company and its stakeholders. *(Refer to Quote 9, Appendix 3)*

These views by the partners interviewed reflect a common international argument against MAFR in that auditor rotation would now be arbitrarily forced on a company, regardless of

the stage or set of specific circumstances that the company finds itself in. For example, just when a company needs the experience of its long standing auditors, for example in merger or acquisition deals, or in an operational change of direction, which would present significant audit risks, this may coincide with the need to rotate the audit firm, with the incoming audit firm at a significant disadvantage due to unfamiliarity of the client.

5. Unintended consequences

All the audit partners without exception stressed significant negative consequences from the pursuit of MAFR, many going so far as to conclude that MAFR will ultimately therefore reduce audit quality. Of most concern was (1) the loss of valuable client-specific and industry-specific knowledge in the rotation, as well as (2) the unmanageable and unnecessary costs that MAFR would cause the audit firms to incur.

a. Loss of knowledge and experience

A primary negative consequence of MAFR that was raised was the significant loss of client specific knowledge that would leave with the outgoing audit firm upon firm rotation. At the heart of that client and industry knowledge is an understanding of the audit risks at the client. It was the view that the auditor who has a better understanding of the audit risks, will ultimately produce the best audit quality in the end product, which is the audited financial statements and the audit report, not to mention the value-added report provided to management together with the audit itself. One partner made the point by stating that the loss of a client to a firm will decrease audit quality because it has the effect of “promoting incompetence”. *(Refer to Quotes 16, 17 and 18, Appendix 3)*

Many partners were concerned that the “new broom sweeps clean”, “fresh eyes” argument in favour of MAFR does not justify the loss of institutional knowledge from the outgoing audit firm. The incoming auditor will take a significant amount of time to familiarise themselves with the client’s business and understand the audit risks appropriately. *(Refer to Quote 19, Appendix 3)*

One partner, who was experienced in the audit of large listed organisations, and who has recently experienced moving from one large complex client to another under the rule of normal audit partner rotation, even just within the same industry, expressed their concern around the complexity of some of the large listed groups and the fact that it takes many years to gain the required experience to properly act as the audit partner. In reality, what happens with five year audit partner rotation is that the replacement audit partner within the firm will start “shadowing the old partner”. This allows the new partner to learn the industry and understand the audit and financial reporting risks in the complex entity. In time he/she will take over as the engagement partner (i.e. the person who signs the auditor’s final report concerning the annual financial statements) and this produces an appropriate system of training and continuity, preserving the significant institutional knowledge gained by the audit firm over time. The opinion was that this continuity and deep understanding of the complex client is lost in a system of MAFR. *(Refer to Quote 20, Appendix 3)*

The above opinion was also expressed by a mid-tier audit firm partner who made the point that the larger and more complex the company under consideration, the more audit risk the incoming auditor will be exposed to due to unfamiliarity of the operations and risks of material misstatement. In the respondent’s opinion, MAFR will produce “a team that has zero knowledge, nor the partner, nor do the manager, nor any of the staff have any knowledge of that client”. *(Refer to Quote 21, Appendix 3)*

b. The distraction of having to source new business

One partner in particular had an interesting opinion regarding the business case during the transition between outgoing and incoming audit firms under a regime of MAFR. As the outgoing auditor nears the end of the firm’s term in a system of MAFR, the firm needs to replace that income stream that is about to be lost. There are staff salaries that need to be paid, plus other expenses. The audit partners are ultimately responsible for sourcing new work in an audit firm and will be under significant pressure to source new audit work to replace the clients that need to be rotated, or to turn the audit client into an advisory, non-assurance client. Apart from the fact that this creates a clear conflict of interest to auditor independence, this will require significant planning, tendering, and meeting with

prospective audit committees to make presentations, studying potential audit clients to perform proper pre-engagement activities, etc. This increased stress, time and cost will take its toll on audit quality on the outgoing client audits in their last year or two of the rotation term. *(Refer to Quote 22, Appendix 3)*

The business case impact of MAFR was expressed by a number of partners as being a very important consideration. The above opinion expresses the concern that an amount of unprofessionalism, conflict of interest and distraction may impact the audit when the firm knows it will need to source new work to replace the coming lost income from the assurance work. The firm will need to consider setting itself up to perform advisory services to the audit client and this priority will be seen as a business necessity to remain profitable. The problem then will be a self-interest threat to the independence of that auditor, or simply a distracted lack of attention, and perhaps they will be less likely to raise audit adjustments or report modifications and reportable irregularities in the last couple of years on the engagement. This will threaten audit quality. It is important to note that this is not necessarily the case with the current system of audit partner rotation every five years as the firm retains the business in the rotation.

c. Unmanageable costs

Many of the audit partners expressed significant concern regarding the degree of tendering and costs involved that MAFR will introduce to the market. The typical argument was that MAFR will result in many more audits going out for tender, albeit tenders whereby the incumbent auditor will not be allowed to bid for reappointment. The other firms will need to tender for the work as they also have to deal with the fact that MAFR will require them to give up audit clients. So the effect will be the need to produce many more tender documents, together with the extensive research, pre-engagement activities and presentations that necessarily come with tendering for audit work. The cost was considered by many to be unmanageable and hugely time consuming. In the opinion of one mid-tier audit partner, the expected effect on their firm will be the need to consider developing an entire department to dedicate their resources to producing tenders and presentations to audit committees. This person also felt that, as a mid-tier firm, these tender proposals to

the larger companies would simply be turned down because of the perception by stakeholders and audit committees that non-big four audit firms cannot or perhaps should not be auditing large listed companies. As documented under the market concentration section, many are in agreement that MAFR will simply result in a rotation of the large company audits amongst the big four firms.

Another area of cost increase will be the pressure on the auditors to increase the audit fees, thereby increasing the cost to the companies. This seems to be a counter effect to the low-balling effect that many partners raised (refer below). An auditor should base their audit fee on factors such as the degree of work required in the form of staff time, staff seniority required on the audit team, specialist skills needed, size of the client's operations and degree of audit risk involved, as guided by accepted practice, the auditing standards and ethical codes. Then surely the incoming audit firm, who because of their unfamiliarity with the client, who will therefore need to spend much more time understanding the business and its high risk areas, understanding systems descriptions, training staff etc., will need to charge a higher fee? *(Refer to Quote 23, Appendix 3)*

An opinion expressed in this regard was that this unfamiliarity cost is more significant the larger and the more complex the client is. The more complex and diverse the entity's operations are, as is the case with large listed companies, the greater the degree of audit risk and audit complexity. Audit risk refers to the likelihood of there being a material financial misstatement, or area of financial fraud, impacting the fair presentation of the financial statements of that company. In addition, if the company is in an industry with which the audit firm is less familiar or less experienced, then again the unfamiliarity costs are again higher, and surely this should be reflected in the audit fees? If the audit fee is sticky upwards, due to the audit committee and management's reluctance to increase fees simply because MAFR was implemented into legislation, the cost of MAFR will be borne by the audit firms. Most of the partners were already of the opinion that the profits and remuneration to be had in the audit firm were not commensurate of the risk and work required (refer to discussion below), so this further added cost layer causing a margin squeeze would not be manageable or fair in their opinion.

d. A move away from assurance services

A concerning trend expressed by some of the audit partners, especially those who are not from big four audit practices, is the move of small-tier firms away from audit to focus on accounting and tax advisory work. In these partner's experience, smaller firms are unable to reasonably compete with the mid- and large-tier firms in offering of assurance services and therefore cease to provide audit services. What were identified as the reasons for this? Mostly it was the regulatory burden and risk-reward imbalance that is believed to be in the offering of audit services, but also the dominance of the larger firms, especially considering that only the larger companies require statutory audits in terms of the Companies Act 71 of 2008 (i.e. the public interest entities). Concern was expressed by these respondents that this trend is not good for the profession and for promoting competition in the industry. If MAFR was introduced, depending on which category of companies it was aimed at, it may cause the smaller firms to further question whether they should be offering assurance services. In the opinion of the partners who expressed this, the regulator (IRBA) should consider these smaller firms and the possible impact that MAFR could have on their businesses.

e. Audit fee low-balling

The problem of low-balling, which is the offering of an unrealistically low fee so as to obtain the business, was also raised by many partners. In a system of MAFR there could be a situation whereby, as more firms have to tender for the work as rotation is imposed, audit fees will become a significant determining factor in the eyes of the audit committees, management and the audit firms themselves. This can produce low-balling, which is the under bidding of the competition simply to win the audit engagement, to the degree that the audit fee is too low to perform the audit with appropriate quality, resources and in compliance with the professional auditing standards. Again there is the link being brought up by the interviewed partners between MAFR and a reduction in audit quality. The international ethics code also prohibits this activity and explains that unduly low fees creates a self-interest threat to the auditor's professional competence and due care if it is so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price (IFAC, 2006, section 240).

A mid-tier audit firm partner expressed the opinion with regard to low-balling audit fees, especially in light of MAFR, that it will produce an environment where much more tendering will need to take place. The concern was directed in particular at the non-big four firms, which the partner believed were more likely to low-ball as smaller firms have more to lose by not securing the audit work on a tender. It is interesting to note that this partner was not from a big four audit firm and yet he/she admitted that it is the non-big four firms that have the incentive to low ball as they are heavily reliant on their client in terms of proportion of total revenue. If MAFR was to be implemented without proper regulation and policing of the audit fee, there would be a problem of low balling audit fees without a doubt. *(Refer to Quote 24, Appendix 3)*

A suggestion was that if the IRBA moves the regulation to one of MAFR or even joint audits, a fees system could be implemented, as is similar with attorney's fees, where guidance is provided by the regulator, as well as a system for dispute regulation on fees. This may help prevent low balling. *(Refer to Quote 25, Appendix 3)*

6. Possible alternatives to MAFR

In the discussion with the audit partners around possible alternatives to MAFR the responses were partly determined by the degree to which the partner felt that auditor independence or audit quality was a problem in South Africa. As has been noted already most (11/14) were of the opinion that auditor independence was not a legitimate concern in reality, and therefore they felt that there was really no need to seek an alternative to MAFR or significantly change the current system of principles and regulations. However, despite strong feelings against the need to change the current legislative environment with respect to auditor independence, if regulations were going to change, a few alternatives to MAFR were provided.

a. Mandatory audit tendering

The partners that commented on this felt that legislating a system of requiring the audit to be placed for tender after prescribed periods would be preferable to MAFR. Mandatory tendering was felt to be preferable as it would allow the incumbent auditor to compete through tender for the client again, as opposed to MAFR which would exclude the incumbent for being reappointed. However, the fact that the audit committee or the shareholders are currently able to place the audit out for tender in any given year was felt by some to negate the need to impose the requirement through legislation. As mentioned already, the legislating of tendering or MAFR removes the need, or at least the incentive, for the audit committee (or shareholders) to apply their collective mind as to whether the incumbent auditor is well-suited and independent to the company, or whether it is the right time in the life cycle of the business to seek new auditors. This is because mandatory tendering and MAFR is a matter of regulation imposed on the audit committee, not a matter of professional judgement.

b. Combined (joint) audits

There was considerable mixed opinion as to whether joint audits were a viable alternative to MAFR. The partners from the black-owned emerging audit firms were in favour of combined audits, pointing out that combined audits which they had been involved with in the past had significantly grown their firm's skills and capacity to perform such assurance services to large public interest entities. This was an important point for them, being that joint audits which involved a more experienced firm and a smaller, less established firm (like the black-owned emerging firms), or even normal mid-tier firms, would allow a significant skills transfer and opportunity to build the necessary resources to provide large companies, such as JSE listed companies, with assurance services. Joint audits could provide the much needed skills transfer to smaller firms that MAFR could not. This opinion was also strongly expressed by one mid-tier audit firm partner (Audit Partner 9) who pointed to the success that combined audits has brought to market concentration in France. France is a country that has applied a system of combined audits for a number of years and in the opinion of this audit partner, to great success.

In the French example given by this partner, if you go back about 20-25 years in France there were three local French firms competing with the big audit firms at that time. What would then happen in the joint audit system was that one big audit firm would partner with the local French firm. Over time that allowed one local French firm to grow to the international practice that it is today, currently auditing 13 of the top 40 listed companies (the CAC 40) on the Euronext Paris exchange. In the opinion of this partner, joint audits allowed the firm to grow to a size in which it would never have reached in a jurisdiction such as the United Kingdom (UK). In the UK, of the top 100 companies on the Financial Times Stock Exchange (FTSE) 100 Index, all are audited by big four firms, with only one exception. This partner goes on to explain that in their view the resistance around the world to combined audits is often because it will challenge the dominance of the big four firms. What has already happened is that the big firms have reduced from five or six over the years to four and this is not good in their opinion for the profession and public interest. *(Refer to Quote 26, Appendix 3)*

The partners in favour of combined audit arrangements point out the problem that smaller firms have from a business perspective. From a business perspective the audit firm leadership cannot justify taking on more staff resources to audit larger companies until they are actually appointed as the auditor or else they risk going out of business from a profit point of view. But without the resources the audit firm cannot justify tendering for the work to secure the audit. *(Refer to Quote 27, Appendix 3)*

An audit partner who favoured the joint auditors approach suggested that perhaps the IRBA should consider phasing in MAFR by first implementing a system of combined audits for large public interest companies, which would allow the mid-tier audit firms to up-skill and build their resources to be able to properly compete and produce good quality audits in a later system of MAFR without combined audits. This partner made an illustration with the South African mining industry where they pointed out that maybe only three audit firms have the ability to audit the large mining companies. Perhaps joint audit would allow more firms the opportunity to service this industry because as it stands now, no responsible audit committee is going to appoint or recommend for appointment any firm other than those three firms who have the mining audit experience.

However, again the question is posed from other partners, which is relevant to the debate: Why exactly is South Africa considering changes to the regulations? Is it really because of independence and audit quality concerns, or is it to achieve other objectives such as increased competition and transformation? In their opinion it is important for the regulator (IRBA) to be transparent about the true priorities and intentions, as changes to regulations may have the unintended consequence of actually reducing audit quality.

There were serious concerns expressed by some against joint audits. All the big four partners were against a system of joint audits, while most non-big four partners were in favour on the grounds that it would allow their firms to grow to compete with the big four. The main concern expressed by the big four partners was the unnecessary cost and duplication of work required in such a system. This was expressed by one partner in particular who had some experience with joint audits, as joint audits is currently a requirement in the banking industry and used to be applicable in the insurance industry in South Africa. Based on approximately ten years' experience with joint audits, this partner has found joint audit engagements to be costly and ineffective. The main reasons provided for this were that there is much unnecessary overlap and duplication of work, with two audit partners, two managers, two teams, all billing time and often covering the same ground twice rather than effectively coordinating work and trusting each team to get their respective sections audited. In their opinion joint audits would not contribute towards increased independence, would not be feasible from a cost perspective and would not be practical. *(Refer to Quote 28, Appendix 3)*

One of the partners, who is from an emerging black-owned audit firm, and who has experienced joint audits in public sector audits, raised the concern that joint audits (unfortunately in their opinion) work better when they are between two equal firms, such as two big four firms or two mid-tier firms. The problem they have experienced in their practice is when the management or the audit committee perceives the joint audit as an "unequal partnership" in the sense that one of the firms is the smaller mid-tier or black-owned firm and the other is the more established big four firm. The problem with this is that the opinion of the big four firm usually holds sway, and this is more so the case in the

eyes of the audit committee. So whereas joint audits in this partner's opinion will allow the smaller firm to grow and up-skill, it may not improve independence due to this perception of unequal partners and the smaller firm's voice and opinion on the audit findings or audit direction may not be given equal importance.

It is significant to note that both the managing partners from the emerging black-owned firms, whose practices have significant experience with joint audits in state-owned companies, agree that joint audits have allowed their firms and staff to up-skill and grow to the point where they could act as sole auditor on the state-owned companies. This has allowed these smaller black-owned South African firms to grow into mid-tier size firms, improving competition and also black economic transformation in the profession. Responding to the common argument of increased cost and duplication of work, one of the managing partners from the emerging black-owned firms expressed the opinion that it can work and is "a brilliant opportunity to achieve two-in-one", namely increased independence and transformation. Duplication of work is simply a management problem that can be overcome. *(Refer to Quote 29, Appendix 3)*

c. Audit manager rotation

Nearly all the audit partners agreed that rotation of audit team members in addition to the audit partner would not be a viable alternative, simply because the article clerks (trainees) on the audit team have a short rotation period inherently as they serve their three year training contract and generally leave the audit firm or move on to other roles within the firm. It was also felt that even the management layer on the audit team experiences a sufficient degree of natural rotation as audit managers are promoted in the firm, move to other areas in the firm or leave the firm for alternative job opportunities. Therefore audit manager or audit team rotation would not improve independence of the auditor. The current system of partner rotation was agreed by all partners interviewed to be a system that does indeed mitigate the familiarity threat that can develop due to long standing relationships with the audit client.

7. Addressing market concentration

Market concentration is a function of the number of firms and their respective shares of the total capacity in a market. All the audit partners expressed concern, despite their other differing opinions on other related matters, that a significant unintended consequence of forcing MAFR on South Africa would be the likelihood that the audit of large companies (particularly the listed companies) would simply rotate around the big four audit firms and therefore actually reduce competition rather than grow it. As mentioned, none of the partners are fully in favour of MAFR, most are against it, but some are of the opinion that a slower, more structured implementation of MAFR (perhaps via a system of mandating joint audits), could allow non-big four audit firms to grow in skills and resources to allow them to compete in time for larger company audits in a system of MAFR. However, these partners were more in favour of a simple joint audits regulation as opposed to MAFR. There was significant disagreement as to whether market concentration was a concern. As could maybe be expected, none of the big four partners believed that market concentration was a problem or that it was the regulator's (IRBA) place to step in to actively address it. Comparisons were made to other industries such as banking, telecommunications and construction, whereby similar concentrations of companies are present and therefore the audit industry should not be seen as much different. In addition, the market concentration of the South African audit industry is comparable to that in other countries.

Of the partners who agreed that market concentration was a problem, all were in favour of joint audits rather than MAFR as a means to improve competition. It is fair to say, and a significant observation, that there was no person interviewed who was in favour of a direct move from the current system to one of MAFR, either to improve independence or to improve competition in the audit industry.

In response to being asked whether MAFR will allow mid-tier to compete for the larger company (public interest entity) audits, one big four partner described the situation as a "shifting of the deck chairs" around the big four. The key question they raised was whether the audit committee would be prepared to appoint a firm that clearly did not have the past experience or resources for the large listed company audit engagement? In their opinion the

audit committee would not take the risk of such an appointment as they expect a substantial degree of experience, resources and industry knowledge that the mid-tier firms did not possess. The audit committee expects a large audit firm to be present in every location that their business is located internationally and to draw on such geographically spread resources in order to perform the audit. These respondents did not believe that the smaller firms could provide this required service as auditors that the big four firms could and hence would not be appointed after the tender process. The problem will be that the smaller firms will tender for the audits in a system of MAFR, but will not be appointed due to the above concerns of the audit committee. *(Refer to Quote 30, Appendix 3)*

Referring to the larger listed multi-national companies, one partner made the point that in their opinion, having been involved in a few companies of this size and geographic diversity, the mid-tier firms could not possibly perform assurance services on that scale. In that sense MAFR would actually reduce competition as these audits would have to move from the one big four firm to one of the other three. *(Refer to Quote 31, Appendix 3)*

This opinion is also shared by some mid-tier audit partners. The concern is simply that the audit committee, when faced with having to choose another audit firm during a mandatory rotation is likely to stay with a big four firm, rather than risk negative stakeholder perception by moving away from the big four. *(Refer to Quotes 32 and 33, Appendix 3)*

Considering the risk involved and the experience, skills and size of mid-tier firms, why would the audit committees of large companies award the audit to a non-big four firm? This was a common question raised by audit partners, of both large and mid-tier firms. Audit committees of larger companies would be less inclined in their opinion, for reasons of perceived risk or quality or resources, to award tenders to non-big four firms, regardless of whether MAFR was introduced.

One partner expressed, regarding large listed companies in particular, that the current system of five year partner rotation, together with the audit committee and shareholders having the power to put the audit out for tender, allows all four big four audit firms (or all firms for that matter) to bid for appointment – including the incumbent big four firm.

However, the effect of MAFR would change this significantly. Under MAFR regulations the audit committee and shareholders will be required to rotate the incumbent big four firm, but the incumbent will not be allowed to bid for the tender i.e. to bid for reappointment. Therefore, since the audit committee will likely only favour another big four firm (as it is a listed company), this results in only three possible choices for auditor - as opposed to four in the current system. So the thinking is that MAFR in effect will actually reduce competition in practice. Can the audit committee of a large listed company realistically be expected to award the tender to a non-big four audit firm, considering stakeholder perceptions and the size and experience of the mid-tier firms? The majority of the audit partners interviewed agreed with this reasoning as far as it applied to large listed entities. This effect will therefore be to reduce market competition in the audit industry.

Another argument that MAFR would actually reduce competition was expressed by mid-tier audit partners, with the point that the smaller firms do not currently have the skills, experience or resources to service the large complex companies. Many of the big four partners made this point as well. And how could the leadership of the audit firm gear up to responsibly perform such audits if firstly they may not be awarded the tender and secondly they will only have the client for the rotation period, whatever period that may be legislated under MAFR? *(Refer to Quote 34, Appendix 3)*

Due to the problem that the incoming audit firms will need to urgently procure the skills and experience to perform the audit professionally, the firm will be tempted to offer the staff from the outgoing audit firm jobs on their audit team. This was referred to by the partner as “cheating the system” of MAFR. *(Refer to Quote 35, Appendix 3)*

An example of this was then given with the internal audit function of a large South African state-owned entity that outsourced this function to one of the big four audit firms. What happened according to the respondent was that the audit firm then employed most of the state-owned entity’s internal audit staff, with the effect that they left the company to work for the audit firm but to perform the same services as the internal audit function. Based on this example, the respondent expressed the view that MAFR would have a similar effect, i.e.

staff will move from one employer to the other yet work on the same audit client. This possibility was also expressed by other partners. *(Refer to Quotes 36 and 37, Appendix 3)*

Will MAFR rotation result in this kind of “headhunting” and employment relocation? If so, the will it occur to such a degree as to negate the added independence that MAFR is intended to produce. The partners who expressed this concern made the point that it would be an economic necessity and make good strategic sense to source the staff who were involved in the audit before the rotation. In their opinion this has already been happening, albeit in a very limited capacity, under the current partner rotation scheme. MAFR would perhaps incentivise the firms to do it on a larger scale.

8. Transformation considerations

All the partners interviewed who were not members of the black emerging audit firms (11/14) expressed serious concern regarding whether the black firms who have been awarded large public tenders have the resources, skills and experience to audit such large public interest entities. The concern was that if a firm is under resourced for the job, or has no prior experience with a specific industry, then a drop in the quality of the audit process and audit outcome is inevitable. Government, in their opinion, has been far too quick to award such large tenders to the black-owned audit firms and should have either sought joint audit arrangements for longer or promoted the ability of existing audit firms to transform from within as a better method of achieving transformation objectives. This concern expressed is very similar to that which all the mid- and large-tier firm partners expressed regarding the upskilling required of non-big four firms before they are sufficiently capable to service the large listed companies. Therefore the opinion expressed was that MAFR poses a significant risk to audit quality if a smaller audit firm, whether black-owned or not, is placed in a position too soon to audit a large company or group of companies. Again we see the possibility of MAFR to either result in reduced audit quality if this situation occurs or simply result in the audit committees not awarding the audit to smaller (non-big four) firms and MAFR causing reduced competition as the large company audits rotate around the big four firms only. All these possible consequences would be contrary to the IRBA’s intentions.

So what were the opinions of the black-owned firm audit partners about their ability to service larger and more complex companies? When asked whether non-big four audit firms, including the black-owned firms, had the skills and resources to handle the larger and more complex company audits, the managing director of a black-owned firm responded that there is a problem with perception rather than with reality. In their opinion the mid-tier firms can audit the larger entities and it is wrong to simply assume that they don't have the skills or resources because they are not big four firms. This partner expressed how difficult it was for them to just be appointed as a service provider to large companies for non-assurance work, because there is such a strong perception that their firm lacks the skills and resources. However, they believed that the perceptions are slowly changing as they prove themselves in the non-assurance work and in joint audit arrangements. This opinion by a black-owned audit firm partner is in contrast to the big four partner and some mid-tier partner opinions, which hold that the smaller firms cannot yet audit the bigger listed entities, many of which are multi-national companies.

Again the concerns expressed in this regard contrasted the differing objectives of improving audit quality so as to achieve sufficient public protection on the one hand, and achieving black economic empowerment (transformation) in the profession. If regulation changes are pursued with too many objectives in mind, or with too little research and stakeholder consultation, then the unintended consequence of a loss of audit quality may result. As many partners pointed out, surely public protection through enhanced audit quality should be the only reason for changing reason in favour of MAFR? And if so, most, if not all partners interviewed, believed that MAFR was not going to achieve improved audit quality.

Of particular interest was the fact that all the non-big four partners were of the opinion that market concentration of the public interest company audits was a problem in South Africa and needed to be addressed for the good of the profession and the public. Many admitted that this was not a South African specific problem by any means, however South Africa was in a unique position whereby transformation was also a high priority in business, across all industries in the economy. By addressing market concentration appropriately in the profession through whatever means was considered most appropriate, it would also thereby improve transformation, as it would allow the smaller black-owned emerging firms

to compete in the private sector, together with the other non-big four firms. The big question that was raised numerous times was the question of whether MAFR was the best means to achieve this transformation. None of the partners, including those from black-owned firms believed it was the best means. As mentioned already, there was one black-owned partner, who was tentatively in favour of MAFR, but only if significant corporate governance weaknesses were addressed first and it was pursued carefully and in a slow staged process, such as via a period of requiring joint audits, to allow the non-big four firms time to gain experience with the larger more complex companies.

A common concern from the mid-tier firms, referred to by one partner as a “chicken before the egg story”, was the constraint around gearing up your audit firm to service large companies. This improved capacity in the mid-tier is one of the IRBA’s clear intentions for MAFR i.e. improve competition in the audit sector, including the ability of black-owned firms to compete, which promotes transformation as well. However, how do mid-tier and black-owned firms upskill and increase their resources so as to responsibly and professionally provide audit services to large private companies? How do they afford to do so without first being appointed as auditors? How, from a pure business perspective, can they justify the cost and the risk of increasing staff and other resources on the hope that their firm will be appointed as the auditor? This was seen as a significant restraint to MAFR achieving improved competition and transformation. One partner from a mid-tier firm expressed the concern that simply increasing staff numbers in expectation of MAFR and in expectation of receiving more appointments (referring to mid-tier and black-owned firms), is dangerous as you need the right skills and the right experience, not simply the numbers and the technology. Or else the sacrifice will be reduced audit quality. A number of partners expressed that this is perhaps what has already occurred by the appointment of the emerging black-owned audit firms to the large public sector and state-owned enterprise audits. Do they (or did they when first appointed) have sufficient skill, experience and resources for such large, high audit risk, high public risk entities?

Some partners suggested that either promoting transformation within the existing firms or allowing mergers with the black-owned firms was preferable to MAFR in promoting transformation. One partner who was not from one of the emerging black-owned audit firms acknowledged that although many consider mergers of these audit firms with the “more established firms” as a solution to promoting transformation in the audit profession, it may not be wise, as the corporate cultures and management styles may not necessarily integrate well. (*Refer to Quote 38, Appendix 3*)

This person went on to state that therefore joint audits may be a better solution than pursuing MAFR or a simple mergers of firms. Joint audits better allow for a mentoring process and skills transfer to emerging black firms, while preserving their autonomy and growth as a separate firm in the market.

Perhaps in disagreement over the regulator’s (IRBA) thinking around transformation through growth of the emerging black-owned firms, the big four audit partners were quick to point out that their firms, and others, were transforming and this should be recognised by the regulator. One managing partner (Audit Partner 2) of a big four firm stated that their target at the moment in the near future is to reach 70% black staff and they were currently on an actual number of around 50%. This partner went on to state that other big four firms may be doing even better and that would mean that the largest “black firms” in terms of number of staff were actually the big four firms, not the so-called “black-owned firms”. The main point being made was that the IRBA needed to recognise these transformation achievements at the firms and therefore no focus on changing legislation to achieve transformation, especially not through MAFR.

Two of the partners interviewed were managing partners of leading South African black-owned firms and so their opinion on MAFR is particularly significant in light of the IRBA’s transformation objectives. The one managing partner of a black-owned firm was of the opinion that MAFR rotation was good for South Africa, and was the only partner of the fourteen interviewed in favour of MAFR, albeit tentatively in favour. They were in favour provided that significant corporate governance weaknesses were addressed first, most

importantly being the dominance of management in the appointment and managing of the external auditor, and if MAFR was pursued carefully and in a slow staged process, such as via a period of requiring joint audits, to allow the non-big four firms time to gain experience with the larger more complex companies. In their opinion, if these issues are not addressed, then MAFR will not improve transformation nor auditor independence and audit quality. The other qualification this partner made was that the period of the rotation must be carefully determined so as not to encourage unfamiliarity and lack of institutional knowledge of the client (if too short) or promote familiarity threats (if too long).

The other black-owned firm managing partner was of the opinion that MAFR was not the right answer for South Africa, mostly because it would result in a loss of institutional knowledge built by the firm. This partner was of the opinion that five year partner rotation was sufficient as it allowed the firm to retain the institutional knowledge and experience and professionally manage any independence threats through its own firm and professional codes and practices. *(Refer to Quote 39, Appendix 3)*

In addition to these concerns expressed above, this partner was also concerned with the likelihood that MAFR will simply become a “game of musical chairs” amongst the big four firms, thereby reducing market competition, as well as promoting low-balling of fees to secure the appointments.

These opinions from the two managing partners of South Africa’s largest black-owned audit firms is significant to the MAFR debate, certainly as far as transformation and market concentration aspects are concerned.

9. The problem of over-regulation

All the audit partners interviewed expressed concern over the degree of regulation in the profession. In fact it is fair to say that the issue of over-regulation resulted in the strongest opinions and even frustration amongst the partners. Many were particularly concerned over the public inspections reports performed by the IRBA and feared that additional regulation was damaging the ability of the practitioners to make professional judgement calls,

something absolutely necessary in performing an audit, and which the International Standards of Auditing (ISAs) strongly require of the auditor. The concern was simply that MAFR would be another unnecessary regulation in an already over-burdened profession. *(Refer to Quote 40, Appendix 3)*

A concerning opinion from all the partners interviewed was the lost appeal as they perceive it, that the profession has in the minds of younger chartered accountants and auditors. All agreed that the audit profession as a career choice was significantly less appealing than it used to be, and this was attributed to over regulation and accompanying risk that has been brought to assurance services. Some partners expressed it as a risk-reward imbalance in comparison to other professions, as well as compared to being a chartered accountant in the corporate market where the remuneration packages, especially considering bonuses and share options, when considered with the reduced risk inherent in corporate careers, makes the audit profession less appealing. This they believe accounts both for the numbers of registered auditors dropping and their continual experience of article clerks, audit manager and even audit partners moving out of public practice and into commerce careers. This lack of appeal in the profession, compared to corporate careers was also raised as a significant reason why the firms were struggling to meet transformation objectives. Black staff who qualified in their firms were continually leaving for careers outside of public practice. *(Refer to Quotes 41, 42 and 43, Appendix 3)*

These concerns around regulation are significant. This sentiment was expressed by every partner interviewed. Of particular concern is the link to the added regulation that MAFR would bring, with its added pressure to compete for business, and the opinion of the audit partners that it will further fuel the risk and pressure in the audit industry, resulting in the career as an audit practitioner becoming less appealing to chartered accountants. Surely a reduced talent pool of aspiring audit partners would be a great risk to audit quality in future?

The impact of the change to international audit standards around audit reporting was raised by a couple of the partners as an example of additional and important communication that the auditor can now provide the stakeholders (refer to the new ISA 701 Communicating Key

Audit Matters). This will go a long way in their opinion to better inform the public and allow them to better understand what the auditor does and it will provide a good medium for the auditor to communicate real practical audit risk areas. The point being made here in relation to MAFR is that the changes required by ISA 701 will go a long way to address the need for better communication between the auditor and the public about the audit engagement, as well as changing public perception about auditor independence. In the view of all partners interviewed there is an expectation gap between reality and perception when it comes to auditor function and auditor independence. Perhaps the requirements of ISA 701 will help bridge the perception and expectation gap around the audit function and auditor independence? *(Refer to Quote 45, Appendix 3)*

Chapter 5: Summary and Conclusion

This section presents summary of the findings and an explanation as to the importance of the results, including recommended areas for further future research.

The purpose of this study is to examine the opinions of experienced audit practitioners with regards to legislated audit firm rotation, considering that the South African audit regulator (IRBA) views mandatory rotation as a possible partial solution to the threats of familiarity to auditor independence. The views of the audit profession, who act as an important stakeholder in the pursuit of quality financial reporting, needs to be understood in order to explore the possible direct and indirect consequences of changing legislation in favour of firm rotation. The response by audit practitioners to key questions around the need for, and the effects of, audit firm rotation, will be useful to academics in performing further research in this area, as well as to regulators, most notably the IRBA.

The semi-structured and open-ended interviews with the fourteen senior partners, plus the interview with the CEO of the regulator (IRBA), a South African representative at the International Auditing and Assurance Standards Board (IAASB) and the Chairman of the King Committee on Corporate Governance in South Africa, achieved, in the opinion of the researcher, the point referred to as “saturation” in the data collection process. Saturation is

believed to have been reached in these interviews in the sense that no new themes or categories surrounding the question of MAFR emerged in the last interviews, indicating that the sample of fourteen practitioners was sufficient for the purpose of the study.

From this study it is fair to conclude that the general consensus of audit partners interviewed is that they are not in favour of MAFR as a means to address auditor independence, nor transformation and market concentration. Most do not believe that the reality of auditor independence is a problem but rather the problem lies in public perceptions of auditor independence and that the regulator should be careful not to react inappropriately to problems of public perception. Corporate governance practices are seen as the best means of addressing any actual deficiencies in auditor independence, as any real deficiencies, if they exist, are a result of poor governance practices in companies, not poor auditor ethics.

There is a strong feeling that MAFR will result in significant unintended consequences, most notably a reduction in audit quality, the very reason that the IRBA is considering MAFR. If a system of MAFR is implemented in South Africa the feeling is that this reduction in audit quality will likely come about because of a resultant decrease in competition, again being counter to the IRBA's intentions, and also because it will further reduce the appeal of younger accountants to pursue careers as audit practitioners. The perceived over-regulation of the profession was a significant theme expressed by all audit partners. The sentiment around over-regulation did however centre on the public inspections practice of the IRBA, but all partners believed that a move to MAFR would add to the already excessive risk and regulation in the industry. It was strongly felt that any more moves towards making the audit profession less appealing to younger accountants will severely impact audit quality in future as the talent pool diminishes.

Can the audit firms handle the added costs that they believe MAFR will impose? Most say that they cannot, and the increased tendering activity will itself have unintended consequences beyond additional costs, such as the possible low-balling of audit fees.

Some partners were in favour of joint audit regulations as an alternative to MAFR, believing that this would better achieve the objectives of audit quality, improved competition and improved transformation, without many of the negative consequences of MAFR. However, the counter opinion was that joint audits impose much unnecessary duplication of work and costs which would need to be absorbed by either the firms or the audit clients. Audit partners who have had experience with joint audits express opinions both for and against joint audit systems.

In conclusion it is fair to say that the participants interviewed are strongly against MAFR and stress its many negative consequences. Even the “black-owned” audit firm partners are not clearly in favour of MAFR. Only one partner of the fourteen, one of the partners of the black-owned firms was tentatively in favour of MAFR. They were in favour provided that significant corporate governance weaknesses were addressed first, most importantly being the dominance of management in the appointment and managing of the external auditor, and if MAFR was pursued carefully and in a slow staged process, such as via a period of requiring joint audits, to allow the non-big four firms time to gain experience with the larger more complex companies. In this participant’s opinion, if these issues are not addressed, then MAFR will not improve transformation nor auditor independence and audit quality. All the other partners interviewed were against any move to change legislation in favour of MAFR.

Latest developments and contribution of the study

In August 2016 the regulator (IRBA) officially announced its plans to implement mandatory audit firm. The regulator will consult further with the industry before making a final decision regarding the specific regulation details to amend legislation (Ziady, 2016). The IRBA the confirmed in September 2016 that its investor and public participation process around the new requirements for mandatory audit firm rotation (MAFR) will open on October 25 when it will issue the proposed new requirements. Written responses must be submitted by interested and affected parties (IAPs) by the closing date of December 24. The requirements are likely to affect JSE-listed and other public interest entities, although the regulator

stresses that the proposed scope and transitional arrangements currently may well be influenced by feedback obtained during the consultation (IRBA, 2016).

The findings of this study will aid the regulator and other parties involved in understanding and then addressing the concerns of the audit profession regarding MAFR, determining the nature and extent of proposed changes to legislation and addressing the potential for unintended consequences.

Limitations of the study and areas for further research

The purpose of this study was to determine the breadth of the issues relevant to the discussion of implementing legislated MAFR, from the perspectives of experienced registered auditors. The study documented the opinions of fourteen experienced registered auditors and was not intended to be representative of the opinions of the entire audit profession in South Africa. In addition, the study was limited to only the opinions of audit practitioners, as opposed to other key stakeholders in quality financial reporting. It can be argued that certain groups within the audit profession, such as big four firm partners, “black-owned” audit partners, or mid-tier firm partners, have differing vested interests in whether MAFR is implemented. This study did incorporate and discuss the views of certain groups, but again these opinions cannot be considered representative of any particular grouping of partners.

Through the data collection and analysis it is submitted that the point referred to as saturation, where no new categories or themes emerged, was achieved. This signals that data collection is complete (DiCicco-Bloom and Crabtree, 2006), indicating that the selection of fourteen practitioners was sufficient for the purpose of the study. The natural next step in the research will be to produce a national field survey, informed by the results of this study, using a questionnaire methodology and distributed to the survey population, namely the South African registered auditors.

The analysis of these audit partner opinions has brought significant additional themes and categories to the fore that need to be incorporated into the national field survey of audit partners. These additional factors can be summarised in the following questions:

- Is there a need for improved auditor independence?
- Is public perception of independence a significant factor driving the perceived need to improve auditor independence through MAFR?
- Are issues of audit quality, transformation and market concentration appropriate objectives for the implementation of MAFR? Are these competing objectives as far as MAFR regulation is concerned?
- What is the role of the audit committee in strengthening auditor independence?
- What is the quality and independence the functioning of audit committees around auditor independence considerations?
- What is the likelihood and nature of the following unintended consequences of MAFR? Namely regarding the following issues:
 - A loss of knowledge and experience
 - The distraction of requiring to source new business
 - Unmanageable costs as incoming auditor and in pursuing audit tenders
 - Incentive for audit firms to move away from assurance services
 - Audit fee low-balling by firms to secure tenders
 - The conflict of MAFR with section 90(2) of the Companies Act
- What is the consensus regarding possible alternatives to MAFR, such as:
 - Mandatory audit tendering
 - Combined (joint) audits
 - Audit manager rotation
 - Strengthening the role, composition and function of the audit committees
 - Seek means to change public perception of auditor independence and the nature of the audit function
- Should, and will, market concentration be addressed by MAFR?
- What will be the impact of MAFR on transformation in the profession?

- Is there a significant problem of over regulation in the profession and is MAFR likely to worsen the problem?
- With MAFR, will auditors adopt a less co-operative negotiation strategy? (Wang & Tuttle, 2009)
- What measures would improve the effectiveness of the existing audit committees that comply with current legislation e.g. independence and competence?
- Considering the possibility of diminishing the attraction of a career as a registered auditor, explore the impact on the audit profession.
- How does or should an audit firm address the issue of lack of knowledge/increased risk in initial years in a voluntary audit firm rotation (where the tender was awarded).

Appendix 1: Interview Sheet

Research Title: Exploring a South African solution to an international concern over auditor independence through specific consideration of mandatory audit firm rotation (MAFR).

Note: I will provide you with a copy of these questions, so that you may add to or modify your responses to any of them afterwards by email.

MAFR = “mandatory audit firm rotation”

Q: In your opinion, what is the current state of auditor independence in South Africa, as you perceive it, and is there a need for IRBA to step in and strengthen auditor independence?

Interviewer notes:

Q: Should South Africa follow the EU and UK and implement MAFR? What do you perceive as the consequences of MAFR in South Africa?

Interviewer notes:

Q: What alternatives, if any, would you propose to audit firm rotation (MAFR)?

Interviewer notes:

Q: Can you provide your opinion on the following alternatives?

- Mandatory Audit Tendering (MAT), as opposed to MAFR.

Interviewer notes:

- Joint Audits (Joint Audit Firms).

(This work allocation may be rotated after a set number of years to mitigate the risk of over-familiarity.)

Interviewer notes:

- Rotating the senior management of the audit team, not simply the engagement partner.

Interviewer notes:

Q: IRBA believes that MAFR will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality. Do you agree?

Interviewer notes:

Q: IRBA believes that MAFR will promote transformation by creating more opportunities for small and mid-tier audit firms to enter certain markets, provided they are competent to audit in those markets. Do you agree?

Interviewer notes:

Q: In your opinion, if MAFR was to be considered in South Africa, and assuming IRBA enforce some form of MAFR:

- After how many years should an audit firm be required to rotate?
- Which audited entities should MAFR apply to?
- What should be the cooling off period for the audit firm?
- Describe any exemptions which could be granted.
- What role could MAFR play in developing the audit industry in South Africa?

Interviewer notes:

For the purposes of the next 2 Questions: An article by a senior audit partner in the September 2015 Financial Mail magazine (refer below) states that there is a dangerous decline in the number of audit partners.

To quote from the article:

- *SOUTH Africa could be on the brink of a large corporate failure unless systemic constraints in the auditing profession are addressed urgently.*
- *These threats stem largely from the decline in the number of registered auditors in the country. According to the Independent Regulatory Board for Auditors (IRBA) annual report for 2014, these figures have fallen over the past five years from 4 398 to 4 281 at the end of last year. This is due to the decrease in new registrations over the same period from 370 to only 219 annually.*
- *The falling registered auditor numbers, for example, have been evident for more than a decade, despite the number of local chartered accountants having grown by almost 50% over the same period. We are simply not seeing a conversion from CA to registered auditor.*
- *And the factors that inhibit such aspirations are well known. Increased regulation, the threat posed by unlimited liability in the event of auditing errors and growing scrutiny by the IRBA of audit files and audit firms all contribute to the profession failing to attract new practitioners. The seven-year process to qualify as a registered auditor also does little to encourage new entrants.*
- *The combination of these factors means that while regulation and governance rules have been tightened, registered auditors are under tremendous pressure to meet these standards from a shrinking pool of talent.*
- *The reduction of the pool of registered auditors will impair the quality of audit and oversight services, which large corporates can hardly afford.*
- *This demands a long, hard look at the auditing profession and the mechanisms employed to attract and then retain the top talent in the industry.*

Source: *Financial Mail On My Mind: Who wants to be an auditor?* by Andrew Hannington, August 27 2015, <http://www.financialmail.co.za/opinion/onmymind/2015/08/27/on-my-mind-who-wants-to-be-an-auditor>

Q: Do you believe that MAFR will accelerate this reduction in Chartered Accountants wanting to build a career as a Registered Auditor in public practice?

Interviewer notes:

Q: Do you foresee any direct and indirect consequences, including any unintended consequences, of IRBA moving towards MAFR?

Interviewer notes:

Financial Mail article provided to participants before the interview, together with the interview questions:

FM On My Mind Andrew Hannington



Who wants to be an auditor?

If SA doesn't do something to stop the decline in the number of registered auditors, we may be sorry one day

South Africa could be on the brink of a large corporate failure unless systemic constraints in the auditing profession are addressed urgently. Despite the country topping the World Economic Forum's Auditing & Reporting Standards table for the past five years, as ranked in its annual Global Competitiveness Report, threats

loom for the profession.

These threats stem largely from the decline in the number of registered auditors in the country. According to the Independent Regulatory Board for Auditors (IRBA) annual report for 2014, these figures have fallen over the past five years from 4 398 to 4 281 at the end of last year. This is due to the decrease in new registrations over the same period from 370 to only 219 annually.

The profession's fading appeal is most strikingly evident in the number of trainee accountants falling from more than 4 100 in 2010 to below 2 800 in 2014 (the IRBA annual report for 2014 shows: 4 134 in 2010; 3 574 in 2011; 2 672 in 2012; 3 128 in 2013 and 2 722 trainee

accountants registered in 2014).

The causes of this decline are not difficult to discern, and nor are they new.

The falling registered auditor numbers, for example, have been evident for more than a decade, despite the number of local chartered accountants having grown by almost 50% over the same period. We are simply not seeing a conversion from CA to registered auditor.

And the factors that inhibit such aspirations are well known.

Increased regulation, the threat posed by unlimited liability in the event of auditing errors and growing scrutiny by the IRBA of audit files and audit firms all contribute to the profession failing to attract new practitioners. The seven-year

process to qualify as a registered auditor also does little to encourage new entrants.

The combination of these factors means that while regulation and governance rules have been tightened, registered auditors are under tremendous pressure to meet these standards from a shrinking pool of talent.

It's true that the rules were eased somewhat in 2011 with changes to the Companies Act that introduced new thresholds in respect of the legal requirements for audit and independent reviews. But governance and reporting rules for the large corporations have moved in the opposite direction.

And it is these entities that are at greatest risk as the crisis in the auditing profession is certainly not limited to its members. The reduction of the pool of registered auditors will impair the quality of audit and oversight services, which large corporates can hardly afford.

On the one hand the country could easily lose its leading position in auditing and reporting standards, which could be construed simply as losing bragging rights. The underlying threat, however, is much greater.

A deterioration in corporate

auditing standards holds the very real risk that the health and reputation of the country's business environment could suffer. This risk is heightened by the increased complexity of corporate reporting and compliance requirements, which is not likely to slacken any time soon.

This demands a long, hard look at the auditing profession and the mechanisms employed to attract and then retain the top talent in the industry.

It may seem alarmist to draw parallels with corporate failures such as African Bank and the collapse of the global financial services industry more recently, but those events were as unexpected as they were damaging. The role and relevance of the independent auditor is always questioned when there is a corporate failure.

Without acknowledging the potential for some fallout from the decline in auditor numbers, we could be setting ourselves up for a calamity. Urgent action and serious dialogue are required to arrest the profession's growth.

Failure to do so could result in untold losses, and we would only have ourselves to blame. ■

Hannington is CEO of Grant Thornton Johannesburg

Appendix 2: Interviews with select non-audit persons (Key experts)

Interview with the Chief Executive Officer of the Independent Regulatory Board for Auditors (IRBA) – Mr Bernard Agulhas, CA (SA)

Date: 3 December 2015
Time: 14:00-16:00
Venue: JSE Offices, Sandton, Johannesburg
Present: Bernard Agulhas (IRBA CEO)
Herman Thlako (IRBA Manager: Office of the CEO)
Michael Harber (UCT Lecturer)

The following notes and information is a product of this meeting.

The objective of the IRBA is to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes. (IRBA, 2016a)

Upcoming decision:

The Board of the Independent Regulatory Board for Auditors (IRBA) is meeting in July 2016 to make a decision on whether they intend to pursue mandatory audit firm rotation (MAFR) in South Africa in principle. If the IRBA decided to pursue MAFR then it would likely be another couple of years before legislation could be changed accordingly and the rules implemented. In 2015 IRBA have been performing roadshows and seeking consultation with various stakeholders around their perspective on MAFR (IRBA, 2015a, 2015c). A consultation paper was issued in this regard specifically in October 2015, requesting comment from executive and non-executive directors (IRBA, 2015a).

Consultation Paper and Workshop on measures to strengthen auditor independence:

Given the importance of responding to the need to strengthen auditor independence, the IRBA Board had a workshop in July 2015 and received comment from audit firms. IRBA also issued a

consultation paper in October 2015, requesting comment from executive and non-executive directors. (IRBA, 2015a)

According to the consultation paper, the main reasons why the Board must consider further measures to strengthen auditor independence are the following:

- It will strengthen auditor independence and so protect the public and investors, which is part of the IRBA's strategy;
- It will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality; and
- It will promote transformation by creating more opportunities for small and mid-tier audit firms to enter certain markets, provided they are competent to audit in those markets. (IRBA, 2015a)

The Board therefore resolved that the IRBA will spend the following 12 months to perform further research and consult with various stakeholders to obtain more information to take an informed decision on how auditor independence could be strengthened. In the meantime, the Board resolved that all audit reports should disclose the number of years which a firm has been the auditor of an entity, to enable investors and the public to determine whether there has been a long association between an audit firm and their client. The IRBA follows a due process before it imposes any new requirements on auditors and will consult with various stakeholders during this process. The IRBA will ultimately consider how it can best protect the public interest.

The proposed process for this research project is as follows:

1. The IRBA will undertake a potential impact analysis of these proposed measures.
2. During the impact analysis, it will embark on an outreach to key stakeholders. This may include meetings, presentations and awareness raising activities.
3. As information is received, the IRBA will collate and discuss feedback with the Board. This will follow a process of:
 - a. identifying the relevant risks to auditor independence and whether it is considered high, medium or low risk;
 - b. identifying factors that mitigate the risk and consider if it is a strong or weak mitigating factor;
 - c. Evaluating the residual risks; and
 - d. Considering a course of action/recommendation if necessary.

Based on the potential regulatory impact analysis, the IRBA will make recommendations to the Board. The Board will then make the final decision.

A request for comment:

Non-executive and Executive Directors have been identified as a major stakeholder for the auditing profession and the IRBA. The IRBA therefore wishes to solicit views on the potential impact that these measures identified above will have on you. The IRBA is particularly interested to obtain views on the following:

1. Which of the measure(s) stated above, in your opinion, will achieve the intended objectives of the IRBA?
2. In your opinion, if MAFR was to be considered in South Africa:
 - a. After how many years should an audit firm be required to rotate?
 - b. Which audited entities should MAFR apply to?
 - c. What should be the cooling off period for the audit firm?
 - d. Describe any exemptions which could be granted.
 - e. What role could MAFR play in the developing the audit industry in South Africa?
3. In your opinion, if MAT was to be considered in South Africa:
 - a. After how many years should the audit be subjected to public tendering?
 - b. Which audited entities should MAT apply to?
 - c. How many times can the auditors be reappointed to the same entity?
 - d. Describe any exemptions which could be granted.
4. What role could MAT play in the developing the audit industry in South Africa? In your opinion, if joint audits were to be considered in South Africa:
 - a. How could some continuity be ensured (e.g., through a staggered approach)?
 - b. How often should sections of the audit be rotated between the joint auditors?
 - c. For how long should two audit firms be joint auditors of the client?
 - d. What role could the joint audits play in the developing the audit industry in South Africa?
5. In your opinion, is there any additional measure(s) that the IRBA should consider to obtain the stated objectives above?

(IRBA, 2015a)

The four key pillars of IRBA

At the forefront of IRBA's mind in the MAFR debate, is the need to pursue a solution that (1) meets the objective of IRBA, but also (2) to be consistent with the priorities set out in the "four key pillars".

IRBA's objective is to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes. Therefore the financial interest of the public is utmost priority in the MAFR decision.

However the four key pillars are also important, namely:

1. **Comprehensive regulator:** To provide for a more comprehensive regulatory model that includes the regulation of Professional Accountancy Organisations (PAO). The Minister of Finance has given in-principle approval that the IRBA will assume this responsibility.
2. **Independence.** Strengthening both the independence of the IRBA and the independence of registered auditors.
3. **Leadership in Africa.** Implement programmes which will contribute to enhancing and improving overall reporting, governance and regulatory practices on the African continent.
4. **Transformed profession.** Influencing the advancement of transformation in the profession.

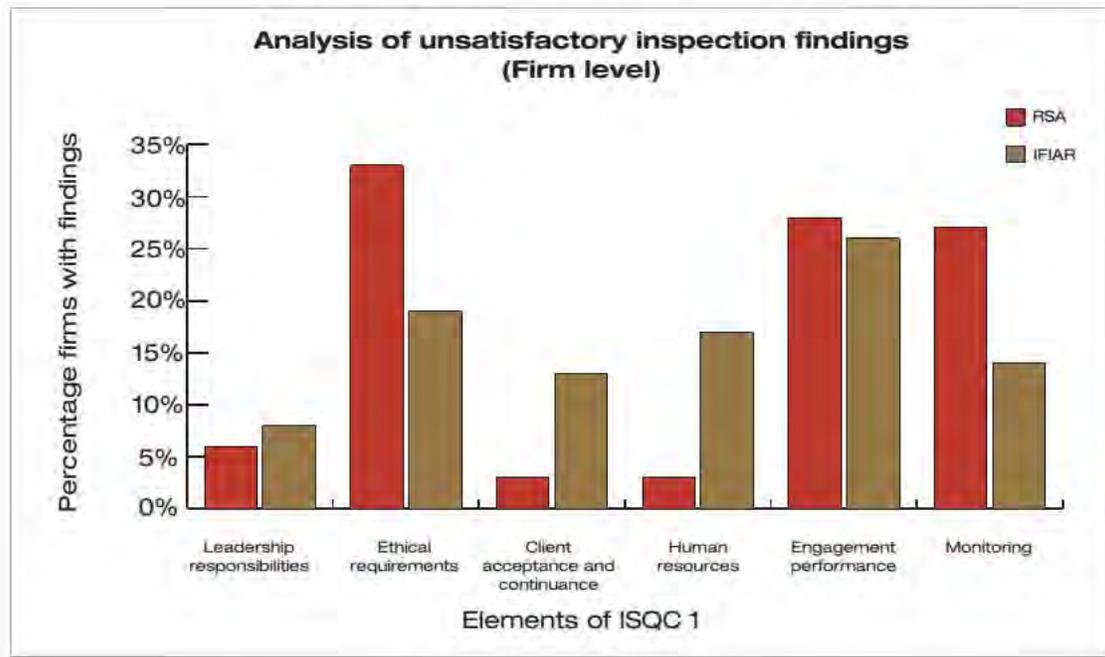
(IRBA, 2016a)

Therefore, the question of whether MAFR will promote transformation is also a key question in IRBA's opinion.

The Public Inspections Report

IRBA performs inspections on selected firms to evaluate their performance on a selection of audit engagements, as well as the design and effectiveness of their quality control policies and procedures. The report provides an analysis of key findings arising from firm and engagement inspections performed by the Inspections Department of the IRBA. The latest report was published in December 2015 and covers audits for the year ended 31 March 2015, and also includes an overview of the scope of the IRBA's inspections. (IRBA, 2015b)

IRBA is concerned that a few of the findings relate to relevant ethical requirements, and more specifically issues whereby independence may be considered the root cause. A root cause was identified as “Failure to fortify the importance of professional scepticism and the independence of the engagement team so as to overcome the threats that could develop as a result of their relationship with clients”, as well as “Failure to strengthen and maintain independence as an underlying principle for high audit quality.” (IRBA, 2015b)



Source: IRBA 2014/2015 Public Inspections Report (IRBA, 2015b)

The above graph from the latest 2014/2015 Public Inspections Report shows a worrying breach of ethical requirements, both relative to other issues, but also in the comparison made to International Forum of Independent Audit Regulators (IFIAR) Inspections Workshop. The IFIAR inspection findings survey of 29 member countries as a percentage of inspected firms with deficiencies per ISQC1 element inspected. It should be noted that the IFIAR results represent the largest six global network firms, whereas the results for South Africa span the entire population of large, medium and small auditing firms that were inspected.

IRBA Newsletter 32 – Dec 2015

The IRBA Inspection Committee reported on 37 audit firm and 375 audit engagement inspections for the year (IRBA, 2015b, 2015d). Most firms showed one or more deficiencies, including ethics (independence), engagement performance and monitoring, which require urgent improvement. A

significant number of individual audit engagement files also showed deficiencies that need urgent attention. A total of 16% of firms and 6% of engagement partners were referred to the Investigating Committee of the IRBA due to fundamental or continued noncompliance with international auditing and financial reporting standards, professional codes and legislative requirements. The report also emphasises the need for audit firms to urgently address ethics and independence matters, as well as engagement quality. (IRBA, 2015b, 2015d)

High-quality auditing and accounting are not only essential for reliable financial reporting, but are also critical in protecting the public interest and boosting investor confidence. In fact, compliance with auditing standards, ethics, financial reporting standards and legislative requirements is fundamental in ensuring a reliable profession that can effectively compete internationally.

Black Chartered Accountant Practitioners (BCAP)

IRBA recognise the need to promote the black-owned firms in the efforts to promote competition and transparency in the audit industry. For example, Sindi Zilwa, co-founder and CEO of Nkonki Inc., one of the largest black audit firms, was the second black woman in South Africa to qualify as a Chartered Accountant. Another example is SizweNtsalubaGobodo Inc. (SNG), ranked the largest black firm with annual revenue of more than R500m, recognised by ABASA (The Association for the Advancement of Black Accountants of Southern Africa) for having produced the highest number of black chartered accountants in the medium firm category (SNG Inc., 2016). The impact of MAFR on the black firms and on transforming the audit profession in general, is important to IRBA.

Government Gazette: Auditing Profession Act, Act 26 of 2005

This change in legislation was explained to the profession in the IRBA communique titled IRBA Strengthens Auditor Independence by Mandating Disclosure of Audit Tenure , issued on 4 December 2015 (IRBA, 2016b).

This change to the legislation through Government Gazette, makes it mandatory that all auditor's reports on Annual Financial Statements shall disclose the number of years which the audit firm / sole practitioner has been the auditor of the entity (audit tenure). A predecessor audit firm in this context refers to an audit firm where there has been mergers/de-mergers or other combinations in the audit firm and an audit firm shall therefore include a predecessor audit firm. Audit tenure refers to the length of the auditor-client relationship. Thus tenure includes the period that the predecessor audit firms (where there has been mergers/de-mergers or other combinations in the audit firm)

issued audit reports on the entity. This rule applies to audit reports issued on the Annual Financial Statements of all public interest entities, as defined in the Companies Act of 2008 and prescribed by IRBA from time to time, for periods ending on or after 31 December 2015. (IRBA, 2016b)

IRBA made the decision to require the mandatory disclosure of audit tenure in the context of strengthening auditor independence which is consistent with measures implemented in other jurisdictions. This disclosure of audit tenure will lead to transparency of association between audit firms and audit clients. The IRBA will monitor compliance with the above rule for auditor's reports on all Annual Financial Statements of public interest entities for periods ending on or after 31 December 2015.

Conclusion

In the opinion of the IRBA, the principle, not the detailed specifics of mandatory audit firm rotation (MAFR), must be considered a serious option for South Africa to achieve the following goals:

1. Strengthen auditor independence and audit quality, and so protect the public and investors, which is part of the IRBA's strategy.
2. It will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality.
3. It will promote transformation by creating more opportunities for small and mid-tier audit firms to enter certain markets, provided they are competent to audit in those markets.

(IRBA, 2015a)

IRBA would require the opinion of all stakeholders in regards to the above possible benefits of pursuing MAFR, together with other considerations, both for and against MAFR, including any foreseen unintended consequences of such a change to the legislation.

Interview with the Chairperson of the International Auditing and Assurance Standards Board (IAASB) Consultative Advisory Group (CAG) - Linda De Beer, CA (SA)

Mrs Linda De Beer's Current and Past Professional Roles:

- Chairperson for the past five years of the International Auditing and Assurance Standards Board (IAASB) Consultative Advisory Group (CAG)
- Chairman of the Financial Reporting Investigation Panel (JSE)
- Member of Committee for Auditing Standards of the Independent Regulatory Board for Auditors (IRBA)
- Member of the King Committee on Corporate Governance in South Africa
- Member of the Issuers' Services Committee of the JSE
- Member of the Financial Reporting Standards Council established in terms of the Companies Act, 2008
- Visiting professor in financial accounting at the University of the Witwatersrand
- Non-executive director of a JSE listed Real Estate Investment Trust ("REIT")

Date: 26 January 2016
Time: 15:30-17:30
Venue: Sandton, Johannesburg
Present: Linda De Beer, CA (SA)
Michael Harber (UCT Lecturer)

Considering the experience of committees that Mrs Linda De Beer CA (SA), as well as the national and international committees which she is a part of, the CEO of IRBA, Bernard Agulhas, recommended that I meet with Linda De Beer to discuss the topic of mandatory audit firm rotation (MAFR). Of particular significance regarding the experience of Linda De Beer, is her role as Chairperson and South African representative on the IAASB Consultative Advisory Group (CAG). This advisory group has representatives of international regulatory bodies such as the Basel Committee on Banking Supervision (the international banking regulator), as well as the World Bank, the European Commission and the World Federation of Exchanges, just to name a few. The full list of member organisations can be found on the IAASB website (IAASB, 2016). Linda De Beer has also considered the issue of auditor independence in depth in her capacity as a member of the King Committee on Corporate Governance in South Africa. The King III Report on Governance and the soon to be finalised King IV Report addresses the board of director's responsibilities to ensure external auditor independence.

Linda De Beer explained that the body she represented on the CAG was the World Federation of Exchanges, which is the umbrella body for the 50 largest stock exchanges in the world, of which the JSE is one. The CAG is heavily involved in the development of International Standards of Auditing (ISAs), both in terms of the strategic and the technical issues relevant to the standards.

Regarding MAFR, the following is a summary of Linda De Beer's opinions, as gathered during the interview:

Overall assessment of whether South Africa should pursue MAFR:

- South Africa is a different environment to Europe so we should proceed with caution, but South Africa should move towards MAFR.
- Auditor independence, both "on the ground" reality, as well as public perception of independence, is a concern and should be addressed, as it is being done so in Europe.
- There is a problem with "scope creep" in the audit profession, whereby the longer the tenure of the auditor, the more non-assurance work they become involved in. This impairs independence by growing familiarity and financial dependence on the client.
- However, moving suddenly and abruptly to change legislation in favour of MAFR would be problematic. A better solution would be a transitional, staggered approach, implemented for a number of years, to allow the profession to adjust, before implementing full MAFR.

"I think if we go big bang, and we immediately require mandatory audit firm rotation for all of these companies, and fairly short periods, I think things can 'bomb out'. So my proposal would be to rather have options."

- Linda De Beer explained that having transitional provisions in the Companies Act, such as allowing companies to choose between MAFR over longer periods of 7-10 years or longer, or implementing joint audits, or starting with mandatory tendering legislation.

"So, I think it's important that it's staggered, and I think it's important that there are options at first and that you work towards where you want to be, let's say in five years' time or so, you know, all of these things must be out of the wash, that there's some level of certainty because we don't know what the issues might be that pop up."

- Linda De Beer expressed the concern that the mid-tier firms do not currently have the capacity and skill to audit the larger complex entities such as the financial institutions. However, a well thought out staggered approach towards MAFR would allow them to up-skill appropriately.
- The South African Companies Act, 2008 has implemented transitional provisions in the past, for example with the requirements for memorandums of incorporation and for social and ethics committees. The precedent is there for transitional provisions in the Act.

Responses to specific concerns raised by the audit profession:

- In some examples, firms have been the auditors for decades. This must impair their independence. What does the profession realistically expect the public to think in such cases?
- Unfortunately it is true that the IRBA is under pressure to respond in kind to the legislative changes in Europe. There is pressure on South Africa as a leading developing country to show that it is following international governance and public protection trends.
- Joint audits are a good option to consider. The mid-tier firms are in a position to partake in joint audits of listed companies and all the problems associated with joint audits, such as duplication of work, skills and resource capacity, can be overcome.
- The outgoing auditor in a system of MAFR will not be incentivised to reduce their attention on the client because they need to source replacement work. Quite the opposite. The outgoing auditor will be concerned that the incoming auditor may detect poor audit quality so there is the incentive to maintain audit quality until the end of the rotation period.
- The incoming auditors are an important “a new set of eyes” on the client. There will not be a significant drop in audit quality in the first year or two for the new auditor because they will be eager to prove themselves and add value. More work will be required by the incoming auditor, and this will reduce profitability in the early years of the engagement, but the auditor is a professional and will want to contribute and maintain an acceptable level of audit quality despite their relative unfamiliarity. Therefore they will simply work harder.
- The new thoughts, new ideas and management comments provided by the incoming auditor will be valuable.
- There will be a marked increase in tendering activity, however this will force the audit firms to become more practical and economical in the tendering process. Too much time and

money is currently spend by audit firms on making proposals to audit committees. The auditors will need to streamline their tender processes.

- There is a need to strengthen the quality of the audit committee and its decision-making, however there has already been a large improvement in this over the past number of years. This line of reasoning has no strong bearing of the MAFR debate.
- As is currently the case (section 94 of the Act) guideline provisions can be provided to the audit committees to help them apply their minds within the framework of the legislation. MAFR will not remove key professional judgement from the audit committee.
- The public interest score categories needs to be adjusted. A score of 350 is simply too low.
- The reduction in the number of registered auditors is not a satisfactory argument against MAFR, but rather a product of two primary factors:
 - Many companies are not required to be audited under the new South African Companies Act, 2008, depending on the public interest score for private companies. Therefore there is a reduced demand for audit.
 - The audit profession is not changing and repositioning itself appropriately to be an employer of choice for chartered accountants. The audit firms are still operating on an old hierarchical business model and a culture that is not as appealing as many corporate businesses.

Meeting with the Chairman of the King Committee on Corporate Governance in South Africa - Mervyn King SC

Mr Mervyn King's Current and Past Professional Roles:

- Former judge of the Supreme Court of South Africa
- Chairman of the King Committee on Corporate Governance in South Africa
- First Vice-President of the Institute of Directors Southern Africa
- Chairman of the International Integrated Reporting Council (IIRC)
- Chairman emeritus of the Global Reporting Initiative (GRI)
- Member of the South Africa Securities Regulation Panel (regulates certain mergers and acquisitions transactions)
- Chairman of Strate (South Africa's Central Securities Depository)
- From 2000 to 2008, King was the South African representative on the International Chamber of Commerce's International Court of Arbitration in Paris
- Director and Audit Committee Chairman of many listed companies in South Africa and internationally

Date: 19 April 2016
Time: 09:30-10:00
Venue: Henley Business School Greenlands, Henley-on-Thames Oxfordshire, UK
Present: Mervyn King SC
Michael Harber (UCT Lecturer)

Mr Mervyn King SC was presented with the nature of the study, research methodology and summary of the findings. The following key input and opinions were provided by Mr Mervyn King SC:

- MAFR is likely to have significant unintended consequences if implemented in South Africa. The regulator needs to proceed carefully.
- South Africa should not follow the direction of Europe with MAFR. Rather, South Africa should start with a system of joint audits for certain categories of companies (higher levels of public interest).
- MAFR should only be implemented for reasons of audit quality and public protection. It would be unwise to pursue MAFR for any other reasons, namely transformation and market competition.
- There are more suitable means of achieving other priorities such as transformation and market competition.
- The restrictions placed on auditors in South Africa in terms of Section 90, namely regarding the inability to provide accounting services to audit clients, will be a significant inhibitor or concern for audit firms to fully respond to MAFR as intended. The regulator should address this potential conflict.

Appendix 3: Extract of quotes from interview participants

The purpose of this appendix is to document some of the key opinions of the interviewees, as extracted from the interview transcripts. These are the quotes that have been referenced in the Presentation and Analysis of Results section.

Quote 1 (Audit Partner 12)

“But then you say on the flipside, you know the counter argument against that, when the client is such a dominant number in your world - you know, four or five percent of your fees - you can never be independent. In reality with any client paying fees to the practitioner you can never be independent, so you get to the heart of it because I’m ultimately coming back to the client for my fee discussion and I can’t be independent. And so whether you do that rotate [MAFR] it’s not going to make a difference.”

Quote 2 (Audit Partner 10)

“If you are asking us a theoretical question, is more regulation around independence going to create better independence, because the answer is yes, we don’t need to discuss it.”

Quote 3 (Audit Partner 2)

“If there were let’s say, an error. We had, I’m thinking of last year, let’s say, we had an error with a set of listed companies [a group of companies]. I think it’s an easy scapegoat to say “ah, you guys have been for thirty years the auditors and that’s why you missed it!” I think they [the public] missed completely the point. I think there’s no correlation between an error and how long you’ve been their auditor. It’s mainly because you just missed something the last year, you must understand, it’s not because you’ve been here for thirty years because the partners are only there five years. That’s definitely for me a perception - that is not a reality. If you want a fresh perspective, we do see that where the partner rotates... The partner comes in with new ideas and so I think that gets actually done.”

Quote 4 (Audit Partner 5)

"I'm just a bit concerned that there's a degree of over-reaction around things and that really worries me. I mean, we are professionals at the end of the day. Independence ethics is the cornerstone of what we do... you know, the firms have their policies and procedures in place around ethics and independence and it's taken very seriously. So, I mean we have, ours [referring to the firm] is even narrower than most and likewise what IRBA and the codes have got in place, so it's extremely rigid. I'm just a bit worried that this heightened focus, too much focus on it...by all and sundry, various stakeholders. I'm worried that the regulator's jumping onto something because this is what's happened overseas. We're number one in terms of World Bank Risk Report."

Quote 5 (Audit Partner 5)

"You're personally invested. It's my name. I've signed. You're out there in the public... You're holding yourself out there. It's me, it's not [firm name], I'm signing there as well."

Quote 6 (Audit Partner 1)

"the Audit Committees that I have served on over the years and continue to serve on now take auditor independence very seriously. Our firm and my experience of the other big firms, I can't talk for the smaller and medium sized firms... the audit firms themselves take auditor independence extremely seriously... If you just consider that South Africa is the pre-eminent market as far as implementation of corporate governance King III etcetera is concerned, it really is at the top of its game. And those Audit Committees are very diligent and they take all of the issues - not just auditor independence, all of their budgetary duties... very seriously."

Quote 7 (Audit Partner 12)

"We are 'beating the pack' anyway so why more corporate governance [referring to the Global Competitiveness Reports issued every year by the World Economic Forum]. We are beating the pack worldwide, we have good governance and it's vigorous and

you know if you follow the principle set out for the independent non-executives it's that they are not independent. I have a beef with a non-executive director who's been there for twenty years - so where is the rotation? So for twenty years as a non-executive you'd say well you are not independent, so you know rather look at the independence of the non-executive directors through the IOD (Institute of Directors) and other lobby groups and King III as opposed to the auditors. I think the auditors are a lot more independent than the non-executive... so you know you don't want the CEO's friends as non-executives. You want true non-executive directors... but the guys do take their job seriously. Many non-executives take their job seriously. You know our Audit Committees have very vigorous processes. I attend a lot of Audit Committees and it's a very vigorous process. It's dependent on the non-executive and the strength of the non-executives, versus the executives and I think we have got good non-executives [in general] than in some smaller company where it is way too cosy. You know we've had corporate failures where the non-executives have never seen the financials and all those kind of things because those shouldn't be in the profession."

Quote 8 (Audit Partner 1)

"the perception might be different [referring to the public's view of South Africa's commitment to corporate governance and auditing standards, including its implementation thereof] and so I suppose my point of departure would be I have to seriously question that mandatory rotation is in any way going to [improve audit quality]"

Quote 9 (Audit Partner 1)

"If I were an Audit Committee member or an Audit Committee Chair, I would resent the responsibility or the power that I inherently have as a non-executive being taken away from me. I would much rather see the focus on improving audit governance. Because that is where the responsibility is. It is the Board of Directors that has the fiduciary duty." This particular partner is currently, and has been in the past, an audit committee member on public interest entity audit committees.

Quote 10 (Audit Partner 10)

“What we experience is, particularly in the mid-tier, is that, if the FD is a big four, he is totally prejudiced against everybody outside. And normally you will find that, where there is a change, the firm that he trained at, somehow gets included, or ends up getting the job. I am not necessarily talking about listed companies, let’s say larger companies, not listed... And then what we experience with, let’s say larger or mid- sized businesses that are not listed, is that, there’s a perception that they are auditors, it’s almost like it’s a given, it’s almost like he is the manager, it’s like a permanent employment contract in a way... and to remove them is to “fire them”. Yes. So I think [improving governance practices] would improve independence, like as you say the relationship is two-sided and the stricter they are in their corporate governance the better the auditor needs to behave I suppose, if you want to call it that.”

Quote 11 (Audit Partner 7)

“I do believe in the sternness of my profession and I do believe that most of the audit partners and the firms do uphold independence. But there is one thing that is a threat to it. Can I call it a threat? It is the practicality of an audit partner’s wish to retain an audit being linked into the relationship with management. Versus being linked to the audit committee and to the shareholders. For me, that’s the only thing that needs to be changed is if we need to uphold independence.”

Quote 12 (Audit Partner 7)

“Before we even hear about it as the audit committee, management will box it down and these guys are so scared to bring it forward. Then management box it down. By the time it comes to the audit committee it is a “by the way”, watered position. Because the management is there and these guys are presenting and they are really prepared to fight for it. The audit committee normally takes a very bad stance of saying “management sort it out with the auditors”, and for me that is the only thing that threatens the independence of our profession.”

Quote 13 (Audit Partner 7)

“For the audit fee to be approved the audit committee asks ‘have you agreed it [the fee] with management?’ ‘Management do you agree?’ ‘Yes?’, then yes we are happy and it’s done. The moment there is a debate in an audit committee between management and the auditors about the fee the audit committee chair, or the audit committee itself says, ‘please go and sort it out and report back.’”

Quote 14 (Audit Partner 6)

“In reality, what I’ve seen, the audit committee does not use its power at all and in fact you will see and if you track the evolution of the audit profession, there has been concern that management tends to be dominating... they do everything. Virtually all audit opportunities when the client needs a new auditor, management runs the show and in fact it’s management’s decision and the audit committee frankly, what they do, is rubber stamp.”

Quote 15 (Audit Partner 7)

“Sometimes I sit back and I say; is it because the audit committee believe they are here because of management? Do they also feel threatened that if management don’t like me, they might say I must actually leave the board? I have often had those couple of questions in my mind - to say it looks like the issue is the lack of independence of the audit committee members in the first place. And now when you start to look into it you start to see the retired [audit] partners, or not necessarily retired partners, but retirees sitting in these audit committees, so it is their only source of income! So maybe it is important for them to keep on, you know. Because now a person is sixty five, seventy... and that’s where they get their income from. So maybe there is reduced independence even at that level.”

Quote 16 (Audit Partner 1)

“I am sure an Audit Committee Chairman and management will tell you that the most value an auditor can bring to the auditing process is their deep seated industry knowledge and expertise within that particular industry and relating to that

organisation. And that institutional knowledge, if you institute mandatory firm rotation, is completely lost.”

Quote 17 (Audit Partner 1)

“When you start out with a new organisation, particularly these massive, multi-national organisations, you don’t know what you don’t know. As a result you don’t know what questions to ask. And for me that is a massive risk relating to mandatory firm rotation... You must remember that in a partner rotation it is a very structured and managed process. So, typically what you would do within the more complex industries, take financial services or telecommunications as an example... The new partner would start shadowing the old partner. He will start learning about the industry. And typically the new partner would not be someone who hasn’t had exposure to that industry in some shape or form. It would be someone who has a base knowledge and then for a period of time they shadow the outgoing partner to learn about that particular organisation so that, you know, when he or she takes over as the signing partner there is continuity... It is lost with audit firm rotation. And what we also find is management at the organisations is changing so frequently these days. Very often the only people who have this institutional knowledge of an organisation are the audit partners, [especially the more experienced older partners].”

Quote 18 (Audit Partner 14)

“On the other side of the scale I use the word, you promote incompetence... Because the incoming auditors are unfamiliar... I can remember for five years [auditing] for our firm a fairly big client as a new young partner. And every year, in fact the management was an ex-article clerk [at our firm], and every year both of us said: “It’s amazing. We don’t know how we could have done the previous audit”, given how little knowledge we had and what we picked up. It was literally almost that we felt that it doubled every year. The knowledge base. So, you may be improving perceived independence, but I think you’re promoting incompetence. And maybe the word is too strong. I think you’re going to give up quality... I know a very senior auditor in our friends who says he’s been on some or other [listed company’s Audit

Committee] for so long and they sit and they listen to him and they listen to his input. Now he's got to send in a young partner and they probably won't even be interested in listening to him, because he knows nothing about the business. [And it's not his fault. He's just new.] So, I think that I'm concerned. I'm concerned if a regulator wants to make a change because of a perception. Surely there's other ways of addressing a perception."

Quote 19 (Audit Partner 14)

"But in your first year your quality is going to be terrible, because you're not going to know what's going on – [although you may] see new things. But I mean, wouldn't something like a peer review have the same impact? Although I don't know whether I would like to review some other auditor's file and criticize him."

Quote 20 (Audit Partner 1)

"I audited one of the big three [sector name] companies, rotated off that [normal partner rotation] and I have just recently taken on another one [large multi-national company]. And having spent probably the better part of fifteen years in the [sector name] industry I've pretty much thought I knew the industry well, I can tell you the new company was very different. [Without my extensive industry experience] it would have been even harder... But the institutionalised knowledge of that organisation and its issues and its risks... You know, I had to re-learn all of that. And in that window period of getting up to speed... I think that there is a risk because the auditor is not necessarily in a position to be able to assess the risks within the organisation from a financial reporting perspective. Control reporting perspective and respond to those risks. And it is really, my simple thing was when you start out with a new organisation, particularly these massive, multi-national organisations you don't know what you don't know. As a result you don't know what questions to ask. And for me that is a massive risk relating to mandatory firm rotation. You must remember that in a partner rotation it is a very structured and managed process. So, typically what you would do is within the more complex industries, take financial services or telecommunications as an example and there are others as well. The new partner would start shadowing the old partner. He will start learning about the

industry... And typically the new partner would not be someone who hasn't had exposure to that industry in some shape or form. It would be someone who has a base knowledge and then for a period of time they shadow the outgoing partner. To learn about that particular organisation so that, you know, when he or she takes over as the signing partner... That's the continuity... It is lost with audit firm rotation."

Quote 21 (Audit Partner 12)

"But to start changing your entire audit team in a year - both your first, your second, your third year [article clerks] to retrain, or to have a zero knowledge of a client. In the order of a magnitude of a Standard Bank [listed banking group] - it's impossible... Now you've got a team that has zero knowledge, nor the partner, nor do the manager, nor any of the staff have any knowledge of that client. They come in and besides the client to be they won't be happy about it either... [MAFR is] going to be contrary to its intention."

Quote 22 (Audit Partner 5)

"So, we know we're out of the door so basically the idea is going to be - we better turn this client, this audit client into an advisory client. So already the focus is going to be - I need to turn this thing around and make sure our tax and advisory offerings are well entrenched in this client, so that when the day comes, year ten (or whatever period MAFR requires), we sign off those accounts, we flip over... Because the audit firm's dealing with very real business considerations, they've got staff to pay... We're running a business... So I'm your audit partner year nine or eight, I know I've got my KPI's to meet, it's my client. You know, invariably I am going to end up trying to position that I become a bit of an advisory partner so I can switch the auditor role into an advisory role. So year nine, I start taking the eyes off the ball on the audit. I'm not saying this is going to happen but I'm going to be looking around... So you've got that - it could happen. I'm not going to say it's going to, but we are running a business and we need to make sure the flow, the income flow is there. Be it from an advisory and tax as opposed to the audit line. So one will be looking at that now for an incoming firm, year one, a newbie, has no idea about the client, the history,

perhaps the industry, limited knowledge on the industry. It's going to take them a few years to get up to speed."

Quote 23 (Audit Partner 12)

"Due to total lack of familiarity and knowledge [referring to the new incoming audit firm] - you know so the cost will have to go up... The client will be in that thirty percent learning curve in year one. And we found that when we had our audits there is big learning curve cost in the first year and the clients are saying, you know I am not prepared to pay that but if it's continually rotating and it's compulsory to [rotate firms] the firms will say, you know, that I would want to cover some of that cost. The cost will go up, quality will certainly go down and might never recover and you know I'm thinking of the mega complex audits in particular..."

Quote 24 (Audit Partner 8)

"Well, I have a theory that low-balling is only done by small firms. Big firms don't need to low-ball. Why? Because they've got millions and millions of dollars' worth of other work that, they get profits from. They don't have to worry about whether [they win the tender]. They're not going to cut corners in audit because they've got other fees in consulting. The smaller firms have a problem with that. They don't have that, so... They need to secure the business, so they might low-ball. Yes, it's to stop that type of thing. So, if I'm prepared to live with auditor rotation if that type of law comes in, because I can tell you now we've lost a lot of tenders, just simply on firms cutting it by half. If you want audit firm rotation it's got to be backed up by, (how do I put it?). By rules and regulations, governing the tender process and backup, and supporter stuff to see that that's not abused."

Quote 25 (Audit Partner 11)

"If they want to regulate more and either put in mandatory audit firm rotation or joint audits, why doesn't the regulator, like with the attorneys, give guidance on fees... especially considering low-balling. Why do the attorneys, if there is quarrel about a fee, go and get their fees taxed at the court? There are set rates that apply and it gets taxed and that's what you can charge, especially in a court case as well."

It's done with a cost order, and they tell you this is what the cost is, you know it's not your full invoice amount, normally it's calculated by the court. So as regulator, why can't [IRBA] research and have a look what happens in Europe and the UK, audit fees compared to a risk rating for a company, turnover, number of employees... or a PI score, or to a percentage of turnover or assets. Just to give a range where the audit fees should be. It gives guidance one to the audit committee... and also to the auditor."

Quote 26 (Audit Partner 9)

"And what has that done for [them]? It's allowed them to grow to a size which it would never have grown to before and it's exposed the firm to work which they would never have been exposed to if, for instance, they were in the United Kingdom. So let's take the United Kingdom as an example, I don't know if you're aware in the United Kingdom but in the top 100 companies in the United Kingdom, 99 are audited by the big four firms."

Quote 27 (Audit Partner 9)

"So, you know, we built the practice which is capable in handling that kind of work and we do handle that kind of work. But it's kind of the chicken and the egg situation if you're not exposed to it... So even if they get given say a 65%/35% [split] and the smaller firm got 35% of the work, they would be able to break their teeth on the nature of the work – work that they're currently almost excluded from at the moment. It means they can take a long term view on their practice. They can gear up. They can spend money on putting in the kind of infrastructure and the kind of governance that you need to play in that space. And if you've got joint audit with some kind of mandatory tendering at the end of the process and you do that properly, well, that might be an alternative [to MAFR]"

Quote 28 (Audit Partner 5)

"I've been exposed to that over the years as you know, at [client name], that's how we got involved in [client name] in the early days when it was still a society and in terms of its Act of Incorporation, you needed two sets of auditors. The incumbent

when the two firms merged, they became one firm and they had to appoint another set, that's how we got involved. So I've had at least nine or ten years' experience within joint audits and it's extremely painful. It's costly, it's ineffective. I don't see [how it contributes to independence]. I just see lots of duplication, overlap, you know, every meeting you go - two auditors have got to go along. And maybe the two partners, the two managers - that's four of you. All billing time. Every document, so everyone's pouring over it, giving input into the Audit Committee submission. And I in the bank sector, I think they mandated to have joint audits... in that field, okay maybe... Because of the increased risk. But not joint audits for public interest entities. I just think it's totally not practical, quite frankly."

Quote 29 (Audit Partner 6)

"I think South Africa has a brilliant opportunity to achieve two-in-one. One, the quality of auditor independence increases, yes people will argue that there is an increase of cost and duplication of work. You can manage it. Duplication is limited. And guess what, you have it anyway with the banks. How do they manage it? So don't use cost as that [an argument against joint audits]. Guess what? Players like us are happy to absorb that cost."

Quote 30 (Audit Partner 5)

"I think all you're going to do is have 'the shifting of the deck chairs'. The big four will remain the big four. There might be the transformation angle so maybe the big five. You know I'm saying, given the South African avenue here and you might, let's be fair, call it the big five, that it's going to be a 'shifting of the deck chairs'. That's all that's going to happen. Is the Audit Committee, given the strength of the Audit Committee, are they honestly going to appoint a firm that clearly hasn't had the experience, doesn't have the resources, the staff, to do a large listed company audit? No disrespect to the second tier firms or let's call it the next tier. I mean, clients expecting us to have the depth and breadth of skill and how these smaller firms going to acquire that skills and also have the ability to deliver seamless service across numerous jurisdictions. Our clients expect us to be in every location where they're located and they want us to speak with one voice. How are these other firms

going to do that? If you look at what has gone out to tender, the, from what I understand in the UK and the likes, it's really just shifting it around and there's no major... So when they, and those that have gone out to tender, where has it gone? You'll most probably find that the smaller firms, one of them will get invited to come and tender, but they'll fall out somewhere along the process. [It is not going to address market concentration], it's just going to shift between the big five, put it that way. That's honestly the way I see it."

Quote 31 (Audit Partner 2)

"Because there's only going to be three left. There's no way that a mid-tier firm will do the [company name] audit in 130 countries within the next twenty years."

Quote 32 (Audit Partner 14)

"But what I want to come to, is typically when we get an opportunity to make a proposal for a big public company that's audited by the big four, and you go there and you really... I mean, in this one instance we really went to town with the presentation. And in the meeting you can pick up that people are quite positive, and then you get the letter saying no, they're staying with the current big four auditor. So on reflection, think about it, you're an independent, non-executive director on an Audit Committee where you're at risk. So are you really going to change the incumbent... to 'Joe Soap'? To a non-big four? Or just change from the big four? Let's say they do it. Let's say they've got that type of appetite for risk, or perceived risk. And they do it, and it's a stuff-up. [Then their heads are on the block.] If they had moved from big four firm to big four firm then... nobody could fault that. You would went from the same to another... you're just going to go in a circle. That's not going to improve market concentration at all. You may even see a movement up to the bigger firms."

Quote 33 (Audit Partner 3)

"I'll give you an example... I have just gone through a proposal process. It's not a large firm. It's actually mid-market firm. I went to see the chair of the Audit Committee afterwards and he gave me the feedback and one of the things he

specifically said was, it was clear to them, the Audit Committee and the panel. It was not just the Audit Committee - management was a part of the panel. That there was a big difference in the quality of the whole process and the documents and the presentations. Between the big four and the next tier. That was clear [to them]. He then immediately said "forget about anything below the big four".

Quote 34 (Audit Partner 12)

"We don't have the skillset for the banks and then the insurance companies as well - unless they are really small, so you can pick on a mega insurance company. You know we don't have the manpower and then to gear up the manpower for five years you know... [from a business perspective] you can't, commercially..."

Quote 35 (Audit Partner 12)

"What can happen is you know the guys will cheat like they are cheating on the section 90 [of the Companies Act], they will loan their teams around or a team will come and they will be here for five years and the guy will bring his team along and you will find the same people will do [the audit]... a kind of secondment."

Quote 36 (Audit Partner 12)

"it's the same team but they had different houses, so the guys have to have the economic necessity to do that. So I really don't have a warm feeling or a strong recommendation for mandatory audit rotation and I really don't think that audit independence is such a huge issue in South Africa."

Quote 37 (Audit Partner 4)

“I think it was, it could be Brazil... What happened when they realised that a big team, let’s say a [company name] team will do the audit and then a year before the whole firm has moved to let’s say to [firm name] or another firm, the other firm starts headhunting them and then effectively, that whole team is moving and his partner is moving across to the new firm. Now how’s that for independence? It is just under a different umbrella somewhere and another firm must sign it, but it’s the same team. So to overcome this cost and knowledge and all those things, this team just moves over.”

Quote 38 (Audit Partner 10)

“We can’t just take a black firm and a traditional western firm and merge them because of transformation and think it would be the right thing to do. There are still certain things that those of us from a privileged background maybe just don’t understand about the way people work and the issues that they’ve had to deal with that we are not used to.”

Quote 39 (Audit Partner 6)

“But my personal view is I don’t believe in mandatory audit environments and I’ll tell you why. To a very large extent, especially in large complex operations, it takes time for one to really fully get to grips with the environment. And I see you’ve got other subsequent questions around we should rotate the senior, the entire senior leadership or just the, the lead partner as such. And frankly, for one to have proper institutional knowledge of that, which is institutionalised, you would need them to be there... I’m saying I’m not supporting mandatory firm rotation. One, because frankly I don’t think it has a bearing on independence. Like I say, I think we’ve got enough safeguards in the current systems to manage and govern independence.”

Quote 40 (Audit Partner 5)

“So I’m saying there’s a lot there that’s going to lighten or reduce the expectation gap when it comes to stakeholders and users, because they’ll be able to read each audit report [which] will be specific. It’s not going to be a template. They will be

able to understand... And independence and all of that, rather than just coming with a rule if it's mandatory. We are principles-based at the end of the day. And we're relying on judgement from the profession and from the Audit Committee. Both sides of the engagement are applying their minds and their skills and they're qualified to do so... Doesn't that make us a profession? That fact that we exercise professional judgement? We don't tick boxes. The more we tick boxes... that will directly affect the quality of what we do. That's where the regulator needs to get a balance... I hope common sense prevails. I think we've got a lot of checks and balances in place. I mean enhancing existing structures and I'm not one in favour of rules. We are principle-based, we must deal with it and the King Codes have done tremendous work over the years with the Institute of Directors."

Quote 41 (Audit Partner 10)

"I can tell you the reality is that through all the changes the auditing profession has become a poor profession and I'd rather have become a heart surgeon. And maybe it's a case of demand and supply, but I can tell you that [the average auditor is not earning as much as many professions] and something is wrong, and I know it has nothing to do with ethics... the reality is that through all the changes the auditing profession has become a poor profession... You know the heart surgeon that earns a huge amount of money, takes a risk and he has to work extra hard but there is risk and reward. Our profession is becoming more risk. That imbalance between risk and reward. And it may be the worldwide economy, but I can tell you when we look at our [audit firm name] smaller practices or practices that do audit and other services in the rest of Europe and Australia, we are very, very poor, and it's not just our currency."

Quote 42 (Audit Partner 5)

"If I were to come into this, if I was entering the profession today, training contract today, I doubt it very much if I would have gone the same route. And to me that is the cornerstone. And yes, it's not an attractive profession when you can go out into commerce and industry and not have the sort of scrutiny and pressures that we have and have to face day in, day out, with the heightened regulations. Look we would

lead a comfortable life at the end of the day, but it's not... I'm mean if I'm being realistic, I had a bursary with a top mining house, and [the firm name] took over that bursary. But if I'd stayed and gone to Johannesburg with the mining house, I would have been retired today. I mean it's plain and simple, with share options on the line. But I'm not upset about the choice that I've made, I've enjoyed the route that I've gone."

Quote 43 (Audit Partner 12)

"And the youngsters who are talented that are coming through the universities are not staying in the profession and so there will be a decrease in [audit] quality as the numbers of the grey hairs start to retire from their positions, so there is a possibility of a quality decrease as opposed to an increase and I just think that yes I know the youngsters we employ every year, just none of them want to stay. We just lost a whole bunch of managers late last year that we were sort of grooming for partnership and they said thanks, but no thanks. They don't want to be here they don't want these IRBA regulations. They also don't want the forced transformation. And they go overseas and certainly not stay after articles - they want to get out of the profession, they just don't enjoy the pressures. And then also the other serious issue is you just can't create NAV in the profession you should earn a good living and you live well but you live to your standard but come the end of your days you know you got no share options, you got no build-up of value in terms of you paying off your house you got a pension fund but you don't have the kind of money that some of the colleagues have made by being in business. Because it [the risk in the profession] has gone up so dramatically and the reward hasn't gone up so in fact the rewards has gone down and in the old days the professions used to do well."

Quote 44 (Audit Partner 5)

“And there’s a lot more coming now as we know [referring to audit regulations]. This long form opinion [referring to ISA 701]... And you think how much time is going to go in to prepare that Audit Report. It’s not the willy-nilly thing, the standard template, make sure the thing is signed. If you imagine the debates you’re going to have with management around the risk areas. Audit Committee and management and the engagement, you know, so that’s going to have an impact. Where did we have differences? How were they resolved? We’re talking about material things here. So we’re lifting the hood of this bonnet here, this car, and giving it a much more thorough look. So we are narrowing the expectations gap with this Audit Report. So you know, all of this is all positive stuff, but it’s going to add to costs, it’s going to increase dialogue with management and Audit Committee. It’s going to be an added comfort to the various stakeholders. Now why would you want mandatory audit firm rotation as another regulation?”

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