How to cite this thesis
MANDATORY AUDIT FIRM ROTATION: 
A SOUTH AFRICAN PERSPECTIVE

by

MICHAEL HARBER

A dissertation submitted in fulfilment for the Degree
of

DOCTOR OF PHILOSOPHY (PhD)
in
Auditing

at the
College of Business and Economics

UNIVERSITY OF JOHANNESBURG

Supervisor: Professor Doctor B. Marx

2018
DECLARATION

I certify that the thesis submitted by me for the degree DOCTOR OF PHILOSOPHY (PhD) in Auditing at the University of Johannesburg is my independent work and has not been submitted by me for a degree at another university.

MICHAEL HARBER
DEDICATION

I dedicate this thesis to my wife, Aimée. Without her constant encouragement and support this study would have not been possible. I love you with all my heart.
ACKNOWLEDGEMENTS

- To my wife, Aimée, whose constant loving support over the past years has been the primary reason I have persevered to complete this study. Thank you for the continual sacrifices that you have made to allow me the time needed to complete this. I love you.
- To my parents, to whom I owe a debt that could never be repaid. Thank you for everything you have done for me, as well as for always encouraging and supporting me in my studies throughout my life.
- Professor Ben Marx, my study supervisor and the Head of Department at the University of Johannesburg, Department of Accountancy. Your positive and experienced guidance, time and patience has been invaluable. I thank you for encouraging me to begin the journey in this important area of study, as well as the continuous professionalism that was evident in all our meetings and correspondence. I hope, in time, to emulate you as a supervisor for other students and researchers. You have taught me a great deal and I trust we will continual our research partnership in the years ahead.
- The University of Cape Town and the College of Accounting in particular, for allowing me the study and research leave to work on this study.
- Ms. Camilla Smolicz, the language editor of this document for your professionalism and expertise.
- To the Board of the Johannesburg Stock Exchange (“JSE”) for supporting the study and providing guidance. In particular, Mr. John Burke, the Director of Issuer Regulation.
- Mr. Leon Campher, the Chief Executive Officer of the Association for Savings and Investment South Africa (ASISA) for supporting the study and providing guidance.
- To all the individuals who reviewed the questionnaires for content validity and reliability. Thank you very much for your time and valuable input.
- To each participant who took the time to complete the questionnaires. Thank you very much for your time and valuable input.
ABSTRACT

Study purpose and context: Auditor independence is a critical component of audit quality, which in turn is necessary for the proper functioning of capital markets, public protection and economic decision-making. Mandatory audit firm rotation (MAFR) has received a great deal of attention internationally in recent years, as concerns mount regarding the quality of external audits performed and the independence of auditors. These concerns have been exacerbated by corporate financial collapses that result from unchecked management misconduct and fraud. In these circumstances, the auditors are accused of failing to prevent and detect the financial misconduct, or to act as whistle-blowers. Many have claimed that problem goes beyond negligence and that the familiarity and relationships developed between client and auditor over many years of the audit firm appointment has impaired independence and professional scepticism.

In 2017 the South African audit regulator, the Independent Regulatory Board for Auditors (IRBA), issued a ruling to implement MAFR on a ten-year rotation basis, effective April 2023. This ruling follows similar regulation enacted in the European Union (EU) in 2014. The debate concerning MAFR has shown divergent views among key audit-industry participants. These views include debate surrounding the additional intentions of the IRBA to use MAFR to stimulate socio-economic transformation in the audit profession by building the capacity of black-owned audit firms and facilitating opportunities for small- and medium-tier audit firms to compete for the audits of large and exchange-listed companies.

There is disagreement concerning whether audit quality and auditor independence is impaired in South Africa, as well as whether the existing safeguards are appropriate. The study aims to investigate the perceptions and arguments of key stakeholders in the South African MAFR debate, with specific consideration of audit quality, socio-economic transformation and market concentration factors, in order to understand and explore possible unintended consequences of MAFR, as well as provide recommendations to audit industry stakeholders and regulators.
Research methodology applied: The study employs a sequential mixed methods design which builds on the findings of existing international research, as well as the limited South African research to date. Based on a review of the relevant academic literature, together with a qualitative summative content analysis of the South African MAFR debate, theoretical models are derived, with associated hypotheses for testing. Qualitative and quantitative data is then obtained through specifically tailored questionnaires of the following four key stakeholders in the South African MAFR debate, namely: individual South African audit partners; Chief Financial Officers of exchange-listed companies; audit committee chairs of exchange-listed companies; and equity fund managers from the largest asset management firms. These four participant groups comprise experienced professionals who represent important stakeholders to the audit engagement, with appropriately diverse roles and perspectives on the external audit function.

Main findings and implications: The study findings indicate a widespread and significant push-back against MAFR from audit partners, Chief Financial Officers and audit committee chairs. The findings from equity fund managers show considerably mixed views. Overall the findings indicate the belief that MAFR is likely to decrease audit quality and is unlikely to improve auditor independence and professional scepticism in South Africa, contrary to the intentions of the IRBA. In addition, the participant groups do not believe that it will improve transformation or decrease market concentration of audit firms. There is considerable evidence to suggest that MAFR may inhibit the ability of audit firms to transform and may further concentrate the presence of large audit firms providing assurance services to the exchange-listed companies. As an alternative to MAFR, the IRBA and the audit industry should consider promoting and reinforcing the existing measures that are designed to preserve auditor independence.

The research findings make a valuable contribution to the existing body of knowledge on audit quality, auditor independence and MAFR. No such research has been conducted in a South African context and the findings have wide applicability in other jurisdictions. The study provides numerous practical recommendations for the audit industry, as well as descriptions of possible unintended consequences from the implementation of MAFR that should be considered and mitigated. The findings and
recommendations therefore represent important contributions to regulators, standard-setters and industry decision-makers for consideration in future legislation, regulation, corporate governance codes and best practice standards applicable to auditor independence.

**Keywords:**
Auditing, audit quality, auditor independence, auditor tenure, auditor rotation, corporate governance, mandatory audit firm rotation, accounting profession
STUDY CUT-OFF

Professional standards, relevant laws, regulations, codes and other related best practices consulted for this study are, for cut-off purposes, conducted up to 30 September 2018.
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC</td>
<td>Audit committee</td>
</tr>
<tr>
<td>ASISA</td>
<td>Association for Savings and Investment South Africa</td>
</tr>
<tr>
<td>BEE</td>
<td>Black Economic Empowerment</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CFO</td>
<td>Chief Financial Officer</td>
</tr>
<tr>
<td>CIPC</td>
<td>Companies and Intellectual Property Commission</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>ICAEW</td>
<td>Institute of Chartered Accountants England and Wales</td>
</tr>
<tr>
<td>IESBA</td>
<td>International Ethics Standards Board for Accountants</td>
</tr>
<tr>
<td>IFAC</td>
<td>International Federation of Accountants</td>
</tr>
<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>IODSA</td>
<td>The Institute of Directors in Southern Africa</td>
</tr>
<tr>
<td>IRBA</td>
<td>Independent Regulatory Board for Auditors</td>
</tr>
<tr>
<td>ISA</td>
<td>International Standards on Auditing</td>
</tr>
<tr>
<td>JSE</td>
<td>Johannesburg Stock Exchange</td>
</tr>
<tr>
<td>KING IV</td>
<td>The King IV Report on Corporate Governance for South Africa</td>
</tr>
<tr>
<td>LSE</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>MAFR</td>
<td>Mandatory Audit Firm Rotation</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Co-Operation and Development Countries</td>
</tr>
<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>PIE</td>
<td>Public interest entity</td>
</tr>
<tr>
<td>SAICA</td>
<td>South African Institute of Chartered Accountants</td>
</tr>
<tr>
<td>SCoF</td>
<td>Standing Committee on Finance</td>
</tr>
<tr>
<td>SOX</td>
<td>The Sarbanes–Oxley Act of 2002</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
</tbody>
</table>
# TABLE OF CONTENTS

DEDICATION .................................................................................................................................... III  
ACKNOWLEDGEMENTS ................................................................................................................ IV  
ABSTRACT ........................................................................................................................................ V  
STUDY CUT-OFF .......................................................................................................................... VIII  
LIST OF ACRONYMS ................................................................................................................... IX  
LIST OF FIGURES ........................................................................................................................ XVII  
LIST OF TABLES .......................................................................................................................... XVIII  
ANNEXURES .................................................................................................................................. XX  

## CHAPTER 1: INTRODUCTION .................................................................................................. 1  
1.1 INTRODUCTION AND CONTEXT ....................................................................................... 1  
1.2 A BRIEF HISTORY OF AUDITING AND THE AGENCY THEORY .................................. 7  
1.3 KEY DETERMINANTS OF AUDIT QUALITY ...................................................................... 9  
1.4 PROFESSIONAL STANDARDS AND REGULATORY RESPONSES ......................... 12  
   1.4.1 An overview of regulatory response to MAFR ......................................................... 13  
   1.4.2 Primary arguments for and against MAFR ............................................................... 15  
1.5 THE IMPACT OF CORPORATE FINANCIAL SCANDALS ........................................ 16  
1.6 THE IRBA’S POSITION IN SOUTH AFRICA ................................................................. 20  
   1.6.1 The IRBA’s rationale for MAFR ............................................................................... 21  
   1.6.2 Three key objectives envisaged by the IRBA for MAFR ........................................... 22  
1.7 THE STATED RESEARCH PROBLEM AND OBJECTIVES ........................................ 25  
1.8 MOTIVATION FOR THE STUDY .................................................................................... 28  
   1.8.1 The call for research from academia ............................................................... 29  
   1.8.2 The call for research from the profession ............................................................ 29  
   1.8.3 ‘State of crisis’ and the expectations gap ............................................................... 31  
1.9 METHODOLOGY CONSIDERATIONS AND RESEARCH APPROACH ..... 32
<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.10</td>
<td>ETHICAL CLEARANCE</td>
<td>35</td>
</tr>
<tr>
<td>1.11</td>
<td>STUDY LAYOUT</td>
<td>36</td>
</tr>
<tr>
<td>1.12</td>
<td>CONCLUSION</td>
<td>39</td>
</tr>
<tr>
<td><strong>CHAPTER 2:</strong></td>
<td>THE AUDIT FUNCTION AND THE CONCEPT OF AUDIT QUALITY</td>
<td>40</td>
</tr>
<tr>
<td>2.1</td>
<td>INTRODUCTION</td>
<td>40</td>
</tr>
<tr>
<td>2.2</td>
<td>DEFINITION AND HISTORY OF THE AUDIT FUNCTION</td>
<td>41</td>
</tr>
<tr>
<td>2.2.1</td>
<td>History of accounting and auditing</td>
<td>42</td>
</tr>
<tr>
<td>2.2.2</td>
<td>A response to the agency problem</td>
<td>44</td>
</tr>
<tr>
<td>2.2.3</td>
<td>The auditor as agent</td>
<td>47</td>
</tr>
<tr>
<td>2.3</td>
<td>THE CONCEPT OF AUDIT QUALITY</td>
<td>48</td>
</tr>
<tr>
<td>2.3.1</td>
<td>South African regulatory framework and reporting obligations</td>
<td>50</td>
</tr>
<tr>
<td>2.3.2</td>
<td>Critical links to the empirical study</td>
<td>52</td>
</tr>
<tr>
<td>2.4</td>
<td>LINK BETWEEN AUDITOR INDEPENDENCE AND AUDIT QUALITY</td>
<td>53</td>
</tr>
<tr>
<td>2.4.1</td>
<td>Independence of mind versus independence in appearance</td>
<td>54</td>
</tr>
<tr>
<td>2.4.2</td>
<td>Establishing the importance of auditor independence</td>
<td>57</td>
</tr>
<tr>
<td>2.4.3</td>
<td>Critical links to the empirical study</td>
<td>58</td>
</tr>
<tr>
<td>2.5</td>
<td>PROBLEMS WITH MEASURING AUDIT QUALITY</td>
<td>60</td>
</tr>
<tr>
<td>2.5.1</td>
<td>Using audit outcomes as a proxy of audit quality</td>
<td>61</td>
</tr>
<tr>
<td>2.5.2</td>
<td>Market perceptions of audit quality</td>
<td>64</td>
</tr>
<tr>
<td>2.5.3</td>
<td>Critical links to the empirical study</td>
<td>66</td>
</tr>
<tr>
<td>2.6</td>
<td>CONCLUSION</td>
<td>68</td>
</tr>
<tr>
<td><strong>CHAPTER 3:</strong></td>
<td>THE EFFECT OF AUDIT TENURE AND ROTATION ON AUDIT QUALITY</td>
<td>69</td>
</tr>
<tr>
<td>3.1</td>
<td>INTRODUCTION</td>
<td>69</td>
</tr>
<tr>
<td>3.2</td>
<td>AUDIT TENURE</td>
<td>70</td>
</tr>
<tr>
<td>3.2.1</td>
<td>Threats to independence from tenure</td>
<td>71</td>
</tr>
<tr>
<td>3.2.2</td>
<td>Opposing views on the impact of audit tenure</td>
<td>72</td>
</tr>
</tbody>
</table>
3.2.3 Personal relationships between auditor and client................................. 74
3.2.4 Conclusion from the literature regarding auditor tenure.......................... 75
3.2.5 Distinguishing between audit partner and audit firm rotation .................. 78
3.2.6 Critical links to the empirical study...................................................... 79

3.3 THE EFFECT OF AUDIT Partner ROTATION ON AUDIT QUALITY ... 81

3.3.1 Evidence in favour of partner rotation.................................................. 81
3.3.2 Evidence against partner rotation......................................................... 83
3.3.3 Critical links to the empirical study...................................................... 84
3.3.4 Audit partner perceptions...................................................................... 86
3.3.5 Critical links to the empirical study...................................................... 88

3.4 THE EFFECT OF AUDIT FIRM ROTATION ON AUDIT QUALITY........... 90

3.4.1 MAFR: Interview and survey-based research....................................... 90
3.4.2 MAFR: Using a proxy measure for audit quality.................................. 98

3.5 THE IMPACT OF MAFR ON COSTS ..................................................... 101

3.5.1 Critical links to the empirical study...................................................... 104

3.6 CONCLUSION................................................................. 106

CHAPTER 4: THE ROLE OF THE AUDIT COMMITTEE IN THE OVERSIGHT OF AUDITOR INDEPENDENCE ....................................................... 108

4.1 INTRODUCTION....................................................................................... 108
4.2 THE EFFECTIVENESS OF THE AUDIT COMMITTEE ............................ 110
4.3 AUDITOR-CLIENT NEGOTIATIONS REGARDING FINANCIAL REPORTING......................................................................................... 113
4.4 THE MANAGEMENT-AUDIT COMMITTEE DIVIDE .............................. 116
4.5 CRITICAL LINKS TO THE EMPIRICAL STUDY...................................... 119
4.6 CONCLUSION....................................................................................... 121

CHAPTER 5: THE SOUTH AFRICAN CONTEXT TO THE MAFR DEBATE .... 123

5.1 INTRODUCTION....................................................................................... 123
5.1.1 South Africa’s commitment to stakeholder protection.......................... 124
5.2 STATUTORY REQUIREMENTS FOR THE JUNE 2017 MAFR RULE .... 125

5.3 EXISTING MEASURES IN SOUTH AFRICA TO SAFEGUARD AUDITOR INDEPENDENCE................................................................. 127

5.3.1 Critical links to the empirical study.................................................. 130

5.4 THE IRBA CONSULTATION PAPER .............................................. 131

5.4.1 The intended rotation period........................................................... 132

5.4.2 The IRBA’s reasons for MAFR ....................................................... 132

5.4.3 Critical links to the empirical study................................................ 138

5.5 RESPONSES TO THE IRBA CONSULTATION PAPER ............... 139

5.5.1 Summary of the IFAC response .................................................... 140

5.5.2 Summary of the JSE response ....................................................... 141

5.5.3 Summary of the CFO Forum response .......................................... 143

5.5.4 Summary of the SAICA response .................................................. 144

5.5.5 Summary of the ASISA response .................................................. 146

5.5.6 Summary of the ‘Big Four’ audit firms’ response ............................ 148

5.5.7 Summary comparison of key issues ............................................. 162

5.5.8 Critical links to the empirical study............................................... 164

5.6 MARKET CONCENTRATION AND TRANSFORMATION CONSIDERATIONS................................................................. 165

5.6.1 Market concentration and MAFR.................................................. 167

5.6.2 Interviews with South African audit partners................................... 172

5.6.3 Critical links to the empirical study............................................... 172

5.6.4 Transformation and MAFR ......................................................... 175

5.6.5 Response from the audit profession regarding transformation ....... 178

5.6.6 Diversity and performance in an organisation............................... 179

5.6.7 Critical links to the empirical study............................................... 180

5.7 INTERVIEWS OF SOUTH AFRICAN AUDIT PARTNERS ............... 181
7.5.2 CFOs of JSE-listed companies ........................................................... 219
7.5.3 Audit committee chairs of JSE-listed companies .............................. 221
7.5.4 Equity fund managers ..................................................................... 223

7.6 QUESTIONNAIRE DISTRIBUTION ...................................................... 225

7.7 QUESTIONNAIRE DESIGN AND CONTROL ......................................... 226
7.7.1 Design of each questionnaire .......................................................... 227
7.7.2 Testing the questionnaires for validity and reliability ....................... 227

7.8 RESPONSE RATES ............................................................................. 228

CHAPTER 8: RESEARCH FINDINGS AND ANALYSIS ................................. 231

8.1 INTRODUCTION .................................................................................. 231
8.2 DEMOGRAPHIC DATA OF PARTICIPANT GROUPS ............................ 231
8.3 RESEARCH FINDINGS ON DIRECT EFFECTS OF MAFR ................. 233
  8.3.1 Perceived impact of MAFR on auditor independence and professional scepticism .............................................................. 234
  8.3.2 Perceived impact of MAFR on auditor client-specific knowledge ...... 261
  8.3.3 Perceived impact of MAFR on transformation in the audit profession 273
  8.3.4 Perceived impact of MAFR on the degree of market concentration by the Big Four firms ..................................................... 289

8.4 RESEARCH FINDINGS ON INDIRECT EFFECTS OF MAFR ............ 301
  8.4.1 Perceived impact of MAFR on audit partners’ quality of work life and the appeal of the audit profession ...................................... 302
  8.4.2 Perceived impact of MAFR on costs to audit firms and companies .... 313
  8.4.3 Perceived impact of MAFR on exercising professional judgement ..... 334

8.5 RESPONDENTS’ OVERALL POSITION ON MAFR ......................... 340
8.6 CONCLUSION OF FINDINGS CHAPTER ........................................... 354

CHAPTER 9: CONCLUSIONS AND RECOMMENDATIONS ....................... 355

9.1 INTRODUCTION .................................................................................. 355
9.2 CONCLUSIONS FROM THE LITERATURE STUDY ............................ 355
9.3 CONCLUSIONS FROM THE EMPIRICAL STUDY ........................................... 360

9.3.1 Hypotheses conclusions ........................................................................ 361
9.3.2 Conclusions concerning audit quality ................................................. 364
9.3.3 A summary of key findings for each participant group ...................... 367

9.4 STUDY RECOMMENDATIONS .................................................................. 377

9.4.1 Key recommendation based on empirical study ............................... 377
9.4.2 Additional recommendations based on empirical study .................. 379

9.5 LIMITATIONS OF THE STUDY .............................................................. 387

9.6 CONTRIBUTION TO THE EXTANT BODY OF KNOWLEDGE AND AREAS
   FOR FUTURE RESEARCH ........................................................................... 389

9.7 CONCLUSION .......................................................................................... 394

BIBLIOGRAPHY ............................................................................................... 395

ANNEXURES .................................................................................................... 416
LIST OF FIGURES

Figure 1.1: A framework for assessing the impact of auditor independence on audit quality ........................................................................................................................................................................................................................................ 10

Figure 3.1: Model of direct and indirect effects of mandatory rotation on audit quality ........................................................................................................................................................................................................................................ 87

Figure 5.1: Summary of 2014/2015 IRBA Public Inspections Report findings ------- 135
Figure 5.2: Market concentration of listed companies in South Africa (measured by company market capitalisation) ........................................................................................................................................................................................................................................ 167
Figure 5.3: 1980s and 1990s – Significant mergers in the audit market ............... 169

Figure 7.1: Instrument development model (mixed methods) ............................ 209
Figure 7.2: Research design used in the study .................................................... 211
Figure 7.3: Model of direct effects of MAFR ......................................................... 212
Figure 7.4: Model of indirect effects of MAFR ...................................................... 213

Figure 8.1: Opinions regarding IRBA inspection findings .................................... 246
Figure 8.2: Opinions regarding corporate failures ............................................. 247
Figure 8.3: Black audit partners’ perspectives on transformation ....................... 285
Figure 8.4: Overall position at beginning of questionnaire ............................... 345
Figure 8.5: Overall position at end of questionnaire .......................................... 346
Figure 8.6: Perspectives on appropriate tenure period ....................................... 352
LIST OF TABLES

Table 2. 1: Audit quality proxies from literature ........................................................ 62

Table 5. 1: Summary of key issues ........................................................................ 163
Table 5. 2: Description of the audit partners interviewed................................. 183

Table 6. 1: Countries ranked by the WEF for financial market development (2015-2016 Global Competitiveness Index) .............................................................. 195

Table 8. 1: Demographic data of respondents ....................................................... 232
Table 8. 2: Perceptions on the current state of independence and professional scepticism ............................................................................................................. 235
Table 8. 3: Perceptions on the impact of MAFR on auditor independence .......... 237
Table 8. 4: The investing public’s opinion of auditor independence ................. 253
Table 8. 5: The perceived impact of MAFR on the investing public’s opinion of auditor independence .............................................................. 256
Table 8. 6: Client-specific knowledge, experience and expertise ...................... 263
Table 8. 7: The impact of changes in client-specific knowledge on the MAFR debate ........................................................................................................................ 266
Table 8. 8: Perspectives on transformation statistics ............................................. 275
Table 8. 9: Audit partners’ perspectives on transformation (Big Four vs. non-Big Four) .................................................................................................................. 277
Table 8. 10: Audit committee chairs’ perspectives on transformation ............... 279
Table 8. 11: Black respondents’ overall position on MAFR ................................ 287
Table 8. 12: Perspectives on market concentration considerations .................. 292
Table 8. 13: Perspectives on quality of auditors’ work life .................................. 305
Table 8. 14: Perspectives on the appeal of the audit profession ......................... 309
Table 8. 15: Participants' perspectives on cost to companies ............................ 314
Table 8. 16: The nature of potential costs to the audit firm ............................... 323
Table 8. 17: Additional cost implications for the audit firm ............................... 325
Table 8. 18: Quantifying perceived effects of MAFR ....................................... 328
Table 8. 19: Perspectives on exercising professional judgement .......................... 336
Table 8. 20: Perspectives on preferable alternatives ........................................... 342
ANNEXURES

Annexure 1: Calls for additional research on MAFR.................................................. 416
Annexure 2: List of countries showing application of MAFR...................................... 421
Annexure 3: Key national-level studies that employ a proxy measure for audit quality ........................................................................................................................................ 425
Annexure 4: Hypotheses and linkages from theoretical model (Direct and Indirect effects) ........................................................................................................................................ 428
Annexure 5: Linking the hypotheses to the questionnaire.............................................. 430
Annexure 6: List of companies, auditors and equity asset managers ......................... 434
Annexure 7: E-mails to participants from the JSE (Questionnaire distribution) ...... 436
Annexure 8: E-mail to participants from the ASISA (Questionnaire distribution) .... 440
Annexure 9: Cover letters provided by the study leader (Questionnaire distribution) ........................................................................................................................................ 442
Annexure 10: QUESTIONNAIRE for the JSE accredited registered auditor ........... 445
Annexure 11: QUESTIONNAIRE for the JSE Audit Committee Chair....................... 469
Annexure 12: QUESTIONNAIRE for the JSE chief financial officer (CFO) ............... 489
Annexure 13: QUESTIONNAIRE for the equity fund manager................................. 509
Annexure 14: Ethical clearances.................................................................................. 525
CHAPTER 1: INTRODUCTION

1.1 INTRODUCTION AND CONTEXT

Internationally mandatory audit firm rotation (MAFR) has received a great deal of attention in recent years with growing concerns surrounding the independence of external auditors and particularly the lengths of tenures between audit firms and companies (Fontaine, Khemakhem, & Herda, 2016). In June 2017 the Independent Regulatory Board for Auditors (IRBA), the South African statutory body responsible for regulating the auditing profession, issued a regulation requiring MAFR for all public interest entities, effective April 2023 (IRBA, 2017b). This regulatory change follows the changes in the European Union (EU) to move beyond audit partner rotations to full firm rotation as a means of further safeguarding the independence of auditors and the quality of the audits of companies. The United States (US) regulators have repeatedly considered MAFR regulations over the past two decades but have consistently decided in favour of audit partner rotation due to the negative consequences inherent in MAFR. These two large auditing jurisdictions (the EU and the US) illustrate the international divide on the issue. Some countries have adopted MAFR in recent years, but most have decided against it or implemented it and then subsequently repealed it, usually in favour of audit partner rotation (Casterella & Johnston, 2013; Fontaine et al., 2016).

After a period of consultation in South Africa and no small amount of heated debate and disagreement amongst stakeholders, the IRBA ruled in favour of the European position on the matter. There have been significant and repeated calls by the auditing profession

---

1 The IRBA has provided a definition of a public interest entity, as would apply to the MAFR ruling. The specifics of such a definition include all listed entities, as well as certain non-listed entities that possess a measured degree of risk and exposure to the public. A formal definition can be found in the following IRBA communiques - IRBA (2016a) and IRBA (2016b).
and the business community in South Africa that insufficient evidence and reasoning have been provided by the IRBA to justify MAFR (Harber & West, 2017). A unique aspect of the South African debate is the intention of the IRBA, in addition to improving auditor independence, to use MAFR as a means of addressing the racial inequality in the audit profession, which is largely understood to be a consequence of South Africa’s apartheid history. The audit firms are believed to be unequally constituted of white professionals and are therefore not representative of the racial demographics of the country. A further intention of the IRBA is to promote competition in the market by creating more opportunities for the ‘non-Big Four’ audit firms to propose (tender) and be appointed for the larger (especially exchange-listed) companies, thereby reducing the concentration of larger companies audited by the ‘Big Four’ international audit firms, namely, Deloitte, PwC, EY and KPMG (IRBA, 2016e).

The proper functioning of capital markets depends on the quality of financial information as investors and other stakeholders of organisations rely on the accuracy of financial information to inform their decision-making. This is the primary reason why the quality of the audit outcome is important. If investors perceive that financial information was inaccurate or misleading, there would be a breakdown in the efficiency of the decision-making process as the perceived risk of engaging in financial transactions, such as issuing credit or valuing company shares, for example, would be considered unacceptable (Ball, Tyler & Wells, 2015; Firth, Rui & Wu, 2012; Knechel, Krishnan, Pevzner, Shefchik & Velury, 2013). Users of financial statements, auditors, regulators and society are all key stakeholders in the financial reporting process and use audited financial information with a resultant degree of comfort as to its accuracy, enabling them to make a wide variety of economic decisions. The audit of an organisation’s financial statements has therefore been described as an activity of public protection, providing the investing public and other stakeholders with a much needed stamp of credibility and assurance as to the fair presentation of the financial position, performance and cash flows of the organisation (Francis, 2004; Hay, Knechel & Willekens, 2014; Lennox, Wu & Zhang, 2014). This is aptly expressed by the chairman of the International Accounting Standards Board (IASB):
High quality financial information is the lifeblood of market-based economies. If the blood is of poor quality, then the body shuts down and the patient dies. It is the same with financial reporting. If investors cannot trust the numbers, then financial markets stop working. For market-based economies, that is really bad news. It is an essential public good for market-based economies (Hoogervorst, 2012:2).

Audits therefore play a vital economic role and serve the public interest by strengthening accountability and reinforcing trust and confidence in financial reporting (Fontaine et al., 2016; Hay, 2015; Tepalagul & Lin, 2015). According to Cohen, Krishnamoorthy and Wright (2010), auditors are part of the corporate governance mosaic, playing an important role in working with other actors such as management, the audit committee (AC) and the board of directors to ensure quality financial reporting. As such, audits are a crucial component of capital markets and help enhance economic prosperity, expanding the variety, number and value of transactions that people are prepared to enter into (ICAEW, 2005).

A difficulty encountered in the MAFR debate is establishing agreement on the definition of audit quality. What exactly constitutes a high-quality audit outcome and indeed, what is the purpose of the audit? An organisation’s stakeholders have differing needs and goals with respect to the finances of the organisation, and as such, there are different answers to this question (Knechel et al., 2013). Nonetheless, there is consensus in research that audit quality includes at its heart the concept of a correct opinion provided, based on work conducted, regarding the fair and accurate presentation of financial information, attempting to determine whether such information is free of material errors and inconsistencies. It is this audit process and the resultant quality that is necessary for the proper functioning of capitalist markets².

² There is a significant amount of research to confirm this (as noted by Aschauer et al. (2017); Ball et al. (2015); Bandyopadhyay, Chen & Yu (2014); Carey & Simnett (2006); Casterella & Johnston (2013); Firth, Rui & Wu (2012); Fontaine et al. (2016); Hakwoon et al. (2015); Harber & West (2017); IRBA (2016a); Jackson et al. (2008); Knechel et al. (2013); Kwon et al. (2014); Laurion, Lawrence & Ryans (2017); Tepalagul & Lin (2015)).
A key contributing factor to high audit quality and therefore quality in financial reporting is the independence of the auditor from the organisation being audited, especially the management of that organisation (Fiolleau, Hoang, Jamal & Sunder, 2013; Marx, 2009c; Tepalagul & Lin, 2015). Any impairment of this independence, which could occur due to a variety of reasons, could cause the auditor to lose the objectivity and professional scepticism that is considered necessary to both perform adequate work and form an opinion on the fair presentation of the organisation’s financial statements as well as the underlying transactions that have occurred during the period. It is this very concern which has caused audit and financial regulators globally to improve regulations governing the independence of the auditor-client relationship (Ball et al., 2015). There have been many instances of corporate failures in recent years, most notably Enron in 2001, Parmalat in 2003 and the global financial crisis of 2007/8 which resulted in the collapse of Lehman Brothers, among others. According to Ewelt-Knauer, Gold, and Pott (2013), the global financial crisis reopened concerns about auditor independence and audit quality and brought to the fore questions surrounding the scope and quality of the external audit. Many investors blamed the audit profession in the wake of the global financial crisis, and the same accusations are made following corporate failures where fraud is uncovered as a root cause (Hay, 2015).

In South Africa, examples of corporate financial failures include LeisureNet in 2000, Fidentia in 2007 and the 2017 financial scandal of Steinhoff International Holdings. These are but a few select examples whereby regulators and the investing public have seriously questioned the role of the auditors in failing to prevent such large-scale financial loss and repercussions. It is the occurrence of these perceived failings in the capitalist system that has prompted renewed debate surrounding auditor independence regulations3. According to the IRBA (2017c:2):

> Through the 1990s South Africa continued to experience several corporate failures, putting the role of auditors under the spotlight. Various spectacular corporate collapses and business failures include Unifer, LeisureNet, Saambou,

---

3 This is identified in a significant number of recent studies on the topic of audit quality and auditor independence (refer to Aschauer et al. (2017); Ball et al. (2015); Casterella & Johnston (2013); Daniels & Booker (2011); Fontaine et al. (2016); Hakwoon et al. (2015); Hay (2015); Knechel et al. (2013); Kwon et al. (2014); Pozen (2015); and Simnett et al. (2016)).
Fidentia, Sharemax, Randgold, First Strut (FirstTech Group) and African Bank. Many of these failures are not yet resolved and creditors and investors have still not been recompensed. In all these failures, the investors are the ones who lost the most.

Audit regulators have responded to these perceived audit failures with a variety of auditing reforms focusing on auditor rotation rules (Fontaine et al., 2016; Hay, 2015; Wilson, McNellis & Latham, 2018). The rotation of audit partners is widely considered necessary to ensure that the auditor remains independent of the client over the many years that the audit firm is appointed by the organisation (auditor tenure). This system of audit partner rotation, used to safeguard auditor independence, is recommended by the International Federation of Accountants (IFAC) in their Code of Ethics for Professional Accountants. However, the argument of many regulators is that this regulation does not go far enough, evidenced by the continuing occurrence of corporate financial scandals. A lack of auditor independence has been a common accusation by regulators and other organisational stakeholders in the wake of these corporate financial scandals (Hay, 2015). Therefore, a rotation of the entire audit firm, over and above partner rotation, is deemed necessary by some. This is referred to as MAFR.

As mentioned above, the two largest international jurisdictions, namely the EU and the US, have come to opposing conclusions on the implementation of MAFR as the best means of ensuring a high degree of auditor independence and audit quality. In 2014 EU regulators adopted a complex system of audit firm rotation whereas, after years of debate, the US regulator, the Public Company Accounting Oversight Board (PCAOB), continues to prefer audit partner rotation on a five-year rotation basis, rejecting MAFR. South Africa currently implements a five-year audit partner rotation system similar to the US. However, after much controversial debate on the topic, the IRBA ruled in June 2017 in favour of MAFR, with an effective date prescribed to be April 2023. This ruling has led to many dissenting views from the audit profession and the wider South African business community.
At the risk of over-simplifying the MAFR debate, it is helpful to highlight the key arguments for and against. Proponents of MAFR argue that long-tenure relationships between audit firms and clients, often spanning decades, can lead to audit failures due to high levels of familiarity that impair auditors’ independence and professional scepticism. In contrast, opponents argue that long-tenure relationships between audit firms and clients lead to valuable client- and industry-specific knowledge over time resulting in enhanced audit quality (Cameran, Francis, Marra & Pettinicchio, 2015; Fontaine et al., 2016). These represent the primary arguments for and against MAFR, however, the debate is complex and often includes issues specific to the history, nature and socio-economic context of the jurisdiction concerned. For example, in South Africa, unlike any other jurisdiction internationally, the debate needs to acknowledge and include the consequences of South Africa’s apartheid history and the current national government policy to promote economic racial transformation, often referred to as Black Economic Empowerment (BEE) (BEE Commission, 2001; RSA, 2013). Unlike in other countries therefore, MAFR research in South Africa also needs to consider the racial diversity of the audit profession and the progress of such transformation post-apartheid (elections in 1994). This is reflected in the IRBA’s intention for MAFR to reduce market concentration and improve racial transformation in the audit industry, in addition to its primary goal of improving auditor independence and audit quality (IRBA, 2016e).

There have been repeated calls for further research in South Africa on the many aspects surrounding auditor independence, audit quality and auditor rotation (Harber, 2016, 2017a). The purpose of this study is therefore to analyse the necessity, alternatives and possible consequences of MAFR in the South African context, as ruled by the IRBA, in order to contribute to the international research on the topic as well as to inform regulation in the South African context. Following a detailed review of the international academic literature and professional debate on audit quality and MAFR, a comprehensive set of questionnaires was constructed, covering the broad spectrum of the MAFR debate, including the aspects unique to the South African context. Four stakeholder groups of the auditing profession, central to the MAFR debate, have been surveyed, namely, audit partners, Chief Financial Officers (CFOs), audit committee (AC) chairs and equity fund
managers. The focus has been on the top 100 stock exchange-listed companies in South Africa. The results of this study contribute to the ongoing international research on MAFR specifically, and the concept of audit quality in general, as well as informing the ongoing development of regulation following the June 2017 ruling by the IRBA. Various possible unintended consequences of MAFR are identified and analysed from the questionnaires, with suitable recommendations offered in order to mitigate their negative effects.

1.2 A BRIEF HISTORY OF AUDITING AND THE AGENCY THEORY

Economic decisions in every society need to be based on the information available at the time the decision is made. Reliable economic information is therefore very important for decision-making between transacting parties. As such, the practice of accounting for transactions, verifying and communicating economic information dates back to ancient times and was present in most, if not all societies (Pava, 2016). Accounting was part of the development of cultures from ancient times. With fortified villages, accumulating wealth meant inventory accounting, first using tokens (clay balls) and eventually evolving into writing and the use of abstract concepts such as numbers (Giroux, 2017).

According to Pava (2016), historians have found evidence in the distant past of not only accounting but also common auditing practices such as dual custody of assets, provision of assurance by opinion and segregation of duties, among others. For example, according to Pava (2016), there is evidence that the government accounting system in China during the Zhao dynasty (circa 1122-256 BC) included audits of official departments. As early as the 5th and 4th centuries BC, both the Romans and Greeks devised careful systems of checks and counterchecks to ensure the accuracy of their reports. After the Crusades, Italian city-states created merchant wealth based on the creation of double-entry. Luca Pacioli’s *Summa de Arithmetica* described the Venetian system, which travelled north thanks to Gutenberg’s printing press (Giroux, 2017). Enhanced forms of manufacturing, banking and merchant trade continued. Along the way, accounting sophistication rose as
entrepreneurs discovered the need for complex information to survive. Accounting became a profession as businesses became big enough and important enough to employ professionals (Giroux, 2017).

In English-speaking countries, records from the Exchequers of England and Scotland (circa 1130 AD) have provided the earliest written references to auditing (Pava, 2016; Puttick & van Esch, 2004). It is therefore clear that from ancient times, accounting for wealth and economic transactions, as well as the assurance of this accounting through some form of audit, was a necessary component of business and trade.

Classic agency theory as described by Fama and Jensen (1983) and Jensen and Meckling (1976) can be applied to the role of the external auditor. This theory of the auditor as an independent monitor of a company has been used to frame this research and the literature review. According to Bosse and Phillips (2016), agency theory is undeniably one of the dominant theories of economic organisation and management. Consequently, agency theory models have been applied in various fields in finance and economics, including financial contracting, regulation, public procurement, monopolistic price-discrimination, job design, internal labour markets, team production and many others (Gilson & Gordon, 2013).

In this study, agency theory provides the theoretical basis for the understanding of the role of the audit function. Shareholders appoint auditors to provide assurance with respect to management’s financial reporting and financial management of the organisation. Considering agency theory and the vested interests of corporate management, it is understandable why corporate ‘short-termism’ exists and why it needs to be addressed. ‘Short-termism’ basically refers to management’s bias to maximise profits in the short term by making decisions that are contrary to the longer-term objectives of the stakeholders of the organisation (Pozen, 2015). Management have goals that tend to be unaligned with those of shareholders and other stakeholders, such as job security, salary
increases, performance bonuses and share options, to name but a few. Management also have different aversion levels to risk in the organisation. This dilemma is referred to as ‘the agency problem’. The most common agency relationship is between shareholders (principal) and management (agents), specifically the company’s senior executives (Bosse & Phillips, 2016; Eisenhardt, 1989). Agency theory is considered as the primary reason for the role of auditors, ‘to keep capitalism honest’ and ensure that management fairly present the organisation’s financial position, performance and cash flows to allow stakeholders to adequately assess management performance. MAFR regulation is designed to improve the quality of this audit function and therefore strengthens the assurance that stakeholders can receive regarding management’s financial reports, mitigating some of the risks caused by the agency problem.

1.3 KEY DETERMINANTS OF AUDIT QUALITY

DeAngelo (1981:186) provides a helpful definition of the concept of audit quality, even though it may not be all-encompassing. Audit quality can be considered “the market assessed joint probability that a given auditor will both discover a breach in a client’s accounting system, and report the breach”. This definition has been employed by many research studies on audit quality since 1981 and highlights the role of the auditor in uncovering and reporting financial misconduct by management, either in terms of accepted accounting reporting standards or in terms of financial regulations applicable to the organisation. Considering that an organisation’s stakeholders have differing needs and goals with respect to the finances of the organisation, there are different views of what constitutes audit quality and the primary purpose of the audit. However, the idea that the auditor needs to vouch for the credibility of the financial statements presented by

---

4 This is a useful definition that has been adopted by numerous recent studies on the topic such as those of Ball et al. (2015), Fontaine et al. (2016), Hakwoon, Hyoik & Jong Eun (2015), Jackson, Moldrich & Roebuck (2008), Kwon, Lim & Simnett (2014), Lennox et al. (2014), Lu & Sivaramakrishnan (2009) and Tepalagul & Lin (2015). The definition is important because it identifies the purpose of auditing.
the organisation as well as report financial misconduct is a common requirement in terms of stakeholder opinion and professional standards (Hakwoon, Hyoik & Jong Eun, 2015; Hay, 2015; Knechel et al., 2013).

The link between audit quality and MAFR is important. Tepalagul and Lin (2015) conducted a comprehensive review of research performed between 1976-2013 on auditor independence and audit quality. They highlight the strong link between the independence and capabilities of the auditor and the resultant quality of the audit and financial statements. As shown in Figure 1.1 below, Tepalagul and Lin (2015) provide a useful, four dimensional approach with which to assess the impact of auditor independence and capability on audit quality. The diagram shows that factors such as (a) client importance, (b) non-audit services, (c) auditor tenure and (d) client affiliation with audit firms can impair the independence and capability of the auditor. This categorisation of the four main threats to auditor independence is considered useful for further research and theory and is consistent with the threats described in auditing professional standards such as the IFAC Code of Ethics for Professional Accountants (IFAC Code, Section 290, 2016).

![Figure 1.1: A framework for assessing the impact of auditor independence on audit quality](source: Tepalagul and Lin (2015))
In Figure 1.1 the link between capabilities, independence and audit quality is clearly illustrated. This relationship between auditor independence and audit quality specifically, is very important and underlies the reasoning behind all regulations designed to strengthen the independence of the auditor-client relationship. If auditors do not remain independent, they may be less likely to report irregularities or insist that financial statements be prepared to their satisfaction, thus impairing audit quality (Carey & Simnett, 2006; Casterella & Johnston, 2013; Tepalagul & Lin, 2015). This potentially lessens the credibility of the financial reporting process and impairs the effectiveness of the external auditor as a key gatekeeper against fraud and error in the reporting of information to financial markets.

According to Hay (2015), these two auditor characteristics – capability and independence – are so important to audit quality that recent international auditing reforms by regulators can be classified into those that that aim to improve the independence of auditors and those that intend to increase their competence. MAFR is a regulation designed to limit auditor tenure so as to safeguard the independence of the audit-client relationship, and by so doing, safeguard and promote audit quality.

In Figure 1.1 the link between capabilities, independence and audit quality becomes clear. Of significance is the threat to independence posed by long audit tenures. It is this threat which auditor rotation regulations are attempting to mitigate. Auditor rotation rules, including both audit partner rotation and audit firm rotation, are designed to specifically address the threat to independence caused by long relationships between the auditor and the management of the organisation. An audit necessitates a close working relationship with the management of an organisation. This type of close relationship (familiarity threat) can dilute the independent thought and professional scepticism of the auditor. As shown in Figure 1.1, an impairment of independence results in an actual or perceived deterioration in the quality of the audit and financial reporting. Therefore long tenures have led stakeholders and regulators to question both the perceived and actual
independence of auditors and to demand stricter controls and standards to regulate independence (Fontaine et al., 2016; ICAEW, 2005; Jackson, Moldrich & Roebuck, 2008).

A primary and common means of strengthening the independence of the auditor, in order to safeguard audit quality, is to mandate the rotation of the auditor at defined intervals (Fontaine et al., 2016; Hay, 2015). The reason for this is to limit the number of years in the auditor-client relationship (often referred to as audit tenure) and thereby mitigate the likelihood of the relationship undermining the independence of the auditor. Corporate financial scandals have resulted in accusations of collusion and misconduct between the auditor and the client, with the argument that over time a dangerous and compromising relationship develops between the two, partly influenced by the need for the auditor to acquiesce to the client’s decisions and behaviour in order to retain the appointment (Ball et al., 2015; Hay, 2015; Knechel et al., 2013). A threat to the independence and professional scepticism of auditors could incentivise them to ‘turn a blind eye’ to financial misconduct and fraud. Therefore, as the reasoning goes, limiting the number of years whereby an auditor can provide a client with assurance (audit) services could significantly reduce these threats. MAFR is therefore seen as necessary to instil confidence in the users of such audited financial information that the audit opinion is appropriate, that the auditors are independent of the client and their professional opinion can be trusted.

1.4 PROFESSIONAL STANDARDS AND REGULATORY RESPONSES

International auditing standards have long recognised the importance of auditor independence and the associated threat to this independence caused by long auditor-client tenures. Consequently, the IFAC, through the International Ethics Standards Board for Accountants (IESBA), requires that audit partners rotate off public interest audit clients periodically – currently every seven years depending on circumstances (IFAC Code, Section 290, 2016). The IESBA is the standard-setting board that develops and issues, in the public interest, high-quality ethical standards and other pronouncements for
professional accountants worldwide and its Code of Ethics for Professional Accountants is adopted by many countries worldwide, including South Africa. According to the IFAC (2017), nearly 80% of jurisdictions worldwide have adopted International Standards for Auditing, while more than 60% have fully adopted the IESBA Code of Ethics for Professional Accountants. The IFAC Code explains that the reason for rotating the audit partner is to mitigate the threats to independence as may be caused by self-interest and familiarity (similar to the threats identified in Figure 1.1).

South Africa chooses to adopt regulations that are stricter than the seven-year audit partner rotation period prescribed in the IESBA Code of Ethics currently requiring auditors of companies to rotate off the client every five years according to Section 92 of the Companies Act, 2008 (Act No. 71 of 2008). This five-year audit partner rotation rule is similar to the regulations in the US. In December 2015, in response to concerns of long auditor tenures, the IRBA issued the ‘Audit Tenure Rule’, which requires South African auditors to formally state in the auditor report which accompanies the audited annual financial statements, the number of years that the audit firm has been consecutively appointed by shareholders. According to the IRBA, the intention of this rule is “to raise awareness around issues such as long audit tenure, and requiring disclosure to the shareholders to enable them to be more informed before voting at [shareholder meetings]” (IRBA, 2015d, 2016b:13). This recent ‘Audit Tenure Rule’ further signals the IRBA’s concerns regarding the potential negative impact of long audit firm tenures in South Africa on audit quality.

1.4.1 An overview of regulatory response to MAFR

Of the top 20 countries ranked by the World Economic Forum (WEF) in terms of financial market development, six EU countries have adopted MAFR by virtue of being in the EU (Finland, Norway, Sweden, Luxembourg, UK and Germany) and only one other country, namely China, currently applies MAFR (refer to Table 6.1 in Chapter 6). The remaining
13 countries have either not adopted MAFR or have implemented and since repealed it. In 2014 the European Parliament implemented MAFR, requiring audit firms to rotate off the client after ten years of appointment, subject to various criteria and transitional provisions (Agnew, 2016b; European Commission, 2014). This ruling introduced the strictest form of auditor rotation to one of the largest economic jurisdictions in the world. In contrast, in 2016 the US PCAOB reaffirmed its 2013 decision not to adopt MAFR. The PCAOB conducted extensive hearings and public debate regarding the merits of MAFR and concluded that the existing audit partner rotation every five years, together with other independence requirements, is sufficient to ensure the desired high level of independence and professional scepticism. This decision seems to be reviewed by the PCAOB every few years (Cameran et al., 2015). In October 2016, the Singapore regulator announced its intention to discontinue MAFR in favour of audit partner rotation (Choudhury, 2016). According to the CEO of IFAC, many other countries are at various phases of implementing or discontinuing mandatory audit firm rotation and there is no consensus on the matter:

For global businesses trying to coordinate their audits worldwide, the complexity, costs, and risks of trying to navigate this patchwork regulatory environment detracts from their focus on obtaining the highest quality audit - possibly even going so far as necessitating multiple auditors in different jurisdictions to meet different rotation requirements (Choudhury, 2016:2).

In June 2017 the South African audit regulator, the IRBA, ruled in favour of MAFR (Board Notice 100 of 2017, Government Gazette No. 40888). The ruling, not effective until April 2023, requires that audit firms shall not serve as the appointed auditor of a public interest entity for more than ten consecutive financial years before rotating off the client for a cooling-off period of at least five years, before being eligible to audit the client again (IRBA, 2017b). This ruling and the debate that preceded it, revealed significantly polarised positions from stakeholders. Much evidence and reasoning have been provided by affected parties and there have been many calls for more research, especially relating to the necessity and potential unintended consequences of MAFR in the South African context (Bam, 2017; Bourne, 2017; Harber & West, 2017; Oddy, 2017; Shango, 2017).
1.4.2 Primary arguments for and against MAFR

Various arguments are provided for and against MAFR, yet the validity and credibility of each point is debatable and as such, the debate continues in most jurisdictions (Harber & West, 2017; Stefaniak, Robertson & Houston, 2009). In addition, there are various jurisdiction-specific issues that need to be considered as no two business environments, from a socio-economic and regulatory perspective, are the same. An example of this is the IRBA’s intention to address race representation and diversity, due to South Africa’s unique apartheid history. The main points of disagreement, however, centre on two primary questions. Does a long-tenure relationship between an audit firm and client lead to audit failures due to high levels of familiarity that impair auditors’ independence and professional scepticism? And, does a long-tenure relationship between an audit firm and client lead to valuable client- and industry-specific knowledge over time resulting in enhanced audit quality? As is evident from these two questions, audit tenure can be seen to either impair or improve audit quality, depending on the nature of the answers to these questions (Casterella & Johnston, 2013; Hakwoon et al., 2015).

Therefore, determining a final position on MAFR largely depends on the answers to these two fundamental and somewhat opposing questions. One side appeal to the independence characteristic of audit quality (claimed to be impaired by long-tenure), the other to the capability characteristic (claimed to be enhanced by long-tenure). It is also important to note that the opponents of MAFR are generally not opposed to audit partner rotation as prescribed in the IESBA Code of Ethics (Daugherty, Dickins, Hatfield & Higgs, 2012; Harber & West, 2017). Audit partner rotation is seen as important in preserving independence but whole audit firm rotation is seen by some as excessive, resulting in too many negative consequences, most notably the loss of client-specific knowledge and experience.
Following from the discussion in the preceding paragraphs, it is clear that auditors play an important role in ensuring high quality financial reporting that enables economic decision-making. Auditors need to maintain a high level of independence from the audited client to produce a quality audit opinion and act as whistle-blower against accounting fraud and error. However, the means of best regulating the relationship between auditor and client, especially regarding length of tenure, is subject to much debate and is an urgent professional and regulatory concern internationally (Casterella & Johnston, 2013; Hay, 2015). Two significant jurisdictions, namely, the EU and the US, have come to opposing conclusions on the merits of MAFR as the best means of limiting the effect of auditor tenure on audit quality. Preceding, as well as subsequent to, the June 2017 ruling by the IRBA, many stakeholders in the audit industry have debated the topic of MAFR and its appropriateness in the South African context. The IRBA has decided to follow the example of the EU but many believe that the route of the US (and other countries which have decided against MAFR) is preferable. There are stakeholders who believe audit quality is compromised in South Africa, primarily due to a lack of auditor independence. Others disagree and believe that current regulatory frameworks and regulations are sufficient. Various evidence and motivations have been provided by both sides. This study therefore focuses on analysing the necessity, alternatives and possible consequences of MAFR in the South African context to further the research on the topic and to inform regulation in the local context.

1.5 THE IMPACT OF CORPORATE FINANCIAL SCANDALS

Considering that external assurance of financial information is an integral part of the proper functioning of capital markets, the topic of audit quality has been placed under scrutiny in the wake of several international high-profile accounting scandals. Auditor independence in general, and MAFR in particular, have received significant attention in recent years from regulators, academics and business practitioners, largely due to questions raised about audit quality in the wake of cases of corporate financial mismanagement (Ball et al., 2015; Hay, 2015; Knechel et al., 2013). This increased
attention is due in part to the financial corruption scandals that have occurred in recent years. In virtually all of these scandals, there have been allegations of extensive accounting and financial reporting misconduct, including fraud by management (Arnold, 2009; Firth et al., 2012; Hay, 2015; Manconi, Massa & Ayako, 2012).

Most national jurisdictions have had their own, albeit perhaps smaller, examples of financial fraud and associated accounting deceptions that have caused significant losses to both stakeholders and society at large. A recent example of this was the collapse of Carillion plc in 2018, a large British facilities management and construction services company, which sparked heated debate in the United Kingdom (UK) parliament around the independence of the “Big Four” audit firms and whether stricter regulations are required, or even whether the firms need to be forcible broken up into smaller businesses (The Economist, 2018a). In South Africa, LeisureNet (2000), Regal Bank (2001), Randgold and Exploration (2005) and Fidentia (2007) are examples of corporate financial reporting fraud and irregularities. The 2017 collapse of share price in Steinhoff International Holdings amidst allegations of extensive accounting and financial fraud (case ongoing) is another recent example. Yet again, questions are being asked about why the auditors (Deloitte Inc.) did not raise concerns earlier and why prior years’ financial statements had been signed off without qualification. The audit firm is now facing serious questions as to the quality and appropriateness of prior audit work performed (Bowker, Bonorchis & Wild, 2017).

In the recent past, South Africa has also experienced widespread allegations of political misconduct in what has been termed an attempt at ‘state capture’ through illegal collusion between private sector entities and politicians (IRBA, 2017c; Thompson & Mahlaka, 2017). State capture is defined as a type of systemic political corruption in which private interests significantly influence a state’s decision-making processes to their own advantage. In this regard, many allegations of collusion and misconduct in this state capture debacle have been laid against international organisations, notably, the audit firm KPMG Inc., management consultants McKinsey & Co and software giant SAP, with
investigations and legal proceedings still ongoing. KPMG Inc. is one of the largest audit firms in South Africa and internationally. In 2017, in the face of mounting evidence of state capture, KPMG Inc. has been accused of deliberate collusion and political meddling as well as performing sub-standard work in a number of engagements with organisations linked to state capture (Dludla, 2018; Thompson & Mahlaka, 2017). Again, a lack of independence, integrity and professional scepticism by the audit firm are seen as the primary cause of this behaviour (IRBA, 2017c). KPMG South Africa have suffered the loss of significant audit clients, who have chosen to terminate their relationships with the audit firm. Investigations are currently underway against KPMG Inc. by the national audit regulator (IRBA) and the Companies and Intellectual Property Commission (CIPC) (Dludla, 2018). Another South African audit firm, Nkonki Inc. applied for voluntary liquidation in 2018 following a scandal involving a failed management buyout transaction that was alleged to have been funded by parties linked to the ‘state capture’ corruption allegations. As a result of these ongoing allegations against KPMG Inc. and Nkonki Inc., the South African auditor-general terminated its outsourcing of government audits with the two firms in April 2018, resulting in Nkonki seeking liquidation of one of its offices (Hill, 2018). These South African examples of corporate financial misconduct, especially where the auditor is implicated, have resulted in the public and the IRBA questioning the independence and professional scepticism of the South African audit industry, especially with regard to public interest entities and exchange-listed companies (IRBA, 2016e, 2017c).

Since the June 2017 MAFR ruling, South Africa has received considerable downgrades from the World Economic Forum’s Global Competitiveness Report 2017-2018 compared to the previous year. Ranked out of 137 countries, South Africa dropped from 38th to 72nd position for the “ethical behaviour of firms”, 14th to 21st for the “strength of investor protection” and from 1st to 30th for the “strength of auditing and reporting standards” (WEF, 2017). The Chief Executive Officer (CEO) of the IRBA responded to these downgrades by the following statement:
This drop in confidence indicates that South Africa is no longer seen as a good investment. As confidence drops, investment drops and our markets suffer the consequence. Given that our financial markets and institutional ranking slipped in a number of areas including strength of securities exchange, efficacy of corporate boards, protection of minority shareholders’ interests, decline in strength of investor protection and ethical behaviour of firms, the result is predictable. The IRBA’s role is public protection and it does so through regulation. Given our own interest in audit quality and independence, the IRBA has been working on audit reforms for some time (Agulhas, 2017:1).

Clearly, this deterioration in the World Economic Forum’s Global Competitiveness Report rankings have prompted the IRBA to pursue MAFR. Internationally, regulators are concerned about deteriorating audit quality and MAFR is seen a possible response to perceptions of increasing corporate misconduct. Specifically, the global financial crisis (from 2007) raised doubts regarding the ability of the auditor to detect and report financial irregularities, raising further concerns that financial reporting regulations needed to be strengthened (Fontaine et al., 2016; Hakwoon et al., 2015; Kwon, Lim & Simnett, 2014). Sometimes the nature of the scandal is such that the responsibility for the fraud and negligence is shared by the auditors of the companies involved. The most famous example of this was the demise of one of the largest accounting firms in the world at the time, Arthur Andersen, after the Enron collapse in 2001. The IRBA expresses these concerns in recent correspondence as follows:

High-profile cases associated with Enron, WorldCom, Parmalat, Tyco International, Royal Dutch Shell, Siemens, and locally with corporations such as LeisureNet, Randgold and Regal Bank have made auditors a focal point for governments and oversight structures. Coupled with the earlier comment that investors and the public are also demanding more information and transparency and have become more aware of their rights to be protected, these developments are resulting in global role players revisiting measures to address concerns around the independence of auditors (IRBA, 2016e:10).

Corporate failures such as these have prompted regulators to scrutinise existing regulations that govern the auditor-client relationship. The reputation of the audit function in the mind of the investing public has also been negatively impacted. Audit quality has
been questioned due to a lack of trust in the independence of the auditor (Ball et al., 2015; Knechel et al., 2013).

In light of the above, there has been renewed questioning of auditor tenure and its impact on auditor independence and audit quality, beyond academic circles, by a broader number of regulatory and government institutions (Cameran, Vincenzo & Merlotti, 2005; Hakwoon et al., 2015). Given the significance of threats to auditor independence, as discussed above and illustrated in Figure 1.1, 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 and 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 (Choudhury, 2017; Hakwoon et al., 2015; Hay, 2015; Jackson et al., 2008).

1.6 THE IRBA’S POSITION IN SOUTH AFRICA

In October 2016 the IRBA issued a consultation paper detailing the regulator’s reasons for implementing MAFR as well as the intended rotation periods as well as various other criteria. The paper made clear the IRBA’s intention to publish MAFR as a rule, binding all registered auditors, through its legislative powers in terms of the Auditing Profession Act, 2005 (Act No. 26 of 2005), and that, after publication of the rule, MAFR will be in operation in South Africa (as of April 2023). At the outset of the consultation paper, the regulator recognised that its “ultimate responsibility is to protect the investing public, and to contribute to ensuring a reliable financial market which will generate confidence and promote investment and growth” (IRBA, 2016f:28) and that MAFR was the best means of ensuring this. According to the consultation paper, and then again in terms of the June 2017 ruling that followed, an audit firm will not be eligible to serve as the registered auditor
of a listed company for more than ten consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as registered auditor after the expiry of at least five financial years (the ‘cooling-off period’). This is similar to the ten-year rotation period implemented in the EU.

1.6.1 The IRBA’s rationale for MAFR

A review of the IRBA consultation paper and other correspondence provided prior to, and subsequent the June 2017 ruling, provides a clear rationale for the implementation of MAFR in South Africa. The IRBA states, with respect to its intentions with MAFR, that “its ultimate responsibility is to protect the investing public, and to contribute to ensuring a reliable financial market which will generate confidence and promote investment and growth” (IRBA, 2016f:5). The rationale for implementing MAFR as a means of “protect[ing] the investing public” is as follows:

- Auditor independence is critical for quality financial reporting (IRBA, 2016e). Stated another way, the IRBA believes that the independence of the audit firm and the audit engagement partner from the audit client is a critical contributing factor to the overall quality of the audit outcome. Academic literature would provide substantial evidence that this reasoning is indeed correct (Bowlin, Hobson & Piercey, 2015; Cameran et al., 2015; DeAngelo, 1981; Hakwoon et al., 2015; Tepalagul & Lin, 2015). In addition, the international standards that govern accountants and auditors would also support this assertion, most notably the IFAC Code of Ethics for Professional Accountants and the International Standards on Auditing. These standards are currently part of South Africa’s regulatory framework governing auditors.

- Auditor independence is of particular concern with respect to audits of companies listed on the Johannesburg Stock Exchange (JSE). The IRBA is of the opinion that
independence is compromised and many of the audit firms are too closely aligned with the management of JSE-listed companies (IRBA, 2016e). The regulator believes there is too much familiarity and too ‘cosy’ a relationship between some audit firms and companies on the JSE. It is of the opinion that MAFR is the best means to fix this problem (IRBA, 2016e). This claim that independence is compromised and that MAFR is necessary has been highly contested by the respondents to the IRBA Consultation Paper issued in October 2016 (refer below) and various industry stakeholders. Many of the stakeholders are of the opinion that the IRBA has not provided convincing evidence to justify their conclusions regarding auditor independence and the need for MAFR.

- Long audit tenures, meaning long unbroken periods, usually decades, of audit firm appointment, reduces the independence of the auditor (IRBA, 2016e). As will be shown in the literature review, the international research does not support this conclusion. The regulator believes that forcing audit firm rotation will reduce audit tenures and therefore limit the familiarity and relationships that exist between auditor and company management, thereby improving auditor independence and the quality of financial reporting of JSE-listed companies. Again, this assertion is highly contested by the respondents to the IRBA consultation paper issued in October 2016 and various industry stakeholders.

1.6.2 Three key objectives envisaged by the IRBA for MAFR

Again, from a review of the consultation paper and other correspondence, including the IRBA newsletters, three clear objectives are provided for MAFR in South Africa. The first objective relates specifically to the above rationale. The other two objectives are unique to the South African debate and are not shared by other jurisdictions. The three objectives clearly articulated by the IRBA are as follows:
1. MAFR will strengthen auditor independence and so protect the public and investors, which is part of the IRBA’s strategy; (i.e. promote good quality audits)

2. MAFR will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality; and

3. 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.

(IRBA, 2016e, 2017b, 2017c; Ziady, 2016)

Much of the public debate regarding MAFR has focused on the aspects of transformation, black economic empowerment and market concentration as important considerations (Peyper, 2017). The IRBA consultation paper, while stating that audit quality through auditor independence is the main objective for MAFR, still argues that transformation and market concentration are intended benefits of MAFR legislation:

The IRBA considers MAFR as an important measure to increase competition and thereby improve audit quality... MAFR is not intended to address transformation but rather to strengthen auditor independence. However, the slow pace of transformation as highlighted in our demographic and professional landscape study, certainly raised some serious concerns. The IRBA supports the fact that creating the opportunity for access to work as companies become due for rotation, will help more firms participate in a more meaningful way. It concedes that the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity (IRBA, 2016e:29).

In a 2017 IRBA newsletter, the CEO of the IRBA stated that:

Transformation of the profession has also been brought into the spotlight in recent months and has been further elevated by the parliamentary hearings into MAFR that took place in February and March (2017). The IRBA as an organ of state and a regulator is compelled to drive transformation and ensure that the auditing profession is transformed in a fair, equitable and competitive manner. So, we agree with the Standing Committee on Finance that transformation in the auditing profession requires a closer examination (IRBA, 2017b:2).
It is therefore clear that the regulator is considering MAFR as a means of addressing the racial transformation of the audit industry and the inability of smaller audit firms to compete for listed company audits. These two aspects of the MAFR debate are thus considered in this research as they have a significant impact on the MAFR debate in South Africa.

According to Bernard Agulhas, the CEO of the IRBA in 2016:

Our latest inspections findings include independence issues as one of the top five findings amongst the audits of financial statements. This is consistent with global inspections results. In a South African context, the IRBA Board has also recognised the challenges with lack of economic transformation and domination by certain firms within the profession. Out of the 353 audit partners who sign off on the financial statements of all JSE listed companies, only nine are Black African and over 90% are audited by a few firms. We will only see true empowerment when opportunities are provided equally amongst everyone (IRBA, 2016d:1).

The IRBA is concerned that the audit firms in South Africa are not sufficiently racially representative and that the large listed companies on the JSE are predominantly audited by the Big Four audit firms. Black economic empowerment (transformation / affirmative action) is widely recognised as a specific priority in the South African economy, acknowledged by both business and government as an ethical and urgent national imperative (BEE Commission, 2001; Marais, 2010; Ponte, Roberts, & van Sittert, 2007; RSA, 2013). 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 (BEE Commission, 2001; Ponte et al., 2007).

South Africa is considered a leading jurisdiction for the development of stakeholder protection frameworks, regulation and legislation, evidenced by the World Economic Forum’s Global Competitiveness Reports rankings of 'strength of investor protection'.
'strength of auditing and reporting standards’ and ‘efficacy of corporate boards’ (WEF, 2017). South Africa’s corporate governance codes and practices are among the best in the world and place a high priority on stakeholder protection and stakeholder value creation, evidenced by the Global Competitiveness Report rankings issued by the World Economic Forum in recent years (WEF, 2015, 2017). In addition, South Africa has played a leading role in the development of integrated reporting in organisations and making such reporting mandatory for JSE-listed companies (de Villiers, Rinaldi & Unerman, 2014). According to de Villiers, Rinaldi and Unerman (2014), the reason for this may be South Africa’s history, post-apartheid in 1994, whereby the new government has questioned the capitalist focus on financial performance at the cost of a high degree of social inequality, both in terms of wealth and race.

It is submitted that the above reasoning, including the three objectives or intended benefits of MAFR, as envisaged by the regulator, differentiate the South African debate on MAFR from the international debate. Internationally, the sole consideration of MAFR is whether it will improve audit quality (Fontaine et al., 2016). However, its impact on racial transformation and market concentration by the Big Four is clearly an additional concern of the South African regulator. This study therefore provides a unique contribution to research insofar as it specifically considers the impact of MAFR on South African economic transformation (affirmative action) and market concentration goals5.

1.7 THE STATED RESEARCH PROBLEM AND OBJECTIVES

The foundation of the research problem is therefore as follows:

*Auditor independence is a critical component of audit quality, which in turn is necessary for the proper functioning of capital markets, public protection*

---

5 Regulators in other jurisdictions internationally may be concerned about the high degree of concentration in the audit market by the Big Four firms (The Economist, 2018a; Velte & Stiglbauer, 2012), however South Africa is considered unique in that the IRBA’s intention is to achieve increased transformation and reduced concentration through MAFR regulations. Other jurisdictions that consider MAFR do so only as means to improve audit quality.
and economic decision-making. External audit serves as a mitigating control against risks caused by the principal-agent relationship that exists between company stakeholders (including shareholders) and appointed managers.

There is wide-scale and growing concern amongst the investing public and regulators internationally, in the wake of many examples of financial corporate misconduct, that auditors are failing to prevent and detect financial misconduct as well as failing to act as whistle-blowers in these circumstances. The primary reason for this is believed to be a lack of auditor independence and professional scepticism, caused by the length of tenure in the auditor-client relationship. Some regulators specifically identify the length of audit firm appointment, rather than audit partner appointment, as the causal factor. It is believed that audit firms are appointed for such extended periods, that a familiarity with, and dependence on, the client impairs the independence and professional judgement of the auditor.

In order to mitigate these threats to audit quality, international ethics standards have long required audit partner rotation although this has fallen short of MAFR. In June 2017 the South African audit regulator (IRBA) resolved to implement MAFR in a manner similar to that of the EU. This ruling has been the subject of much debate and disagreement from audit industry stakeholders. Another significant jurisdiction, the US, has continued to reject MAFR in favour of audit partner rotation. There is disagreement internationally among regulators as to whether MAFR, versus other alternatives, is effective on a cost-benefit analysis. Considering the unique South African socio-economic and political history of racial separation and oppression, the South Africa MAFR debate must also consider the priority of moving towards a more inclusive and racially representative audit industry. The South African audit industry comprises predominantly white male audit practitioners and is dominated by the larger audit firms.
There have been numerous calls internationally and within South Africa by accounting professionals, the business community and academics to research the necessity and potential, unintended consequences of MAFR as well as to consider alternatives. This calls for a study into the perceptions and arguments of proponents and opponents of MAFR, with specific consideration of socio-economic transformation and market concentration, as understood in a South African context.

Therefore, the stated research problem is as follows:

**Audit quality and auditor independence may or may not be a problem in South Africa and the reasons for, and intended objectives of, the implementation of MAFR may or may not be sufficient or appropriate in the South African context.**

In order to explore the research problem, the study aims to investigate the perceptions and arguments of key stakeholders in the South African MAFR debate, with specific consideration of audit quality, socio-economic transformation and market concentration factors, in order to provide recommendations on the implementation and possible unintended consequences of MAFR.

Based on the study aim, the following objectives were identified as essential to the MAFR debate in South Africa and fundamental to the logical justification of MAFR (researcher’s own deductions):

1. To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
2. To determine whether longer audit firm tenure is perceived to impair auditor independence in practice.
3. To determine whether MAFR is considered an adequate tool to improve the quality of audits.

4. To determine whether it is believed that MAFR will produce positive effects on transformation in the South African audit industry as well as lower market concentration.

5. To determine whether there are likely unintended consequences from the implementation of MAFR.

6. To recommend possible credible alternatives as well as changes to current proposals, including transitional provisions that will allow MAFR to better achieve its stated objectives.

7. To critically assess and contrast the perceptions and arguments of key stakeholder groups and individuals within the broad ambit of the South African MAFR debate.

1.8 MOTIVATION FOR THE STUDY

There have been substantial and repeated calls from academia, the accounting profession and other stakeholders alike for researchers to provide more credible and robust research on audit firm tenure, auditor independence and MAFR specifically. This was the conclusion of the comprehensive literature reviews performed by Tepalagul and Lin (2015) on auditor independence and audit quality as well as by Ewelt-Knauer et al. (2013) on MAFR. Auditing professionals in South Africa as well as stakeholders in the business community, including company executives, have called for more engagement and research on MAFR.

---

6 Refer to studies such as Ewelt-Knauer et al. (2013); Hay (2015); Knechel et al. (2013); Lennox et al. (2014); Simnett et al. (2016); Tepalagul & Lin (2015) and Velte & Stiglbauer (2012).

7 Refer to Bam (2017); Bourne (2017); Campher (2017); Harber (2017a); Harber and West (2017); Newton-King (2016); Oddy (2017); Ramon (2016), (2017); Shango (2017).
1.8.1 The call for research from academia

According to Hay (2015), although there is substantial research on auditor rotation, there is little research on the effectiveness and consequences MAFR. The rotation of audit firms is a difficult area to research because there are so few practical situations where it has been enforced (Hay, 2015). There is also the complication of needing to differentiate not only between partner and firm rotation but whether or not such rotation has been voluntary or mandatory. This makes findings analysis complicated and often these distinctions are not handled correctly when reaching conclusions on the literature (Knechel et al., 2013). As a result of these complexities, “there is no clear evidence about whether it is effective” and more research is needed (Hay, 2015:162). Bédard and Compernolle, the authors of Chapter 20 of the highly respected “The Routledge Companion to Auditing” written in 2014, note that “academic research has been unable to provide clear answers about the consequences of mandatory audit firm rotation” (Hay et al., 2014:104).

Refer to Annexure 1 for a sample of quotations from recent literature calling for additional research.

1.8.2 The call for research from the profession

The CEO of the International Federation of Accountants (IFAC) is also of the opinion that more research and clarity is needed on the link between MAFR and audit quality: “IFAC points out that evidence does not clearly support the notion that mandatory audit firm rotation will enhance audit quality. Academic research is at best mixed, and practical examples are too often confounded by other elements” (Choudhury, 2017:2).

With regards to the auditing profession, again there are repeated calls for more research on the topic of auditor independence and MAFR before regulators finalise their positions
on the topic. Auditing research focuses on practical issues and is about addressing problems in the practical field of auditing (Hay, 2017). Hay (2017:337) further explains that:

...starting from these practical issues, any research approach will appeal to auditing researchers as long as it has potential to solve the problems at hand. This is unlike the situation in some more methodologically pure disciplines. Auditing has made progress with a variety of research approaches including positive and interpretive research that uses quantitative and qualitative methods, mixed methods research and interdisciplinary research.

Hay (2017) believes that the relevance of auditing research is changing and there is an increasing use of auditing research by standard-setting bodies or professional bodies of accountants and auditors.

The largest stock exchange in South Africa, the JSE, in its official response on MAFR, was concerned that the research was insufficient to arrive at the conclusions that the IRBA had reached and that MAFR was not necessary in South Africa considering the international reputation of its audit standards. The CFO Forum, which represents the CFOs of South African exchange-listed companies, among others, also expressed this same opinion (Newton-King, 2016; Ramon, 2016). The CFO Forum was of the opinion that the IRBA had not clearly demonstrated the magnitude and extent of research conducted, and evidence supporting, the views and conclusions reached in their consultation paper (Ramon, 2017). Clearly, the professional business community in South Africa is calling for additional research on all aspects surrounding MAFR and its adoption in a South African context.

Refer to Annexure 1 for a sample of quotations from the South African auditing profession, including related stakeholders, calling for additional research.
1.8.3 ‘State of crisis’ and the expectations gap

Regarding the need for change and public opinion of the auditing profession, some academics go so far as to claim that internationally, “auditing is in a state of crisis” (Hay, 2015:160). There is international concern that auditors were not effective in preventing recent financial scandals in the global financial crisis, however, this loss of confidence in the light of corporate failures is nothing new. There have been frequent calls to reform auditing regulation after each business crisis, certainly since the days of the Great Depression in 1929 (Hay, 2015). Corporate failures are often blamed on the auditors, largely due to the ‘expectations gap’ between the level of performance expected by auditors and that expected by the users of financial statements. This expectations gap is a global concern, with many defending the auditor by claiming that “audits get noticed only when things go wrong” and the current climate results in too much “litigation and reputational risks” to justify some non-Big Four firms competing for the larger listed audits (The Economist, 2018b:1). Studies have provided some insight into the primary reasons for this expectations gap, such as the deficient performance of auditors (due to fraud or negligence), the deficient standards under which auditors work and the unreasonable expectations of the users of financial reports (Monroe & Woodliff, 1994; Porter, Högartaigh & Baskerville, 2012).

According to Hay (2015), this expectations gap, which is often unrealistic, results in demands of governments and regulators to increase regulation. As such, the audit profession becomes more and more regulated and this tension between the auditing profession, the regulators and public expectations is the reason why the audit profession is believed to be in crisis. Hay (2015) discusses current auditing areas in need of research internationally, stating that issues at the frontier of auditing research include two kinds of research questions, namely, those that emerge from current practical problems or issues, and those that stem from previous research. Hay (2015) states that a high proportion of research areas in auditing are linked to professional concerns and that these need to remain a priority. It is submitted that the issue of whether or not to pursue MAFR in South
Africa is a prime example of such an issue. This study also provides additional findings on the nature of the ‘auditing crisis’ as it may manifest itself South Africa, as well as perceptions on the ‘expectations gap’ in South Africa. This is achieved through a detailed and thorough analysis of the perceptions of these key stakeholder groups.

1.9 METHODOLOGY CONSIDERATIONS AND RESEARCH APPROACH

The sample of quotations provided in Annexure 1 establishes the call for additional research to inform South African audit regulation as well as international research. Audit professionals, business practitioners and academics alike recognise that further research on audit quality, auditor independence and auditor rotation is needed. In addition, many auditors and business practitioners in South Africa feel strongly that the IRBA did not conduct a proper due diligence or consult stakeholders sufficiently before deciding to adopt MAFR and hence a weak argument in favour of MAFR has been provided by the regulator (Harber & West, 2017). This establishes the basis for the contribution of this study on MAFR in a South African context.

International research on MAFR is limited, especially studies that analyse the impact of MAFR on jurisdictions where it has been implemented (Casterella & Johnston, 2013; Hay, 2015). Furthermore, there is very little research in a South African context documenting, analysing and critiquing the arguments for and against MAFR, especially including the uniquely South African arguments regarding the effect that MAFR may have on racial transformation and market concentration.

Regarding the type of research that is most relevant to the MAFR debate in South Africa, the following is submitted to justify the choice of the methodology of this study:

1. **A quantitative measurement of changes in audit quality (using a proxy), from implementation of MAFR, cannot be applied in South Africa.** Since South Africa has not yet formally adopted and applied MAFR, a study of the direct effects
of MAFR on audit quality, using proxies for audit quality, cannot be conducted. Therefore it is not possible to replicate the methodologies of Ruiz-Barbadillo et al. (2009); Kwon et al. (2014); Cameran et al. (2015); and Hakwoon et al. (2015), as these studies were performed in jurisdictions where MAFR had been implemented for some time and many rotations of firms had occurred. In a South African context, however, a significant contribution can be made through analysis of key stakeholder arguments for and against MAFR, attempting to understand its direct and indirect consequences, pros and cons, before full adoption.

2. **A qualitative methodology to understand perceptions and opinions of MAFR, pre-implementation, is more relevant.** The extensive literature reviews provided by Tepalagul and Lin (2015) on auditor independence, Casterella and Johnston (2013) on MAFR specifically and particularly Knechel et al. (2013) on audit quality in general, all emphasise the importance of interviews, surveys and qualitative methodologies to address key research questions in these areas. Knechel et al. (2013) point out that it is important to bear in mind that audit quality is a perceived, rather than directly observed, trait, as only cases of compromised audit quality can be studied (e.g., through the exposure of fraud). According to Knechel et al. (2013:406), “future research may benefit from the increased use of surveys and qualitative techniques that focus on stakeholders of the audit such as boards, investors, and interested third parties”.

As is explained in detail in Chapter 2, audit quality and auditor independence are difficult to define, let alone measure. In addition, many proxies and observable measures are proprietary information and unavailable to the researcher, such as audit work papers, conclusions of the engagement partner, letters to the board, regulatory review findings, personnel evaluations, etc. As such, the perceptions of various participants and stakeholders are an important research area to explore in the absence of such proprietary information (Knechel et al., 2013).
3. The perceptions of key stakeholder groups in the MAFR debate are necessary to understand and analyse (namely, audit partners, CFOs, AC members and equity fund managers). Ultimately the true impact of MAFR will be determined by the decision-making of individuals within these four stakeholder groups. CFOs manage the finances and financial reporting of the company. AC members have a statutory role to facilitate the appointment and dismissal of auditors, sign the engagement letters and formally apply their judgement to the independence and suitability of the auditor. Audit partners are responsible for the audit engagement, performing the audit itself and the self-assessment of the audit team and the audit firm’s independence from the company. Institutional investors have control of the greatest portion of shareholder funds in listed companies via pension funds, medical aid schemes, collective investment schemes and hedge funds, where third party money is invested in company equity and bonds and managed in a fiduciary capacity. The documentation and detailed and critical analysis of the individual opinions of these four stakeholder groups, using a rigorous academic methodology, is currently lacking in both international academic literature and the South African debate.

4. This study is intended to inform the regulator (IRBA) pre-implementation of MAFR. There is the possibility that further research and debate, such as this study, will inform the IRBA, ahead of adoption in 2023. The contribution of this study has the potential to inform the IRBA and other regulators of unintended negative consequences of MAFR adoption or additional changes to regulations that will allow a smoother transition to MAFR.

The broad research design of the study is that of a mixed methods approach. Qualitative and quantitative data is obtained through a content analysis of the South African professional MAFR debate and from specifically tailored surveys (questionnaires) of individual South African audit partners, CFOs and AC members of public listed companies. In addition, a fourth participant group is experienced equity fund managers from the largest asset managers in South Africa.
The study relies on an academic literature review and an understanding of the South African professional debate on MAFR, as the basis for construction of theoretical models and resultant hypotheses. An understanding of the historical professional debate was only possible from a review and summative content analysis of the IRBA communications (most notably the IRBA consultation paper) and the responses of industry stakeholders to this communication. This content analysis of the South African MAFR debate is provided in Chapter 5. From this, theoretical models are derived and hypotheses formulated, allowing for the construction of four field surveys (questionnaires) designed to collect both qualitative and quantitative data. The analysis of this data therefore uses both quantitative and qualitative techniques.

The field surveys were tested thoroughly for validity and reasonableness before being distributed with the intention of collecting both qualitative and quantitative data from the participant groups for further analysis.

Refer to Chapter 7 for a more detailed description of the research methodology employed.

1.10 ETHICAL CLEARANCE

This study employs a research methodology which requires interaction with human subjects as a source of research data, specifically using questionnaires. As such, appropriate ethical procedures and controls were implemented, which included obtaining ethical clearance for the study from the University of Johannesburg, Faculty of Economic and Financial Sciences (FEFS) Ethics Committee. This study is committed to upholding the values of freedom, democracy, equality, human dignity and respect for diversity throughout the research process, especially in the engagement with participants and the handling of the data collected. As such, the research process follows the guidelines established by the highest standards of ethical research, as required by the ethics
committee which granted the ethics approval. The rights of participants to informed consent, privacy, confidentiality and anonymity was strictly adhered to throughout the study.

Refer to the ethical clearance obtained from the University of Johannesburg, Faculty of Economic and Financial Sciences (FEFS) Ethics Committee, contained in Annexure 14.

1.11 STUDY LAYOUT

This study consists of nine chapters. Chapters 1 to 6 comprise the literature review. The primary purpose of the literature review is to establish theoretical models from which to derive and test hypotheses and achieve the study objectives identified in Chapter 1. By achieving this, the stated research problem and objectives outlined in Chapter 1 will be further established. The literature review will also identify gaps in previous research, examine other instances of similar methodologies previously used to address research questions in this subject area, and by so doing, indicate areas for further research in MAFR. Chapter 7 provides a description of the research methodology used in the empirical study, followed by a detailed analysis of the findings in Chapter 8. The final chapter, Chapter 9, provides conclusions and recommendations on the study objectives outlined in Chapter 1.

The study is divided into the following nine chapters:
Chapter 1: Introduction

In this chapter the background to the study is discussed, together with an explanation of the research problem, motivation for the study and study objectives.

Chapter 2: The audit function and the concept of audit quality

In this chapter the nature, history and purpose of the audit function is discussed, together with an explanation of the key underlying concepts central to the MAFR debate, most notably, the concepts of ‘auditor independence’ and ‘audit quality’. A review of relevant academic literature in this regard is conducted.

Chapter 3: The effect of audit tenure and rotation on audit quality

In this chapter the concepts of audit tenure and independence, together with their links to the preservation and maintenance of high quality financial reporting, are explained. Auditor rotation, as a control designed to ensure the independence of the auditor and limit threats to independence, is established. A review of relevant academic literature in this regard is conducted.

Chapter 4: The role of the audit committee in the oversight of auditor independence

In this chapter the important role of the AC, as the other party to the initiation and oversight of the external audit function, is explained and applied to the MAFR debate and auditor independence. The regulatory role of the AC as the independent mediator between management and auditor, responsible to the shareholders who formally appoint the audit firm, is discussed. A review of relevant academic literature in this regard is conducted.

Chapter 5: The South African context to the MAFR debate

In this chapter the South African-specific historical and professional context to the progression of the MAFR debate is discussed. The IRBA’s position is described, together with certain official key stakeholder responses to the IRBA’s arguments in favour of MAFR. The unique South African aspects of transformation and market concentration objectives, considered within the context of South Africa’s history of apartheid, are applied to the MAFR debate.
Chapter 6: International developments with regards to MAFR regulations

In this chapter a review of international jurisdiction positions, historic and current, with respect to auditor rotation regulations is surveyed. Emphasis is placed on the larger economic jurisdictions such as the US, the EU, China and the UK. This review of international developments adds further important context to the South African MAFR debate.

Chapter 7: Description of the empirical research methodology

In this chapter the research methodology used in the study is described and explained. Based on the literature review of Chapters 1 to 6, critical links to the study objectives were established. This chapter then proceeds, based on the literature reviewed, to develop theoretical models of the direct and indirect effects of MAFR, which are in turn used to formulate the study hypotheses. Questionnaires were developed from these study objectives and hypotheses to obtain information from four key stakeholder groups in the South African MAFR debate. These stakeholder groups relate to, and have experience with, exchange-listed companies and the audit firms accredited to provide them with assurance services. The four stakeholder groups consist of audit partners, CFOs, AC chairs and equity fund managers. The methods applied in conducting the empirical research, namely, through the completion and analysis of the questionnaires, are also explained.

Chapter 8: Findings and analysis

This chapter deals with the empirical study and its findings. This consists of the analysis of the responses received from the questionnaires sent to the four stakeholder groups. As part of the analysis of the findings, references to the preceding literature of Chapters 1 to 6 are made to link the empirical study with the literature review.

Chapter 9: Conclusions and recommendations

Based on the findings of the literature review and the empirical study, conclusions and inferences are drawn, and recommendations made, which should contribute to the MAFR debate in South Africa. Possible areas for further research are also identified.
1.12 CONCLUSION

Chapter 1 provided an introduction to the study, with a background to the concept and meaning of audit quality, together with an explanation of the link between audit quality, auditor independence and auditor rotation regulations. The context to the international and South African debate over auditor rotation generally and MAFR specifically was discussed, with particular emphasis on the IRBA’s reasoning in the June 2017 ruling in favour of the implementation of MAFR. The research problem was established, and the study objectives formalised. The chapter concluded with a summary of the study layout. This chapter provided evidence that there is a valid contribution to be made through research into the necessity for, and possible alternatives and consequences of, MAFR in the South African context.

In the next chapter the key concept of audit quality is further examined and linked to the MAFR debate.
CHAPTER 2: THE AUDIT FUNCTION AND THE CONCEPT OF AUDIT QUALITY

2.1 INTRODUCTION

In order to understand the factors that affect the MAFR debate, it is essential to start with the function of external audit and the role it plays in the proper functioning of capital markets. Accordingly, the concept of ‘audit quality’ must be understood, especially considering that the intention of any auditor rotation regulation is to improve, or at least maintain, the quality of the audit process and audit outcome (Knechel et al., 2013). Of particular importance is the investors’ perception of audit quality, which is at the heart of the auditing function since it determines the perceived reliability of financial statements. A prominent discourse in auditing research argues that audit firm rotation, rather than audit partner rotation and the prohibition of non-audit services, is needed to sustain a high level of audit quality (Aschauer & Quick, 2018). As such, the literature regarding audit quality and its application to the MAFR debate needs to be understood.

The broad definition of audit quality provided by DeAngelo (1981) is expanded on, namely, that audit quality is the likelihood or probability that the auditor will uncover a breach of statutory or regulatory requirement (especially relating to the finances of the organisation) and report this breach to the appropriate parties. Reference is made to both academic literature and professional auditing standards to broaden this understanding of audit quality.

This chapter presents a brief history of the emergence of auditing as a necessary development within commerce. The concept of audit quality is then developed, with the key factors influencing audit quality presented and explained. The importance of the independence of the auditor in the audit function can then be understood and linked to
the MAFR debate. A review of literature is then presented regarding audit quality and auditor independence.

### 2.2 DEFINITION AND HISTORY OF THE AUDIT FUNCTION

Auditing is the examination of the records and reports of an organisation (or individual) by specialists, who are independent of the preparation of those documents. It is a professional service of providing assurance, delivered by accounting experts, in response to economic and regulatory demand (Pava, 2016; Puttick & van Esch, 2004). In particular, financial auditing is the process of testing the transactions, events, conditions and account balances reported by the preparers of financial records in an organisation (usually management) in terms of pre-established auditing standards, with the overall objective of providing an opinion as to the truth or ‘fair presentation’ of that information (IFAC ISA 200, 2009). The recipients of this opinion then obtain a degree of ‘assurance’ or ‘comfort’ regarding the validity, accuracy and completeness of the financial reporting of the organisation. A company’s accountants are primarily responsible for preparing financial statements. In contrast, the purpose of the auditor is to express an opinion on the assertions of management found in financial statements. The auditor arrives at an objective opinion by systematically obtaining and evaluating evidence in conformity with professional auditing standards (Puttick & van Esch, 2004). Compliance with these professional standards will result in a high-quality audit and the compliance of the financial statements with applicable accounting standards, such as the International Financial Reporting Standards (IFRS). Therefore, audits of company financial statements increase the reliability of financial information and consequently improve the efficiency of capital markets (Hoogervorst, 2012b; Knechel et al., 2013; Pava, 2016).

The provision of these external assurance services in the context of a company is therefore an activity of public protection, and is described as such in the IFAC Code of Professional Conduct (IFAC Code, 2016). In the eyes of company stakeholders, who rely on the financial statements, which includes shareholders, providers of credit, suppliers,
tax authorities, regulators, trade unions, etc., the audit function provides the credibility and assurance as to the fair presentation of the company’s financial reporting. This financial information informs a wide variety of economic and social decision-making, depending on the needs of each particular stakeholder, and as such, the quality of the financial statements is important (Fontaine et al., 2016; Hakwoon et al., 2015).

2.2.1 History of accounting and auditing

According to Pava (2016), the practice of accounting for transactions, verifying and communicating economic information dates back to ancient times and is present in most, if not all, societies. Accounting historians debate whether it is appropriate to describe the history of accounting as progressive and evolutionary, which implies a state of gradual improvement over time (Napier, 2001). The reason for the debate, according Napier (2001), is that accounting is a social phenomenon and hence, perhaps the concept of ‘progress’ and ‘improvement’ is problematic as it requires making a value judgement. As accounting has become an object of study, less as a technical and more as a social phenomenon, consensus as to what constitutes an improvement becomes harder to secure. There is no debate, however, that accounting, and its related discipline of auditing, is continually subject to change in an ever more complex business world.

Accounting was part of the development of cultures from ancient times, with historians finding evidence in the distant past of not only accounting but also common auditing practices such as dual custody of assets, provision of assurance by opinion and segregation of duties, among others (Pava, 2016; Puttick & van Esch, 2004). There is evidence of government accounting systems in China during the Zhao dynasty (circa 1122-256 BC) which included the audit of official departments. As early as the 5th and 4th centuries BC, both the Romans and Greeks devised careful systems of checks and counterchecks to ensure the accuracy of their reports. Much later in Europe, Italian city-states created merchant wealth based on the creation of double-entry accounting. In
English-speaking countries, records from the Exchequers of England and Scotland (circa 1130 AD) have provided the earliest written references to auditing (Pava, 2016; Puttick & van Esch, 2004).

Considering even further back in history, as long as owners of property have appointed stewards, there has been the need for the practices of both accounting and auditing. The steward, in charge of cattle, goods and other forms of wealth, would need to occasionally produce an account to the master or owner, reciting from simple memory what goods were acquired, what was disposed of and any events or conditions that affected that store of wealth. The master was the listener, the auditor. Thus the word ‘auditor’ (derived from the Latin audire, meaning to hear) acquired a secondary meaning: “one who satisfies himself as to the truth of the accounting of another” (Puttick & van Esch, 2004:12).

Despite these early developments, it was the formation of limited liability, joint-stock companies in the late 19th century that elevated the urgency and necessity of good quality assurance services (Giroux, 2017; Napier, 2001; Pava, 2016). With the innovation of the joint-stock company, whose managers were not necessarily the company’s owners, and the growth of industry and transactional volumes, auditing became a necessary part of modern business (Napier, 2001; Pava, 2016). Since the owners of the corporations were not the ones making the day-to-day business decisions, they demanded assurances that the managers were providing reliable and accurate information. This was the start of the corporate agency problem, the divide between owners and managers of companies.

According to the IASB Chairman, Hans Hoogervorst (2012:2), “Sir David Tweedie, my predecessor as Chairman of the IASB, used to say that it was the job of accounting to keep capitalism honest… It is an essential public good for market-based economies.” Owners and other stakeholders of companies need assurance regarding the fair presentation of financial reports that present the results of economic activity in the business. The numbers need to be trusted so as to encourage further participation by
stakeholders in the business venture or in the negotiation of participants in transactions. Auditing is an integral part of capital markets and audit quality has received much attention in the wake of several high-profile accounting scandals because the investing public recognises this fact (Knechel et al., 2013).

2.2.2  A response to the agency problem

Classical agency theory, as described by Jensen and Meckling (1976) and others, forms the basis of this study on MAFR. According to Bosse and Phillips (2016), agency theory is undeniably among the more dominant theories of economic organisation and management. As such, agency theory models have been applied in various fields in finance and economics, including financial contracting, regulation, public procurement, monopolistic price-discrimination, job design, internal labour markets, team production and many others (Eisenhardt, 1989; Gilson & Gordon, 2013).

Related to agency theory and specifically applicable to companies, a significant issue to consider with respect to accounting and assurance is what is known as managerial ‘short-termism’. Short-termism could be defined as the pursuit of short-term profits by managers in order to meet or beat short-term performance targets (Porter, 1992), often resulting in the destruction of longer term value creation for shareholders and other stakeholders in the company (Martin, 2015; OECD, 2014; Pozen, 2015). It could also be described as an excessive focus of decision-makers on short-term goals at the expense of longer-term objectives, resulting in insufficient attention being paid to the strategy, fundamentals and the long-term value creation of a firm or an institution (EY, 2014). According to Pozen (2015), there has been a growing dissatisfaction internationally against corporate short-termism, namely, the concentration of company boards, especially large public interest and listed entities, on short-term profit objectives at the expense of long-term value and wealth creation. This excessive focus on short-term profit maximisation has often been the incentive behind accounting manipulations and fraud by management (Pozen, 2015).
Again, this highlights the importance of the audit function as a key preventative measure against short-termism turning into financial fraud.

Considering agency theory and the vested interests of company executives in particular, it is understandable why corporate short-termism exists and why it needs to be addressed. Management have goals that tend to be unaligned with other stakeholders, such as job security, salary increases, performance bonuses and share options, to name but a few. Management also have different aversion levels to risk in the organisation. The most common agency relationship, of course, is between shareholders (principal) and management, specifically the company executives (agents) (Bosse & Phillips, 2016; Eisenhardt, 1989).

The problem arises whenever one party (principal) employs another (agent) to create value. The essential features of the agency problem are that the interests of the principal and agent diverge and the principal has imperfect information about the agent’s contribution (Bosse & Phillips, 2016; Eisenhardt, 1989; Watts & Zimmerman, 1983). These features define the problem, and the problem results in costs and inefficiencies ultimately borne by society, one principal at a time. Agency theory therefore draws attention to certain behaviours of management and boards that, in aggregate, create losses for society (Bosse & Phillips, 2016; Gilson & Gordon, 2013). The theory emerged in the 1960s and 1970s from the combined disciplines of economics and institutional theory when economists explored risk-sharing among individuals or groups (Eisenhardt, 1989). Academics were concerned with resolving two key problems that can occur in agency relationships between principal and agent. The first arises when the desires or goals of the principal (e.g. a shareholder who desires long-term value creation) and an agent (e.g. management who want to maximise their current year performance bonus) conflict and secondly it is difficult or expensive for the principal to verify what the agent is actually doing (Eisenhardt, 1989).
The principal and the agent may prefer different courses of action because of differing risk preferences, for example, the shareholder wants to act more conservatively to preserve and maintain operations sustainably over the long-term, whereas company management are incentivised to take speculative bets in their decisions on the chance that profits in the period could be maximised, in order for them to earn higher bonuses or build their status and reputations. This pursuit of personal objectives by managers can incentivise accounting fraud and financial mismanagement. A common example of such accounting manipulation is the overstating of company revenues, understating liabilities or ‘massaging profits’ using discretionary accruals. These are considered to be some of the most common types of accounting manipulations performed by management (Callen & Fang, 2013; Pozen, 2015).

The role of the auditor in ‘keeping capitalism honest’ and allowing stakeholders to identify and address short-term abuses by management as well as simple poor financial management, is crucially important (Bosse & Phillips, 2016; Eisenhardt, 1989; Gilson & Gordon, 2013; Pozen, 2015). The very objective of the auditor is to “obtain reasonable assurance” about whether the financial statements reported by the company to stakeholders are “free from material misstatement, whether due to fraud or error” and to communicate such findings and opinions (IFAC ISA 200, 2009:para. 11). The auditor is therefore a key control in the production of high quality financial information in capitalist societies. As such, the auditor is required to be both competent for the task as well as unbiased and independent from management (Tepalagul & Lin, 2015). As will be explained below, the capabilities and the independence of the auditor are necessary characteristics for this assurance function to be effective.
2.2.3 The auditor as agent

Following from the discussion above, the external audit function is designed as a solution, or at least a preventative and detective control, mitigating the agency problem between shareholder and management. However, if viewed slightly differently, even the auditor can be understood as an agent themselves, as opposed to the intermediary addressing the principal-agent dilemma in an organisation. If, as simple agency theory implies, principals do not trust agents to provide them with reliable and relevant information, then they will hire in external experts, who are independent of these agents. This, however, introduces the concept of auditors as agents of principals, which leads to new concerns about trust, threats to objectivity and independence (ICAEW, 2005).

Seen in this light, auditors act as agents to principals when performing an audit and this relationship therefore brings with it similar concerns about trust and confidence as with the owner-manager relationship. This prompts some to question who is auditing the auditor. Agents (either management or auditors), according to the simple agency model, may be untrustworthy. Auditors, like all parties that engage with a company, have their own interests and motives to consider, especially considering that audit firms are businesses, with profit incentives and employee salaries to pay. Auditors may also be risk-averse and conscious of their potential legal liability, thereby introducing risk management processes that limit the scope of their work and caveats in their reports which principals (company directors and shareholders, for example) may find frustrating (ICAEW, 2005). In the mind of shareholders and non-executive directors, auditor independence from management, as well as the capabilities of the auditor, are of great importance to ensure a high quality audit (Daniels & Booker, 2011; Tepalagul & Lin, 2015). However, an audit necessitates a close working relationship with company management. The fostering of this close relationship (familiarity threat) has led shareholders to question the perceived and actual independence of auditors and to demand tougher controls and standards over independence to protect them. Auditor
rotation, including MAFR, are examples of such controls (Fontaine et al., 2016; ICAEW, 2005; Jackson et al., 2008).

2.3 THE CONCEPT OF AUDIT QUALITY

Audit quality is a concept at the heart of the MAFR debate. The primary reason for the implementation of any form of auditor rotation is always to safeguard the independence of the auditor from company management and any threats to such independence that could develop over time (Aschauer & Quick, 2018; Casterella & Johnston, 2013; Fontaine et al., 2016). Impaired auditor independence leads to the risk of impaired audit quality.

According to Knechel et al. (2013), audit quality as a concept is much debated but little understood:

Despite more than two decades of research, there remains little consensus about how to define, let alone measure, audit quality… perception of audit quality can depend very much on whose eyes one looks through. Users, auditors, regulators, and society - all stakeholders in the financial reporting process - may have very different views as to what constitutes audit quality, which will influence the type of indicators one might use to assess audit quality (Knechel et al., 2013:385).

Knechel et al. (2013:386) go on to illustrate the differing viewpoints with respect to audit quality, from the perspective of various company stakeholders:

- The user of financial reports may believe that high audit quality means the absence of material misstatements;
- The auditor conducting the audit may define high audit quality as satisfactorily completing all tasks required by the firm’s audit methodology;
- The audit firm may regard a high-quality audit as one which can stand up to challenge in an inspection or court of law;
- Regulators may view a high-quality audit as one that is in compliance with professional standards; and
Finally, society may consider a high-quality audit to be one that avoids economic problems for a company or the market. In the end, different views suggest different metrics.

Audit quality is accordingly problematic to define and measure. Knechel *et al.* (2013) explain that there are a number of definitions of audit quality in literature that reference the responsibilities of the auditor in terms of the audit process or the goal of the audit. It is submitted that this is perhaps the best means of defining audit quality. Therefore, in order to proceed, a helpful definition is provided, even if not all-encompassing. As discussed in Chapter 1 and used by many studies on audit quality, DeAngelo (1981) provides a useful, broad definition of audit quality as the probability that:

- The auditor will uncover a breach of statutory or regulatory requirements (particularly financial in nature); and
- Report the breach to the appropriate parties.

International audit standards explain the objective of the auditor as being “*to obtain reasonable assurance*” about whether the financial statements reported by the company to stakeholders are “*free from material misstatement, whether due to fraud or error*” and to communicate such findings and opinions to the users of the financial statements and relevant regulatory bodies (IFAC ISA 200, 2009: para. 11). The auditor is therefore a key control in the production of high-quality financial information in capitalist societies and the end result of an audit is the reporting of findings to others. This reporting happens primarily through the audit report produced by the auditor that accompanies the audited financial statements, but also includes other reporting channels such as reports provided to management, to the AC or to regulators regarding breaches of ethical or statutory

---

8 This is a useful definition that has been adopted by numerous recent studies on the topic such as those of Ball, Tyler & Wells (2015), Fontaine *et al.* (2016), Hakwoon, Hyoik & Jong Eun (2015), Jackson, Moldrich & Roebuck (2008), Kwon, Lim & Simnett (2014), Lennox *et al.* (2014), Lu & Sivaramakrishnan (2009) and Tepalagul & Lin (2015). The definition is important because it identifies the purpose of auditing.
requirements by the organisation. Significant breaches uncovered by the auditor concerning the fair presentation of the financial position, financial performance and underlying cash flows of the organisation, in terms of the established accounting frameworks, need to be reported in the auditor’s report that accompanies the release of the audited financial statements. In addition, breaches of regulatory requirements, which include fraud and gross mismanagement of the organisation, need to be reported to the appropriate regulators.

A review of empirical research over a 25-year period by Francis (2004), concerning US listed companies, indicated that outright audit failure rates are infrequent – less than 1% annually. In addition, outright audit failures with material economic consequences were found to be very infrequent. This evidence does indicate that audit quality may be high in those cases reviewed, however, Francis (2004) acknowledged the difficulty inherent in judging what is an optimal level of audit quality. This is a problem confronting the researcher in analysing audit quality, but is of particular concern for the auditor themselves – how can the auditor accurately judge whether they have performed ‘too little’ or ‘too much’ auditing?

2.3.1 South African regulatory framework and reporting obligations

In South Africa, organisations, particularly companies, considered by regulation to have a significant influence on the public due to the nature and size of their operations, are termed ‘public interest entities’. Auditors of these companies apply the IFRS in the preparation of financial statements as well as the International Standards on Auditing (ISAs) and International Standard on Quality Control (ISQC), which outline the standards for the performance of the audit. In addition, the Code of Ethics for Professional Accountants, as produced by the IESBA and adopted in South Africa, provides regulation and guiding principles on professional conduct for auditors. These are the most commonly adopted standards internationally and are produced by bodies that fall under the auspices
of the IFAC. In addition, there are national regulations and legislation applicable in South Africa that impact the audit process, such as rulings by the IRBA, the Auditing Profession Act (No. 26 of 2005) and the Companies Act (No. 71 of 2008).

These frameworks, regulations and legislation, as identified above, primarily comprise the IFRS, the ISA, ISQC 1, IRBA regulations and pronouncements, the Code of Ethics for Professional Accountants, the Auditing Profession Act (No. 26 of 2005) and the Companies Act (No. 71 of 2008). The primary purpose of these frameworks, regulations and legislation is to guide the audit partner and the audit firm to perform an audit of an organisation in such a manner as to be deemed in compliance with applicable professional standards in order to achieve high-quality audit outcomes. The auditor is thereby required to provide a report on the outcome of the audit to stakeholders of the organisation (the audit report), which must be published in the annual report of the organisation, together with the annual financial statements. The ISA defines the overall objective of audit opinion, contained in this audit report, as providing users of the report with “reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error” (IFAC ISA 200, 2009:74). This outcome of the audit function thereby provides assurance to users of the organisation’s financial statements that they are ‘free from material misstatement’ and are therefore fairly presented and can be relied upon for decision-making and analysis.

Furthermore, in terms of the audit of a company and the requirements of these frameworks, regulations and legislation, the auditor has a responsibility to report beyond the requirements of the audit opinion and the audit report. This is evidenced by the following reporting obligations:

- The audit report and accompanying opinion to shareholders and other stakeholders regarding whether fair presentation of the financial records was achieved (required by the Companies Act, the IFRS and the ISAs).
• Issues of non-compliance with applicable laws and regulations to those charged with governance, namely, the board and AC (required by the Auditing Profession Act and the ISAs).

• Unlawful acts or omissions committed by company management to the IRBA and other authorities (required by the Auditing Profession Act and the ISAs).

• Issues of deficiencies in internal control and all significant matters uncovered in terms of the audit to management and those charged with governance, namely, the board and AC (required by the ISAs).

The above reporting obligations of the auditor illustrate not only the role and function of audit but its importance in ‘keeping capitalism honest’ and facilitating trust in capital markets (Hoogervorst, 2012b; Pava, 2016; Puttick & van Esch, 2004). In addition, management and those charged with governance are better equipped to make financial, operational and strategic decisions within the organisation. As is also clear from the above, the auditor has a significant and important obligation to communicate breaches of financial reporting requirements as well as any significant areas of non-compliance with laws and regulations that are binding on the company, as the auditor may uncover them during the course of the audit engagement. It would therefore not be incorrect to consider the auditor as a means of discouraging fraud in an organisation (preventative anti-fraud control), as well as a whistle-blower where fraud has occurred (detective anti-fraud control). Considering the above, there are numerous reporting mechanisms by which the auditor is obligated to report the outcome of audit findings, providing various stakeholders with a degree of comfort that management is not committing fraud. This further illustrates the auditor’s role as public protector in capitalist markets.

2.3.2 Critical links to the empirical study

From the discussions above, the following critical aspects of the audit function and audit quality were established:
The function of external audit is an important activity in protecting the public from the financial and social consequences of corporate fraud and misconduct.

The quality of the audit is difficult to define, let alone measure, yet regulation and professional standards attempt to ensure its high standard.

Regulations and professional standards are partly designed to safeguard audit quality, which can be defined as the probability that the auditor will detect and then report areas of fraud, financial misstatement and non-compliance with laws and regulations.

Management and those charged with governance can use the work of auditors to more effectively manage the organisation.

The above critical aspects are linked to the following study objective:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.

Refer to the model of direct and indirect consequences of MAFR in Chapter 7 and their hypothesised impact of audit quality.

Auditor independence is particularly relevant to Hypotheses 1, 2 and 3. Audit quality is relevant to all hypotheses.

2.4 LINK BETWEEN AUDITOR INDEPENDENCE AND AUDIT QUALITY

MAFR is a regulatory tool intended to restrict the length of the auditor-client relationship so as to safeguard the independence of the auditor. The primary reason for the implementation of auditor rotation is to safeguard the independence of the auditor from company management and threats to such independence that can develop over time (Aschauer & Quick, 2018; Casterella & Johnston, 2013; Fontaine et al., 2016). As such, the link between auditor independence and audit quality must be established as it is
central to the rationale of auditor rotation regulation. It is important at this stage to define and explain the concept of auditor independence and establish its importance as a characteristic of the auditor for the purposes of producing good quality audit outcomes.

2.4.1 Independence of mind versus independence in appearance

The IFAC Code of Ethics for Professional Accountants is an internationally recognised code of professional conduct. This code is adopted in South Africa and consistent with the IRBA Rules Regarding Improper Conduct and the IRBA Code of Professional Conduct, which is binding on registered auditors in South Africa. This code defines independence in two parts, namely ‘Independence in Mind’ (in fact/reality) and ‘Independence in Appearance’ (perception). This distinction is important in the MAFR debate because these concepts of audit quality and auditor independence are not just matters of fact but also concepts perceived in the mind of audit participants (Chi, Huang, Liao & Xie, 2009; Knechel et al., 2013). In addition, the role of audit regulators as well as the impacts that audit regulators may have on audit quality (positively or negatively), is largely a result of subjective assessments and perceptions of states of affairs in the audit market (Knechel et al., 2013). As such, any thorough analysis of auditor rotation needs to include considerations of stakeholder perceptions of key issues impacting the discussion.

Section 290:6 of the IFAC Code of Ethics for Professional Accountants explains that independence in the context of the audit comprises:

**a) Independence of Mind**

This refers to the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism. It therefore refers to the fact of independence, rather than the perception thereof.
**b) Independence in Appearance**

This refers to the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm’s or audit team member’s integrity, objectivity or professional scepticism have been compromised. It therefore refers the perception of independence in the minds of parties reliant on the audit outcome.

(IFAC Code, 2016)

**2.4.1.1 Professional scepticism**

From the above definitions provided in the IFAC Code of Ethics for Professional Accountants, the concept of professional scepticism is important to a proper understanding of independence. The international auditing standards define professional scepticism as an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud and a critical assessment of audit evidence (IFAC ISA 200, 2009). As explained by the International Auditing and Assurance Standards Board, professional scepticism is important in maintaining audit quality and is becoming increasingly important in today’s complex business world:

> The importance of professional scepticism is underscored by the increasing complexity of business and financial reporting, including the greater use of estimates and management judgment, business model changes due to technological developments, and the fundamental reliance of the public on dependable financial reporting. It lies at the heart of a quality audit (IAASB, 2017:3).

Aschauer et al. (2017) explain that auditors are obliged to maintain their professional scepticism, which they explain as being the propensity of an auditor to defer drawing conclusions until the evidence provides sufficient support for one alternative/explanation over others. If the auditor does not maintain their professional scepticism or is not independent of the client due to bias in the client’s favour, there is a risk of two negative
outcomes with respect to audit quality and either of them represents an audit failure or lack of audit quality. These two outcomes are as follows:

- The auditor may not seek sufficient (quantity) and appropriate (quality) audit evidence upon which to form their opinions on accounting, fraud or financial reporting matters; and/or
- The auditor may not draw reasonable conclusions from the evidence obtained regarding accounting, fraud or financial reporting matters.

Independence in mind is therefore a question of reality (fact), i.e. whether the auditor, considered alone, is acting and thinking in an independent manner, with the required degree of professional scepticism towards the client.

Independence in appearance relates to perception. It asks the question: ‘Does the auditor appear, to reasonable and informed outsiders, by the way the auditor conducts themselves, to be independent of the client?’ It is possible for an auditor to be independent in reality (fact/mind) yet conduct themselves in such a manner that a third party can justifiably question their independence (appearance). As will be established below, and as was discussed in Chapter 1, independence of the auditor is a key requirement for ensuring a high degree of audit quality. It can be concluded that ‘independence in mind’ impacts audit quality and ‘independence in appearance’ impacts perceptions about audit quality.

### 2.4.1.2 The expectation-performance gap

As described in section 1.8.3, organisational ‘outsiders’, who place reliance on the financial reporting and financial well-being of the organisation, often have different expectations concerning auditor performance, referred to as the audit expectation-performance gap (Hay, 2015). Stakeholders, especially the public, often criticise external
auditors for not preventing corporate misconduct and this has led to a noticeable loss of confidence in the audit function. This is currently a global concern (Porter et al., 2012; The Economist, 2018b). However, audit quality is a ‘perceived’ characteristic in the mind of a stakeholder, rather than something objectively measured, with different stakeholder groups having different expectations of the auditor (Knechel et al., 2013). In addition, the credibility of the financial governance and reporting of the organisation (again ‘perceived’) is necessary to promote financial decision-making and the smooth functioning of capital markets. According to Porter et al. (2012:102), investor trust in the auditor “has serious ramifications for the well-being of national and international capital markets and the allocation of scarce economic resources”. Hence, the independence of the auditor, as ‘perceived’ by stakeholders (independence in appearance), is an important aspect of the MAFR debate. The public, including the investing public, need to be assured of the independence of the auditor, in as much as the auditor needs to be independent in fact. This explains the IRBA’s argument in favour of MAFR that it is necessary to restore public confidence in the profession (IRBA, 2017c).

2.4.2 Establishing the importance of auditor independence

In addition to auditing regulations and standards, research has long established over time that independence from the client, especially the executive management of the organisation, is a necessary and fundamentally important characteristic of the auditor in order to safeguard audit quality. Figure 1.1 in Chapter 1 illustrates this relationship diagrammatically. As per Figure 1.1, it is important to note that independence is considered a necessary condition for the production of a quality audit, but it is not a sufficient condition. As per the literature review of Tepalagul and Lin (2015) that produced the model in Figure 1.1 as well as the reviews of literature performed by Cameran et al. (2005), Casterella and Johnston (2013) and Knechel et al. (2013), audit quality is influenced by both the capabilities and the independence of the auditor. However, the

---

Refer to research such as Ball et al. (2015); Bergner (2011); Casterella & Johnston (2013); Daniels & Booker (2011); Fiolleau et al. (2013); Hakwoon et al. (2015); Jackson et al. (2008); Kwon et al. (2014); Marx (2009b); Ruiz-Barbadillo et al. (2009); Tepalagul & Lin (2015)
purpose of this section is to understand the impact of independence on audit quality, which is central to the MAFR debate. This logical link provides the rational basis for auditor rotation regulations.

If auditors do not remain independent in mind (i.e. in fact), they might be less likely to report material breaches and irregularities (via their audit opinion and/or to regulatory authorities). If the auditors are not considered to be independent by the users of the financial statements (independence in appearance), then regardless of whether they are independent in mind, the quality of the audit will be questioned. A lack of independence may reduce the likelihood that the auditor will insist that financial statements be prepared to their satisfaction, in accordance with applicable financial reporting frameworks and principles, thereby impairing audit quality (Carey & Simnett, 2006; Hay, 2015; Tepalagul & Lin, 2015). Therefore, the value of auditing services depends upon the fundamental assumption that public accountants are independent of their clients. In the reasoning of Shockley (1981), which is consistent with later studies as well as international auditing standards and the IFAC code, in order for audits to provide value to capitalist markets, the auditors need to be independent both in fact and in perception.

### 2.4.3 Critical links to the empirical study

From the discussions above the following critical aspects of auditor independence were established:

- Independence is considered a necessary condition for the production of a quality audit but it is not, considered alone, sufficient to ensure a high-quality audit as the capability of the auditor is another key influencing factor.
- Both the concepts of independence and audit quality involve subjective assessments and are subject to the perceptions of audit market stakeholders.
- The concept of independence needs to be understood in two parts, namely, ‘Independence in Mind’ and ‘Independence in Appearance’. Both parts of auditor
independence are to be considered in the MAFR debate. The auditor needs to be independent in fact and in perception.

- The audit characteristic of professional scepticism is also important to the MAFR debate and is influenced by the auditors’ independence. Professional scepticism refers to a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

The above critical aspects are linked to the following study objectives:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
- To critically assess and contrast the perceptions and arguments of key stakeholder groups and individuals within the broad ambit of the South African MAFR debate.

Refer to Hypotheses 1, 2 and 3

Hypothesis 1: Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.

Hypothesis 2: Stakeholders perceive MAFR not to have a significant impact on auditors’ independence and professional scepticism.

Hypothesis 3: Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.
2.5 PROBLEMS WITH MEASURING AUDIT QUALITY

Considering that MAFR is intended to increase auditor independence and thereby improve the quality of audits, it stands to reason that there needs to be an objective and defensible method of measuring the quality of the audit. This is to establish that audit quality is declining and hence may require regulatory intervention, as well as to determine whether MAFR or audit partner rotation have resulted in an increase in audit quality over time once implemented.

It is submitted that the above two assertions need to be established in the MAFR debate in order for the efficacy of MAFR (or partner rotation) to be established. This is what some research on MAFR has attempted to do, namely, measure the changes in audit quality over periods of auditor rotation. However, this type of study is not without significant limitations, largely due to the difficulty in the definition and measurement of audit quality.

A significant problem identified by researchers is that audit quality as a concept is much debated, little understood and difficult to even define:

> Despite more than two decades of research, there remains little consensus about how to define, let alone measure, audit quality. Perception of audit quality can depend very much on whose eyes one looks through. Users, auditors, regulators, and society - all stakeholders in the financial reporting process - may have very different views as to what constitutes audit quality, which will influence the type of indicators one might use to assess audit quality (Knechel et al., 2013: 385-386).

Audit quality as a concept is thus difficult to define and measure (Casterella & Johnston, 2013; Knechel et al., 2013) and this is a primary reason why standard-setters (such as the IFAC) choose to provide a framework and not a definition of audit quality (Hay, 2015). As discussed in section 2.3, various company stakeholders have differing needs with respect to audited financial information and will therefore have differing opinions as to what constitutes a ‘high-quality audit’. Further, audit quality is not usually a visible
characteristic and there are incentives for auditors to provide the minimum level of quality that is acceptable rather than to try to excel (Hay, 2015). However, as stated above, in order to determine the impact on audit quality of a regulation designed to improve audit quality, researchers need to find methods of measuring audit quality. Therefore, measuring audit quality is fundamentally important to auditor rotation research, including MAFR. Various methods of measuring audit quality have been attempted, as will now be discussed.

2.5.1 Using audit outcomes as a proxy of audit quality

A common approach for researchers attempting to measure audit quality is to use a proxy measurement for an audit outcome, however, there are other methods available which do not focus on the outcome of the audit. A proxy is an indirect measure of the desired outcome which is itself strongly correlated to that outcome. It is commonly used when direct measures of the outcome are unobservable and/or unavailable. Various proxies for audit quality have been adopted by researchers in order to attempt to measure audit quality, with varying degrees of success, and all show inherent limitations (Fontaine et al., 2016; Hakwoon et al., 2015; Knechel et al., 2013). In terms of measuring audit outcomes, according to Knechel et al. (2013), the literature has traditionally viewed the presence of higher audit quality in terms of lacking certain negative outcomes, such as restatements or litigation, or having certain positive outcomes, such as issuing going concern opinions when merited. A summary of recent attempts to measure audit quality using measurable audit outcomes is shown below in Table 2.1 below.
Table 2.1: Audit quality proxies from literature

<table>
<thead>
<tr>
<th>Audit Quality Proxy</th>
<th>Description (Rationale)</th>
<th>Limitation as a Proxy</th>
<th>Examples in the Literature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting restatements. (Negative outcome)</td>
<td>Higher audit quality is associated with a lower likelihood of accounting restatements.</td>
<td>The sample sizes of such restatements is small.</td>
<td>Laurion, Lawrence, &amp; Ryans (2017): Partner rotation study in US context using accounting.</td>
</tr>
<tr>
<td>Litigation against the auditor. (Negative outcome)</td>
<td>The lower the quality of audit work the greater the likelihood of the auditor being sued.</td>
<td>The auditor is only taken to court in cases where there is strong evidence of negligence or fraud. There are a small number of instances (low small size). A majority of cases are settled outside of court and therefore kept confidential.</td>
<td>None, due to the limitations inherent in data collection.</td>
</tr>
<tr>
<td>The accuracy of the audit report, usually measured through the use of going concern opinions or modified audit opinions. (Positive outcome)</td>
<td>A higher quality audit will result in more accurate audit opinion and report. A high quality audit will raise going concern opinions before bankruptcy, especially in the preceding year. High quality audits are associated with a greater likelihood of modified audit opinions.</td>
<td>Studies show that 40-50% of bankrupt companies in the US do not receive going concern opinions and 80-90% that do receive such opinion do not enter bankruptcy in the following year (Knechel et al., 2013). The content of the report is limited; i.e. it is a simple pass/fail report, providing limited communicative value.</td>
<td>Firth, Rui, &amp; Wu (2012): Partner rotation study in Chinese context using modified audit opinions. Hakwoon et al. (2015): MAFR study in Korean context, using the propensity to issue first-time going-concern audit opinions. Ruiz-Barbadillo, Gómez-Aguilar, &amp; Carrera (2009): MAFR study using going-concern audit opinions. Jackson, Moldrich, &amp; Roebuck (2008): MAFR study in Australian context using both propensity to issue a going-concern report and the level of discretionary accruals.</td>
</tr>
<tr>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Regulatory reviews, internally by the firm, or externally by the regulator.</td>
<td>Perhaps the most direct outcomes of audit quality are the results of regulatory reviews of audit firms.</td>
<td>Internal reviews tend to yield positive results and regulatory (external) reviews, negative results. Peer review seldom raises a qualification or failed review. Review outcomes are kept confidential.</td>
<td></td>
</tr>
</tbody>
</table>
As can be seen in Table 2.1, discretionary accruals and the use of going concern opinions are the most common audit quality proxies used in auditor rotation studies. The outcome of an audit is uncertain and unobservable. As such, researchers turn to indirect but measurable proxies for audit outcomes, despite the limitations of such measures. As a necessity therefore, in the absence of a better methodology, they tend to identify what high audit quality ‘is not’ (e.g. errors and deficiencies) rather than what it ‘is’ (Knechel et al., 2013). Audit quality is difficult to define and measure and it is a significant limitation in auditor rotation research.

In South Africa, research similar to the studies in Table 2.1 is not possible, considering that MAFR will only be implemented in 2023 according to the June 2017 ruling on MAFR by the IRBA (IRBA, 2017b). A jurisdiction must have already implemented MAFR and had time for its effects to be measured by these audit quality proxies. This is the reason why this study addresses the study objectives through a mixed methods approach that relies on interviews and surveys, similar to the methodology employed by Daugherty, Dickins, Hatfield and Higgs (2012) in a US context. Refer to Chapter 7 for the research methodology.

2.5.2 Market perceptions of audit quality

The framework in Figure 1.1 for assessing audit and financial reporting quality, provided by Tepalagul and Lin (2015), illustrates the importance of both actual and perceived quality. Actual quality is a question of fact whereas perceived quality is a question of opinion, yet both aspects are important in the study of audit quality. The distinction between independence in mind versus independence in fact has been established above. Here a similar distinction is made between actual and perceived audit quality. The role of audit regulators as well as the impacts that audit regulators may have on audit quality (positive or negative), is largely a result of subjective assessments and perceptions of states of affairs in the audit market (Knechel et al., 2013). As such, any thorough analysis
of auditor rotation needs to include considerations of stakeholder perceptions of key issues affecting the discussion.

2.5.2.1 **Differing incentives and perceptions of audit quality**

Auditors, clients and the market are likely to have different incentives with respect to their vested interests in the organisation. In addition, there is a considerable degree of information asymmetry with respect to financial information about the organisation. These factors result in differing perceptions of auditor independence, auditor capabilities and their effects on quality (Knechel et al. 2013; Tepalagul & Lin, 2015). Of particular importance is the perception in the mind of the investing public and this is a key argument used by the IRBA in their justification of the need for MAFR in South Africa (IRBA, 2016e). Knechel et al. (2013) point out that it is important to bear in mind that audit quality is a perceived, rather than directly observed, trait. The perception of audit quality by the investing public influences the trust that is placed in auditing financial information for the purposes of the proper functioning of capital markets and economic decision-making (Aschauer et al., 2017; Hay et al., 2014; Hoogervorst, 2012b; Knechel et al., 2013).

The literature provides evidence of the importance of the market’s perception of audit quality. Evidence shows that the market rewards companies that employ better auditors and auditor reputation matters (Knechel et al., 2013; Skinner & Srinivasan, 2012). Clients of large-tier firms (‘Big N’) or industry specialist auditors enjoy lower costs of debt financing (Causholli, Knechel, Lin & Sappington, 2013; Karjalainen, 2011; Knechel et al., 2013), lower costs of equity capital (Azizkhan, Monroe & Shailer, 2010; Knechel et al., 2013), higher earnings response coefficients (Balsam, Krishnan & Yang, 2003; Knechel et al., 2013), and lower levels of initial public offering (IPO) underpricing (Chang, Gygax, Oon & Zhang, 2008). These results are supported by De Franco, Gaviouis, Jin and Richardson (2011) who show that employing a Big Four auditor is associated with higher proceeds from sales of controlling interests in US private firms. Similarly, Fan and Wong
(2005) show that East Asian audit clients with a 'Big N' auditor receive smaller share price discounts when the clients have agency problems. However, not all country-level studies find a positive Big Four effect on accounting quality or associated Big Four premium (Bauwhede & Willekens, 2004; Langendijk, 1997).

The above literature review shows that there are different stakeholder incentives and perceptions with regards to audit quality. Therefore this study attempts to understand the perceptions of different stakeholders with regards to the South African MAFR debate. As explained above, in the absence of being able to measure the impact of MAFR in South Africa using proxies for audit quality, it is important to focus on the various perceptions of audit market participants.

2.5.3 Critical links to the empirical study

From the discussions above the following critical aspects regarding the measurement of audit quality were established:

- It is important to identify and measure audit quality in MAFR research as the purpose of MAFR is to improve auditor independence (and professional scepticism) and thereby safeguard audit quality.
- Whether or not audit quality is a concern and whether or not MAFR is effective in improving audit quality needs to therefore be established.
- Audit quality is difficult to define, let alone measure. There are various measures of audit quality in the literature.
- Market perception of audit quality promotes trust in the credibility of financial information and proper functioning of capital markets.
- Considering that MAFR has not yet been implemented in South Africa, it is not possible to determine, through the use of audit quality measures, whether MAFR improves audit quality in South Africa. This research therefore performs an
The above critical aspects are linked to the following study objectives:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
- To determine whether MAFR is considered an adequate tool to improve the quality of audits.
- To critically assess and contrast the perceptions and arguments of key stakeholder groups and individuals within the broad ambit of the South African MAFR debate.

Refer to Hypotheses 1, 2 and 3

Hypothesis 1: Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.

Hypothesis 2: Stakeholders perceive MAFR not to have a significant impact on auditors’ independence and professional scepticism.

Hypothesis 3: Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.
2.6 CONCLUSION

Following an explanation of the role of the external auditor as a partial solution to the agency problem and as highly beneficial for capitalist markets, this chapter focused on the concepts underlying the MAFR debate, namely, auditor independence, professional scepticism and audit quality. The critical link between auditor independence and audit quality was established from the literature as well as the importance of making the distinction between actual and perceived independence. In addition, the concept of audit quality has emerged as largely a matter of perception, subject to the diverse priorities and incentives of audit market stakeholders. It has been established that since MAFR will only be effective in South Africa in 2023, this study cannot use measurements of audit quality in order to determine the efficacy of MAFR in the local context. The priority of this study is therefore to understand and analyse the perceptions of audit market stakeholders with respect to issues surrounding auditor independence, audit quality and MAFR.

In the next chapter, the focus turns towards the impact of audit tenure and auditor rotation on independence and audit quality.
CHAPTER 3: THE EFFECT OF AUDIT TENURE AND ROTATION ON AUDIT QUALITY

3.1 INTRODUCTION

Audit quality is determined by the actual and perceived degree of independence and capabilities of the auditor (Figure 1.1). Auditor rotation regulation is designed to address concerns regarding this actual and perceived independence of the auditor in the audit-client relationship (Cameran et al., 2005; Daniels & Booker, 2011; Kwon et al., 2014). By rotating the auditor periodically, it is argued that a much needed ‘fresh set of eyes’ is introduced in the form of the newly appointed auditor. Some stakeholders believe that rotation is effective because ‘a new broom sweeps clean’, meaning that the incoming auditor may be more capable to perform the audit. In addition, the new auditor may be less familiar with client management, and thereby more independent (Bandyopadhyay et al., 2014; Fiolleau et al., 2013). In order to understand these arguments in favour of rotation, the link between audit tenure, rotation and audit quality must be established from the literature.

The focus of this chapter is thus the ongoing debate and research on auditor tenure, applied to the issue of auditor rotation. Auditor tenure, meaning the length in years of the audit-client relationship, could be argued to impair the auditor’s independence. If this is not true, then the case in favour of rotation regulations is weakened considerably. Thus, a primary issue to explore in the literature is whether auditor tenure negatively impacts auditor independence. It is important with respect to the interpretation of research findings to distinguish the difference between audit partner and audit firm rotation. As such, the literature regarding tenure and audit partner rotation is presented first. Following this, the literature on audit firm rotation is explored, distinguishing between voluntary firm rotations and compulsory firm rotations (MAFR).
3.2 AUDIT TENURE

Auditor tenure can be defined as the length of time, in successive years, in which the auditor (partner or firm) has been engaged as the auditor of the organisation. There is therefore a distinction between audit partner tenure and audit firm tenure, as there is between audit partner rotation and firm rotation. As established in the framework of Figure 1.1 and discussed in section 2.4, audit quality is a function of auditor capability and independence, which includes the concept of professional scepticism. Considering that auditor rotation regulation is a regulatory tool intended to decrease the likelihood of impaired auditor independence by reducing the period in years for which an auditor can be appointed by the client, if long audit tenures do not impair independence in practice, there would be no sound argument in favour of MAFR or audit partner rotation. This reasoning is fundamentally important to the MAFR debate and to rotation regulations in general. Long audit tenure is believed by some to cause a reduction in auditor independence in the audit-client relationship. Auditor rotation, including MAFR, is specifically designed to limit auditor (or audit firm) tenures (Roush, Church, Gregory Jenkins, McCracken, & Stanley, 2011). Therefore, it stands to reason that if it can be shown that increasing audit partner (or audit firm) tenure does not impair audit partner (or audit firm) independence, then audit partner (or audit firm) rotation will not be effective.

As shown in Figure 1.1, Tepalagul and Lin (2015) provide a useful, four dimensional approach with which to assess the impact of auditor independence on audit quality: (i) client importance, (ii) non-audit services, (iii) auditor tenure, and (iv) client affiliation with audit firms. In this context, Tepalagul and Lin (2015) were referring specifically to audit partner tenure, not audit firm tenure. This categorisation of the four main threats to auditor independence is useful for further research and theory and will be used in this study. It is important to note that Figure 1.1 illustrates that auditor independence is a necessary, but not sufficient, condition for high-quality audits and financial reporting. The extensive review of literature by Tepalagul and Lin (2015) summarised in Figure 1.1 shows that both the capability and the independence of the auditor contribute to audit quality.
The most important category of threat to independence in Figure 1.1, from the perspective of auditor rotation, is that of auditor tenure. Regulators believe that it is long tenures which impair auditor independence and that forcing rotation of the auditor is a regulatory tool which can be used as a remedy (Fontaine et al., 2016; Hakwoon et al., 2015). Considering that the literature reviewed does indicate a clear correlation between audit quality and independence, it needs to be determined whether shorter tenures, as would be the result of auditor rotation regulations, affect audit quality and auditor independence.

### 3.2.1 Threats to independence from tenure

In most jurisdictions the audit profession is a for-profit and competitive enterprise as well as a necessary public practice (Bergner, 2011; Harber, 2016). It therefore follows that the profit incentive might induce auditors to yield to client pressure in order to retain that client’s business for as long as possible. As such, auditor independence might be compromised. In addition, this profit incentive may induce auditors to seek additional, non-audit services such as tax, internal audit or corporate finance advisory services which would provide lucrative additional revenue from the client over time. The desire to retain the business of the audit or non-audit services may impair independence and professional scepticism over longer audit tenures as a longer relationship with the client deepens the auditor-client relationship, potentially causing the auditor to become reliant on the audit fee revenue and allowing more opportunities to secure non-audit related work. These threats illustrated in Figure 1.1 are also addressed in the IFAC Code of Ethics for Professional Accountants in which numerous guidelines are given to enable the auditor to manage such conflicts of interest. Long audit tenure and client affiliation with audit firms create familiarity between the parties as relationships form (IFAC Code, 2016:Section 290). Auditing literature warns of a so-called trust threat and argues that close relationships that breed interpersonal trust between auditors and the audit-client’s management may threaten auditors’ professional scepticism (Aschauer et al., 2017). In terms of Figure 1.1 and the IFAC Code of Ethics for Professional Accountants, this is
defined as ‘a familiarity threat’ that may develop due to long audit tenures and personal relationships that can develop between auditor and audit client. The fact that many audit firms have long-standing tenures with audit clients, sometimes spanning decades, can create a significant and unmitigated threat to the independence of the auditor. According to those in favour of MAFR, these threats are best mitigated by forcing the audit firm to rotate off the client (Aschauer & Quick, 2018; Fontaine et al., 2016; IRBA, 2016e). According to the IRBA (2016e:18), as of October 2016, there are 30 companies listed on the JSE with audit firm tenures in excess of 20 years, with 2 companies having being audited by the same firm for over 100 years, namely Murray & Roberts Holdings Limited (114 years by Deloitte) and Naspers Limited (101 years by PwC).

As discussed, threats to auditor independence could undermine audit quality, however, reduced capability or competence in the auditor, resulting in sub-standard and inadequate audit work, could also undermine audit quality (Firth et al., 2012; Knechel et al., 2013; Tepalagul & Lin, 2015). Considering that audit quality is a function of both auditor capability and auditor independence, it may not be correct to assume that an audit failure or poor-quality audits are necessarily the result of a lack of independence of the auditor. The cause of an audit failure may also be the lack of capability. Thus, since auditor rotation is aimed at safeguarding auditor independence by limiting the length of auditor-client tenure, it will not be an effective mechanism for addressing concerns in audit quality that are unrelated to long audit tenures. Auditor rotation regulation specifically aims to limit the threat to independence that results specifically from long audit tenures – not from lack of competence (Aschauer et al., 2017; Bowlin et al., 2015; Cameran et al., 2015).

3.2.2 Opposing views on the impact of audit tenure

The review of research pertaining to auditor independence and audit quality by Tepalagul and Lin (2015) establishes that there are two primary 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 Code, 2016). Therefore, this view supports some form of regular audit partner or audit firm rotation. As discussed above, reducing the time by which an auditor is engaged with the client (auditor tenure) is a means of reducing the familiarity threat and promoting independence of mind and action by the auditor. The other view argues 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). Competence includes the characteristics of skill and experience (Tepalagul & Lin, 2015). For example, client-specific experience, used as a proxy for expertise, was found to enhance the auditors’ ability to respond to fraud indicators (Brazel, Carpenter & Jenkins, 2010).

Consistent with Tepalagul and Lin (2015), according to the literature review of Knechel et al. (2013) on audit quality specifically, the debate on auditor tenure revolves around two competing arguments, namely:

- Short tenure means an auditor has less knowledge and expertise of the client’s operations and financial reporting; versus
- Long tenure may mean that an auditor’s objectivity is potentially impaired due to various threats that develop over time, especially the familiarity threat.

Advocates of MAFR believe that the ‘fresh look’ at an organisation that a newly appointed auditor brings is not only advantageous but comes with added independence and professional scepticism with respect to that organisation’s financial activities and associated financial reporting. According to Ewelt-Knauer et al. (2013), MAFR opponents believe the potential costs of mandatory rotation exceed its benefits and that therefore the likelihood of audit failures might be greater in the initial period of an auditor-client relationship because of lack of auditor knowledge about client-specific risks, processes and operations. The proponents of MAFR claim the exact opposite.
These two opposing views provide conflicting arguments on whether or not to pursue MAFR, as advocates argue the possible benefits of auditor tenure, while opponents argue its costs. Advocates of MAFR emphasise this cost of long tenure (loss of independence and professional scepticism) while opponents emphasise its benefits (client-specific knowledge and experience gained over years). A system of audit partner rotations, as opposed to MAFR, attempts to “maintain auditor independence and bring a fresh look to audit engagements, while maintaining continuity and overall audit quality” and involves significantly less “switching costs” (Laurion et al., 2017:209), thereby achieving a compromise. Therefore, in one sense, audit partner rotation can be understood to be the compromise position between no rotation at all and MAFR (Laurion et al., 2017). Regulators are attempting to balance the need to achieve a fresh look and independence against the need for the audit engagement team to be composed of competent auditors.

### 3.2.3 Personal relationships between auditor and client

Some studies focus on the personal relationship that develops between the auditor and client over time, where a bond, loyalty and/or trust can be developed. This has been described already as the ‘familiarity threat’ that could negatively impact the independence and professional scepticism of the auditor. According to Ball et al. (2015) and Carey and Simnett (2006), these person-to-person relations, irrespective of whether they are developed intentionally or unintentionally, can impact an auditor’s objectivity and therefore independence. As the length of an engagement increases, the auditor is more likely to accept client pressure or side with managers on important reporting decisions (e.g., the choice and application of accounting policies), creating the possibility of ‘aggressive accounting policy choices’ that push boundaries. This is the typical familiarity threat argument, where increased familiarity results in a desire to appease or favour management’s desired financial reporting outcomes.
In contrast to this, evidence exists suggesting that auditor-client trust and relationships, instead of threatening independence, may increase audit quality. According to Wilson et al. (2018:1), increased tenure, "at the firm level and interpersonal or individual level, has been shown to increase trust; and further, trust is positively related to employee voice, such as speaking up about fraud (whistleblowing)". The findings of Wilson et al. (2018) suggest that auditor familiarity enhances trust, which, in turn, positively influences an employee’s intentions to whistle-blow to the auditor.

3.2.4 Conclusion from the literature regarding auditor tenure

According to Knechel and Vanstraelen (2007), the debate continues about the relationship between auditor tenure and audit quality in spite of extensive empirical evidence examining audit failures, earnings management and the issuance of auditor’s opinions. Evidence suggests that long auditor tenure does not have a negative impact on audit quality (Knechel & Vanstraelen, 2007). The study by Tepalagul and Lin (2015), which consisted of a comprehensive review of research pertaining to auditor independence and audit quality, sheds additional light on this important link in the MAFR debate. 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).

In another literature review examining the causes and consequences of auditor switching, Stefaniak et al. (2009) note that most studies look at the association of auditor tenure and various measures of audit quality. In general, they find that audit quality is higher when there is a longer auditor-client relationship. Both of these extensive literature reviews by Tepalagul and Lin (2015) and Stefaniak et al. (2009), indicate that longer audit-client relationships do not impair the independence and professional scepticism of the auditor. These findings therefore provide a significant argument against a policy of auditor rotation, whether simple partner rotation or MAFR.
Shockley (1981) reports that auditors do not regard tenure exceeding five years as reducing independence. A Belgian study by Knechel and Vanstraelen (2007) found that longer tenure neither increases nor decreases the likelihood of going concern opinions for companies that subsequently went bankrupt. Other researchers produce conflicting findings on the association between tenure and auditor’s behaviour. Deis and Giroux (1992), in a paper studying the determinants of audit quality, report that quality-control findings decrease as auditor tenure lengthens. Carey and Simnett (2006), consistent with the findings of Knechel and Vanstraelen (2007), confirm that in Australia, long partner tenure is associated with lower likelihood of going concern opinions.

However, in contrast to Carey and Simnett (2006) and Knechel and Vanstraelen (2007), a US study on going concern opinions suggests that audit failures are more likely in the early years of the auditor-client relationship (Geiger & Raghunandan, 2002). Bamber and Iyer (2007) point out that the incentive of the individual audit partner may conflict with that of the audit firm. They find that long partner tenure increases the likelihood of the auditor acquiescing to the client’s preferences and that audit firm tenure is associated with the decreased likelihood of auditor concessions. Specifically, the findings of Bamber and Iyer (2007) indicated that auditors do identify with their clients and that auditors who identify more with a client are more likely to acquiesce to the client-preferred position. On the other hand, according to Bamber and Iyer (2007), more experienced auditors and auditors who exhibit higher levels of professional identification are less likely to acquiesce to the client's position. These findings of Bamber and Iyer (2007) provide evidence in favour of audit partner rotation, rather than audit firm rotation – similar to the findings of Ball et al. (2015) described above.

Further conflicting results were identified by Johnson, Khurana and Reynolds (2002) who concluded that 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 were 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.

From the perspective of the audit client, there is limited evidence regarding the effect of audit tenure on independence. However, according to Tepalagul and Lin (2015), the existing research suggests that clients perceive long auditor tenure positively. In an early survey study, Knapp (1991) finds that the AC perceives auditors with tenure of between 5 and 20 years as being more likely to discover material errors than those with shorter tenure.

In the above research, it is certainly clear that there is a degree of mixed results, however, the majority of findings do indicate that auditor tenure itself, especially audit firm tenure (as opposed to individual partner tenure) does not impair independence (Ball et al., 2015; Knechel & Vanstraelen, 2007; Stefaniak et al., 2009; Tepalagul & Lin, 2015). This is significant in the MAFR debate as MAFR is primarily concerned with the threat that long audit-client tenures poses to independence (Bamber & Iyer, 2007; Fontaine et al., 2016; Knechel & Vanstraelen, 2007; Lennox et al., 2014).
3.2.5 Distinguishing between audit partner and audit firm rotation

According to Casterella and Johnston (2013) and Knechel et al. (2013), a common mistake in research on auditor rotation is not to distinguish between audit partner and audit firm rotation. The conclusions above by Tepalagul and Lin (2015) and Stefaniak et al. (2009) that audit tenure does not seem to impair independence are concerned with the impact of audit firm tenure, not audit partner tenure. Therefore, as per the above, the evidence, although mixed, suggests that audit firm tenure does not impair auditor independence or audit quality. According to a literature review by Simnett et al. (2016), although the evidence is mixed regarding audit firm tenure, it is less so regarding partner tenure. Most studies conclude that audit quality is reduced with long audit partner tenures (Simnett et al., 2016). This conclusion in the literature explains why, or is at least consistent with the fact that, most jurisdictions require partner rotation, not audit firm rotation (refer to Chapter 6 for a comparison of international jurisdictions with respect to rotation regulations). Currently, in terms of the South African Companies Act (No. 71 of 2008), audit partner rotation is required on a five-year basis with a two-year cooling-off period.

A proposed positive correlation between length of audit firm tenure and impaired auditor independence or audit quality is a primary argument for the advocates of MAFR regulation. Ball et al. (2015) agree, stating that if empirical evidence could be found to associate audit quality with shorter audit tenures, this would support the argument for auditor rotation (including MAFR) being prescribed by regulation. The findings of Ball et al. (2015) are significant and somewhat consistent with the academic review of literature performed by Knechel and Vanstraelen (2007) and by Tepalagul and Lin (2015). Ball et al. (2015), in an Australian context, measured both the duration of relations between the lead audit partner and client firm management (person-to-person relations) as well as the duration of the audit firm’s engagement by the client (firm-to-firm). These findings show evidence of a negative association between the length of tenure between the lead audit partner and client firm management (person-to-person relations) and audit quality.
Conversely, Ball et al. (2015) find a positive relation between audit firm engagement by the client (firm-to-firm) and audit quality. This suggests there may be quality benefits from prescribing audit partner rotation and quality costs from prescribing audit firm rotation. This is one of the few studies that considers the impact of both audit partner and audit firm rotation on audit quality. These findings are consistent with those of Simnett et al. (2016) that most studies on the relationship between partner tenure and audit quality show that quality is reduced, the longer the tenure.

From the above, it can be seen that although the literature shows a degree of mixed results, it nonetheless indicates that long audit firm tenure does not generally impair auditor independence and may even improve audit quality through the increased skill and experience of the audit firm with respect to the financial reporting of the client. However, at an audit partner level, tenure is negatively associated with audit quality. These conclusions are further evidenced by the extensive literature reviews conducted by Knechel and Vanstraelen (2007), Tepalagul and Lin (2015) and Simnett et al. (2016). Thus, based on the evidence in the literature, a stronger argument can be made for audit partner rotation, in comparison to audit firm rotation, in its ability to improve audit quality, yet the results are mixed and not conclusive.

3.2.6 Critical links to the empirical study

From the discussions above the following critical aspects regarding the link between auditor tenure and independence were established:

- There are opposing views in the auditor rotation debate with respect the benefits and costs of rotation, whether firm or partner rotation.
- The primary argument in favour of rotation states that as tenure lengthens, a familiarity develops between auditor and management of the client and this results in the dilution of independence and professional scepticism. The counter view is that as tenure lengthens, auditors increase their understanding of their clients’
complex business and thereby improve their expertise as auditors, resulting in higher audit quality.

- There are mixed results on the impact of auditor tenure on audit quality, however, the weight of the evidence suggests that auditor tenure does not impair audit quality.
- A common mistake in the literature on the MAFR debate is not to distinguish between research on audit firm tenure and that on audit partner tenure.
- Research indicates that long audit firm tenure does not impair auditor independence and may even improve audit quality by increasing skill and experience of the audit firm with respect to the financial reporting of the client. However, at an audit partner level, some studies have shown tenure to be negatively associated with audit quality. This provides some evidence in favour of mandatory partner rotation but not MAFR.
- Research on the perspectives of the audit client indicates limited evidence regarding the effect of audit tenure on independence.

The above critical aspects are linked to the following study objectives:

- To determine whether longer audit firm tenure is perceived to impair auditor independence in practice.
- To determine whether MAFR is considered an adequate tool to improve the quality of audits.
- To determine whether there are likely unintended consequences from the implementation of MAFR.
3.3 THE EFFECT OF AUDIT PARTNER ROTATION ON AUDIT QUALITY

Section 3.2 considered auditor tenure research specifically, from both firm and partner tenure perspectives. This section focuses on the impact of audit partner rotation on auditor independence and audit quality. Following this, the link between audit firm rotation and audit quality in the literature will be considered.

3.3.1 Evidence in favour of partner rotation

The findings of Ball et al. (2015), which examined partner rotation in 266 publicly listed Australian companies, suggest that partner rotation increases audit quality, but audit firm rotation does not. In order to explain these findings, Ball et al. (2015) suggest that there are significant quality costs from rotating the audit firm which are not applicable in rotating just the engagement partner. One possible reason is the primary argument given by those who oppose MAFR – the loss of client-specific, institutionalised knowledge and experience gained by the firm over years. This is lost under audit firm rotation as the firm as a whole is replaced but is largely retained with partner rotation. According to Ball et al. (2015), while the audit partner takes ultimate responsibility for an engagement, normal

Refer to Hypotheses 1, 2 and 3

Hypothesis 1: Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.

Hypothesis 2: Stakeholders perceive MAFR not to have a significant impact on auditors’ independence and professional scepticism.

Hypothesis 3: Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.
Turnover in audit staff and client management appear to reduce the importance of person-to-person relations. When only the audit partner is rotated and the audit firm remains the same, the audit methodology, procedures and other engagement personnel do not necessarily change (Lennox et al., 2014). Additionally, according to Ball et al. (2015), internal and external audit review appears to play an important role in aiding professional scepticism and promoting auditor independence. Internal review or peer reviews within the audit firm provides a ‘second look’ at the firm’s work, and this may increase professional scepticism as the audit tenure lengthens.

Research by Firth et al. (2012) in China shows results consistent with those of Ball et al. (2015). Chinese firms, operating in a jurisdiction of mandatory partner rotation, are associated with a significantly higher likelihood (compared to non-rotation firms) of a modified audit opinion. Audit opinion modification was the proxy used for audit quality (refer to Table 2.1 in Chapter 2). The observation of this effect was restricted to firms located in less developed regions of China. In contrast, MAFR was found to have no effect on the likelihood of modified audit opinions. This suggests that auditor rotation is superior to MAFR as a means of improving audit quality.

Consistent with the findings of Ball et al. (2015) and Firth et al. (2012), research by Lennox et al. (2014) shows broad support for rotating the audit partner, suggesting that it results in higher quality audits in the years immediately surrounding rotation. Specifically, Lennox et al. (2014) find a significantly higher frequency of audit adjustments during the departing partner’s final year of tenure prior to mandatory rotation and during the incoming partner’s first year of tenure following mandatory rotation. This suggests that the internal review process and the peer-review motivation provided through hand-over of the client to a colleague within the firm, results in incentives to maintain audit quality. The following interpretation of the results of Lennox et al. (2014) is particularly helpful:

First, an engagement partner is more likely to require an audit adjustment when the partner is scheduled for mandatory rotation at the end of the year. This suggests that the departing engagement partner has motivation to clean up the client’s financial statements before handing over the audit to the new partner. This
is consistent with a positive peer review benefit, whereby engagement partners perform higher quality audits when they are scheduled for mandatory rotation. Second, we find that a newly appointed engagement partner is more likely to require an adjustment during the partner’s first year of tenure following mandatory rotation. This is consistent with newly appointed engagement partners bringing a fresh perspective to the audit that can identify more financial reporting problems. Our findings have significant implications for public policy because many countries rely on mandatory audit partner rotation rather than mandatory audit firm rotation to ensure high-quality audits (Lennox et al., 2014:1801).

3.3.2 Evidence against partner rotation

Despite the research in favour of partner rotation, as described above, there are some findings that are not directly or explicitly in favour of the ability of audit partner rotation to improve independence and audit quality. This can be substantiated by the following research findings:

- Bedard and Johnstone (2010) provide empirical evidence that is inconclusive with regards to audit partner rotation. By analysing whether engagement processes employed by the audit partner differ based on partner tenure, Bedard and Johnstone (2010) find that the level of planned effort does not differ for clients having longer versus shorter tenure and that, following partner rotation, new partners invest significant effort in gaining client knowledge in the first year of the engagement. These findings do not support partner rotation but do indicate that new partners make a concerted effort in the first year of appointment, recognising their lack of client-specific experience and thereby seeking to bridge this knowledge gap.

- Chi, Huang, Liao and Xie (2009) use abnormal accruals and earnings response coefficients as proxies for audit quality and find little evidence that these variables are affected by mandatory partner rotation. However, Lennox et al. (2014) point out, regarding the study by Chi et al. (2009), that these earnings quality metrics may be poor proxies for audit quality, which may explain the insignificant results.
• Using interviews and surveys which explore audit partner perceptions on rotation, findings by Daugherty, Dickins, Hatfield and Higgs (2012) suggest that accelerated partner rotation may have an unintended negative impact on audit quality. Partners were of the view that accelerated rotation periods (from seven years to five years) increase partners’ workloads and the likelihood of needing to relocate employers and residence. However, this study was concerned with the reduction of the rotation period, not the question of the efficacy of rotation itself. The study of Daugherty et al. (2012) is analysed in more detail later as the research methodology used in the present study to understand the direct and indirect consequences of auditor rotation shares similarities with the research methodology used in the study on MAFR.

• In a Chinese context, Bandyopadhyay, Chen and Yu (2014) find that audit partner rotation does not improve audit quality in jurisdictions where legal conventions are more developed and/or where audit markets are highly concentrated with a handful of large audit firms dominating the market – an environment not dissimilar to that of South Africa. However, it was not shown to decrease audit quality either.

In summary, the academic findings with regards to audit partner rotation are less mixed than those regarding auditor tenure (section 3.2). The research generally favours partner rotation as a means of improving audit quality, with the benefits of partner rotation seeming to outweigh the costs. This provides strong support for audit partner rotation as a means of improving audit quality.

3.3.3 Critical links to the empirical study

From the discussions above, the following critical aspects regarding audit partner rotation were established:

• There is broad support in favour of mandating partner rotation, with findings suggesting that it results in higher quality audits, especially in the years
immediately following rotation. The research therefore favours partner rotation as a means of improving audit quality, with the benefits of partner rotation seeming to outweigh the costs.

- Partner rotation allows the firm to retain client-specific, institutionalised knowledge and experience gained over years. When only the audit partner is rotated, and the audit firm remains the same, the audit methodology, procedures and other engagement personnel do not necessarily change.
- There are perhaps significant quality costs from rotating the audit firm, which are not applicable in the rotation of just the engagement partner.

The above critical aspects are linked to the following study objectives:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
- To determine whether MAFR is considered an adequate tool to improve the quality of audits.
- To determine whether there are likely unintended consequences from the implementation of MAFR.
- To recommend possible credible alternatives as well as changes to current proposals, including transitional provisions that will allow MAFR to better achieve its stated objectives.

Refer to Hypotheses 1 and 2

Hypothesis 1: Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.

Hypothesis 2: Stakeholders perceive MAFR not to have a significant impact on auditors’ independence and professional scepticism.
3.3.4 Audit partner perceptions

Studies such as those of Daugherty et al. (2012) and Shockley (1981) research the topic of audit partner rotation differently to the above studies, choosing instead to assess partner perceptions and opinions. Structured interviews and surveys, using a more qualitative design, have yielded valuable insights into the potential impacts of auditor rotation. Cohen et al. (2010), although not a study on partner rotation, attempts to understand the experiences of auditors in their interactions with the AC, board and internal audit with respect to the broad functioning of audit and financial corporate governance. This qualitative (and often exploratory) methodology provides valuable insights into auditing and governance research questions. Daugherty et al. (2012) first interviewed 7 practicing audit partners from 7 different firms, followed by a field survey distributed to 370 practicing partners across 14 firms. Cohen et al. (2010) conducted interviews with 30 experienced audit partners and managers from three of the Big Four firms. Shockley (1981) surveyed 176 people comprising audit partners, professional accountants, loan officers and financial analysts. These research designs are very similar to those employed in this study.

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 of mandatory partner rotation and cooling-off periods. The survey also considered how recently enacted, more stringent rules may negatively affect 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 3.1 below.
In Figure 3.1, 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 the 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 commute further to work. Daugherty et al. (2012) sought to test the direct and indirect effects of audit partner rotation by examining the opinions and perceptions of practising audit partners. Opinions were gathered on 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. 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 – an unintended consequence of accelerated rotation/extended cooling-off periods on audit quality (Daugherty et al., 2012). An
additional important conclusion from the findings of Daugherty et al. (2012) is that negative impacts on the appeal of the audit profession and work-life factors arising from auditor rotation, can impair the quality of audits.

The above studies are based on the perceptions of audit partners and other stakeholders in corporate governance and the audit process. The findings, especially Daugherty et al. (2012), reveal the push-back 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. As will be documented below, these results regarding audit partner rotation are similar to auditor perceptions and opinions regarding MAFR.

### 3.3.5 Critical links to the empirical study

From the discussions above, the following critical aspects regarding audit partner perceptions of rotation were established:

- A qualitative methodology using interviews and surveys has been successfully employed in researching audit quality, corporate governance and auditor rotation. The perceptions and arguments of key stakeholder groups in the MAFR debate are an important contribution, especially in exploring the potential for unintended consequences. The research designs discussed are similar to the methodology used in this study.
- Auditors do not perceive tenure exceeding five years as reducing their independence.
- Partners perceive that rotation can increase workloads and the likelihood of relocating for work. There are therefore negative quality of life aspects to auditor rotation.
- Rotation introduces the likelihood of committing significant time upskilling and learning a new industry.
• Negative effects on the appeal of the audit profession and work-life factors, arising from auditor rotation, can impair the quality of audits.

• Partners perceive that there are perhaps significant quality costs in rotating the audit firm, which are not applicable upon the rotation of just the engagement partner.

The above critical aspects are linked to the following study objectives:

• To determine whether MAFR is considered an adequate tool to improve the quality of audits.

• To determine whether there are likely unintended consequences from the implementation of MAFR.

• To recommend possible credible alternatives as well as changes to current proposals, including transitional provisions that will allow MAFR to better achieve its stated objectives.

Refer to Hypotheses 1, 7, 8, and 12

Hypothesis 1: Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.

Hypothesis 7: Stakeholders perceive that MAFR will require audit partners to undergo significant efforts to upskill and retrain themselves for new industries.

Hypothesis 8: Stakeholders perceive that MAFR will reduce the appeal, in the minds of chartered accountants, of the auditing profession in comparison to other career options.

Hypothesis 12: Stakeholders perceive that, in addition to the current measures in place, there are better solutions than MAFR to address the concerns raised by the IRBA.
3.4 THE EFFECT OF AUDIT FIRM ROTATION ON AUDIT QUALITY

The preceding sections 3.2 and 3.3 explored the effects of auditor tenure and audit partner rotation on audit quality. More research has been conducted on partner tenure and rotation compared to audit firm tenure and rotation, as partner rotation is a more common form of rotation regulation and is recommended by the IFAC in their Code of Ethics for Professional Accountants. The move beyond partner rotation towards firm rotation regulation is a relatively recent international trend (Hakwoon et al., 2015; Hay, 2015). As expressed by Fontaine et al. (2016:2), MAFR “has received a great deal of attention in recent years, due in part to a concept release from the [US] Public Company Accounting Oversight Board (PCAOB) requesting comments on the advantages and disadvantages of MAFR”, as well as recent developments in the EU. These developments are discussed further in Chapter 6.

This section reviews the research on audit firm rotation, rather than partner rotation. The findings on the impact of firm rotation on audit quality can be divided into interview and survey based research, similar to that of Daugherty et al. (2012), Shockley (1981) and Cohen et al. (2010), as discussed in the previous chapter, as well as research attempting to measure a proxy for audit quality.

3.4.1 MAFR: Interview and survey-based research

Audit firm rotation is difficult to research due to its limited and as a result, “there is no clear evidence about whether it is effective” (Hay, 2015:162). South Africa will only enforce MAFR in April 2023, as per the IRBA ruling. As such, it is not possible to currently use an audit quality proxy to measure the effectiveness of its implementation. In the absence of being able to measure changes in independence or audit quality as a result
of MAFR, qualitative techniques such as interviews and surveys of key stakeholders, provide useful insights into the debate.

A literature review of a wide variety of stakeholder perspectives on MAFR by Ewelt-Knauer et al. (2013) attempts to highlight deficiencies in the existing research literature, identify opportunities for further research and make recommendations for policy-makers. The findings show varied opinions on the topic and that the impact of MAFR on audit quality and auditor independence is inconclusive, with additional perceptions-based research needed. Whereas Ewelt-Knauer et al. (2013) did find evidence in the literature that MAFR may have a positive impact on ‘independence in appearance’, most research fails to generalise these findings to measures of audit quality associated with ‘independence in fact’. Ewelt-Knauer et al. (2013) also identify some potentially adverse effects of rotation.

Two recent studies, a Canadian study by Fontaine et al. (2016) and a South African study by Harber (2016), employ a qualitative, interview-based design to understand experiences, perceptions and opinions of audit firm rotation. The Canadian regulatory environment is similar to South Africa insofar as it currently requires audit partner, not audit firm, rotation. Fontaine et al. (2016) conducted interviews with experienced AC members whereas Harber (2016) interviewed experienced audit partners. Both groups represent significant stakeholders and role players in the MAFR debate. Ewelt-Knauer et al. (2013) perform a review of stakeholder perspectives research and conclude that the opinions are mixed but provide valuable contributions to the MAFR debate. However, Ewelt-Knauer et al. (2013) also conclude that more qualitative, interview and survey based methods are needed to explore the topic further, from a wide variety of stakeholder groups, as is the purpose of this study.

A recent interview and ‘online experiment’ design was used by Aschauer and Quick (2018) with regards to investment consultants of credit institutions in Austria in order to
test their perceptions of the effect of MAFR on non-audit services. Based on the assessment of 140 professional investment consultants, the results show that the provision of tax services by the audit firm decreases independence in appearance and perceived audit quality, while the rotation system does not induce a significant effect. This provides evidence in favour of restricting non-audit services but not auditor rotation.

3.4.1.1 Audit committee member opinions

Fontaine et al. (2016) examine AC perspectives on mandatory partner and firm rotations as well as the costs associated with switching audit firms. The study also attempts to understand the ways in which committee members monitor auditor independence and objectivity. Using in-person interviews, similar to Harber (2016), the findings of Fontaine et al. (2016) showed that all AC members interviewed in this study were adamantly opposed to MAFR. MAFR was perceived as a threat to their shareholder-granted authority to make audit firm appointment decisions. Participants believed that their professional judgment and observations are the most effective means of ensuring auditor independence. MAFR was viewed as an unnecessary intervention that infringed on their ability to apply their judgement on the independence and appropriateness of the auditor (Fontaine et al., 2016).

3.4.1.2 Audit partner opinions

Auditors have been found to generally oppose MAFR (Ewelt-Knauer et al., 2013). This conclusion was based on a review of literature and was found to be the case for both Big Four and non-Big Four audit firms. This is relevant for this study as the intention of the IRBA in South Africa with MAFR is to allow non-Big Four firms the opportunity to compete for audits and thereby lower market concentration (IRBA, 2016e, 2017c). According to Ewelt-Knauer et al. (2013:29), there are two primary reasons why auditors tend to oppose MAFR, namely:
1. It is believed to be a barrier to building an effective working relationship with management, ACs and boards of directors; and
2. Perhaps more importantly, auditors fear that MAFR heightens the risk of audit failure due to the reduction in company-specific knowledge that is developed over time.

The research by Harber (2016) on auditors’ perceptions provides results consistent with the literature review of Ewelt-Knauer et al. (2013) and the two primary reasons highlighted above. The findings of Harber (2016), as they relate to the South African context of MAFR, include the unique aspects (to the South African debate) of socio-economic transformation and market concentration objectives of the audit regulator (IRBA). The study comprised interviews with three key experts in the field of auditing and corporate governance, followed by semi-structured interviews with 14 senior and managing audit partners of medium and large tier audit firms (Big Four firms) around the country. The findings show significant resistance to MAFR, with arguments to justify this position. The majority of audit partners claimed that MAFR would not achieve an increase in audit quality and would produce many unintended consequences that would actually reduce audit quality.

All of the respondents believed that it was irresponsible to pursue MAFR for reasons other than audit quality and that the IRBA must not seek to improve black economic transformation or competition through such disrupting legislation, considering the many, likely unintended negative consequences, some of which would decrease audit quality (Harber, 2016).

Of particular importance in the findings of Harber (2016) are the following arguments provided by audit partners against MAFR in South Africa, which can be summarised as follows:
Auditor independence is not compromised in South Africa in reality, yet there may be a justifiable concern regarding the perceptions of independence;

MAFR is a tool to address the risk posed to auditor independence, and should not be used to address market concentration and socio-economic transformation in South Africa;

Audit quality will suffer through the loss of client-knowledge and experience built up over years;

ACs of large, public interest and listed companies are not likely to appoint (or recommend for appointment) a non-Big Four audit firm;

The costs of retraining, tendering for work and learning the client’s business will result in an unmanageable cost increase to audit firms, to the detriment of audit quality;

Audit clients (companies) may incur significant direct and indirect costs dealing with audit firm rotation, including the need to consider tender proposals more frequently and, more significantly, dealing with less experienced incoming auditors;

MAFR will further exacerbate the lost appeal of the audit profession as a career of choice for young professional accountants, to the detriment of audit quality;

The AC is best positioned, and legally mandated, to act as an external safeguard to auditor independence;

There may be better alternatives, which include regulatory tools, to addressing the regulator’s concerns regarding audit quality, market concentration and socio-economic transformation in the South African audit industry;

Regulations should not be used to promote competition and reduce market concentration; and

MAFR may reduce the ability of audit firms to invest in transformation initiatives.

(Harber, 2016)

A survey of the audit profession performed by the Institute of Chartered Accountants Australia produced similar arguments against changing legislation in Australia in favour
of MAFR. Auditors surveyed raised the concern that there would likely be significant unintended consequences for the auditing profession, and that the underlying causes of poor audit quality or auditor independence which may lie on the AC-management side of the engagement, would remain unaddressed by such legislation (ICAA, 2015).

3.4.1.3 Management and shareholder opinions

Managers have been found to have varying opinions on MAFR. In opposition to firm rotation, some managers share auditors’ concerns regarding lost expertise (client-specific knowledge) of audit teams (PCAOB, 2011). In addition, there is a fear that employees may be very reserved towards new auditors, hampering the audit in general, and fraud detection in particular. At the same time, however, managers are also concerned that longer audit tenure (as there may be without MAFR) may prevent auditors from appropriately questioning the practices of the client, which is a result of reduced independence (Ewelt-Knauer et al., 2013).

Regarding the debate from a shareholders’ perspective, a concern raised by investors was that they may no longer be able to distinguish a voluntary change of the audit firm (due to, for example, ‘opinion shopping’ of management) from a compulsory rotation. In other words, MAFR reduces the signal effect of an auditor change and thus increases the cost of information (Ewelt-Knauer et al., 2013; Harber & West, 2017). Allowing those charged with governance at a company to decide when to rotate the audit firm allows additional valuable information in the form of the reasons why the firm was replaced.

The literature on management and investor (shareholder) perspectives of MAFR is limited. This study aims to contribute to this aspect of the MAFR research through surveys of four key stakeholder groups, which include representatives from both management and shareholders of companies.
3.4.1.4 A caution regarding inference over populations

The research of Fontaine et al. (2016) and Harber (2016) should not be considered representative of the target populations, the one being Canadian AC members and the other, South African audit partners. These two studies are exploratory and make use of purposive sampling in order to understand and analyse the breadth of the issues raised by the respective stakeholder groups. As such, conclusions regarding the views of the population using inference cannot be made. These exploratory studies are useful to inform further research of these stakeholder groups, via field surveys for example, as is done in this study.

3.4.1.5 The perceived trade-off of independence versus client-specific knowledge

The most common argument against MAFR being capable of improving audit quality relates to the potential loss of client-specific knowledge (Fontaine et al., 2016; Hakwoon et al., 2015; Knechel et al., 2013; Wilson et al., 2018). As tenure progresses, the audit firm, which includes the audit partner, other senior staff and the audit teams deployed, gain in their understanding of the organisation’s financial reporting risks, internal control systems and other audit-related matters. According to Wilson et al. (2018:1), this increasing knowledge and experience with the organisation, which is largely lost upon the rotation of the audit firm, yet preserved with audit partner rotation, is the predominant reason why studies “indicate generally that audit firm rotation would not necessarily be beneficial” and “would theoretically result in increased audit risk during the first years of a new audit firm engagement”. However, Wilson et al. (2018) go further to explain that the literature does indicate that perceptions of auditor independence, in the minds of certain auditing stakeholders and users of financial statements, does improve with the implementation of MAFR. This is evidence in favour of the ability of MAFR to improve the perception of audit quality.
From the above we can conclude that the literature shows that a trade-off exists in stakeholder perceptions. On the one hand there seems to be the belief that longer firm tenure does result in a more experienced and knowledgeable auditor. However, there is also a parallel belief that MAFR makes auditors more independent. It is therefore submitted that there is a need to better understand stakeholder perceptions in regard to the nature and consequences of this trade-off, as it applies to the MAFR debate.

3.4.1.6 Critical links to the empirical study

From the discussions above, the following critical aspects regarding perception and experience-based studies were established:

- A qualitative methodology using interviews and surveys has been successfully employed in the research of MAFR. The research designs discussed in this section are similar to the methodology used in this study.
- AC members are likely to be opposed to MAFR as they believe it is unnecessary and that the professional judgement of the AC, together with other regulations governing auditor independence, are sufficient to maintain auditor independence.
- Audit partners are likely to be opposed to MAFR for various reasons which have been identified above. It is of particular importance to note that audit partners may believe that MAFR could, counter to regulator intentions, even reduce audit quality.
- In a South African context, audit partners may be of the opinion that MAFR will negatively impact socio-economic transformational objectives and increase market concentration. Again, this would be the opposite of the IRBA’s intentions.
- The study by Harber (2016) forms part of the mixed methods approach adopted in this study of MAFR in a South African context.
- Management, those charged with governance and shareholders can provide valuable insights and are considered key stakeholders in the audit outcome.
Archival and experimental methods are limited to jurisdictions where MAFR has already been adopted. There is still a need to understand the perspectives of key stakeholder groups in jurisdictions where MAFR has been adopted as well as those where it is being debated, such as in South Africa.

The above critical links are relevant to all of the study objectives and Hypotheses 1 to 12.

3.4.2 MAFR: Using a proxy measure for audit quality

Mixed results have been reported by a number of studies examining whether audit firm rotation improves auditor independence as well as audit and financial reporting quality. Most research on audit firm rotation provides little evidence that it is effective in improving audit quality (Casterella & Johnston, 2013; Fontaine et al., 2016; Hay, 2015). However, Casterella and Johnston (2013) provide an important caution with regards to the interpretation of the research in this area. In their view, a simple aggregate of audit firm rotation research, as presented in some studies, is misleading because it does not separate the research in jurisdictions where firm rotation is voluntary (as is currently the case in South Africa) from those where it is mandatory (as it will be in South Africa from 2023). Casterella and Johnston (2013) provide the key findings of 24 separate studies on audit firm rotation since 2001 and the results are clearly “in favour of the anti-audit firm rotation position”. Most studies do not provide evidence that audit firm rotation will enhance audit quality. However, 13 of these studies were in a regime of voluntary rotation and 11 in a regime of mandatory rotation. According to the data of Casterella and Johnston (2013), of the 11 studies that consider MAFR specifically, 8 provide support for MAFR. So, again, it does appear that results are mixed, with the literature review of
Casterella and Johnston (2013) indicating that MAFR may be beneficial (8 studies of 11 reviewed).

When the 11 studies are reviewed in more detail, it is clear that the methodologies employed differ and some of the research is limited in scope, such as one study that only reviewed Arthur Andersen clients between 2000 and 2004. Another example of a study that shows support for MAFR, included in the review by Casterella and Johnston (2013), examined only municipal and county audits in Florida, USA, in 2003. Therefore, it is important to understand the nature and extent of the MAFR study before generalising its findings. As such, this section emphasises studies which have employed a more extensive scope with respect to data collection.

Based on the review of research by Casterella and Johnston (2013), it can be concluded that research is not in favour of voluntary audit firm rotation as a means of improving audit quality, however, the results are more mixed concerning MAFR. As explained by Casterella and Johnston (2013), many researchers and regulators do not account for this distinction between voluntary and mandatory firm rotation in the research.

Annexure 3 provides a review of five key studies that use a proxy for audit quality and have been conducted on a national scale, in jurisdictions that have implemented MAFR. These jurisdictions are Spain (Ruiz-Barbadillo et al., 2009), South Korea (Hakwoon et al., 2015; Kwon et al., 2014) and Italy (Cameran et al., 2015). The results of these studies provide evidence against MAFR being effective. However, it must be acknowledged that an inherent limitation exists in these approaches surrounding the researchers’ ability to employ robust and objective proxies that accurately measure audit quality. As discussed in Chapter 2, audit quality is a difficult concept to define, let alone measure, with a proxy (Casterella & Johnston, 2013) and hence this must be considered a significant limitation in each such study, curtailing the ability to make a conclusive statement on the effectiveness of MAFR.
It is clear that the issue is not settled in the literature, but evidence does lean in favour of the view that MAFR does not increase audit quality. A significant problem in the research is the lack of a suitable proxy measure for audit quality in order to determine the effect on financial reporting of a move to MAFR. Measuring audit quality using indirect proxies of quality is tenuous at best (Casterella & Johnston, 2013; Hay, 2015).

3.4.2.1  Critical links to the empirical study

From the discussions above, the following critical aspects regarding MAFR research that seeks to use an audit quality proxy were established:

- The research and the literature reviews make the error of not clearly separating the findings in jurisdictions where firm rotation is voluntary (as is currently the case in South Africa), from those where it is mandatory (as it will be in South Africa from 2023).
- Studies examining whether audit firm rotation improves auditor independence using proxies for audit quality, report mixed results. However, the evidence favours the conclusion that MAFR is not effective in improving audit quality.
- There are not many studies of national scope that assess the measurable effects in jurisdictions where MAFR has been employed.
- The literature on voluntary audit firm rotation indicates that it also is not effective as a means of improving audit quality.
- The debate is not settled, and more research is needed, specifically in jurisdictions where MAFR has been implemented.

The above critical aspects are linked to the research methodology insofar as they further establish that a study of MAFR using measurable proxies for audit quality is not possible in a South African context. The reason for this is that proxies are used to measure changes in the quality of the audit due to the firm rotation, and MAFR will only be
implemented in 2023. However, it is possible to use audit quality proxies to measure the impact of voluntary rotations in South Africa before 2023.

3.5 THE IMPACT OF MAFR ON COSTS

Some practitioners in the auditing profession maintain that MAFR in particular, causes unnecessary costs and may, in fact, impair audit quality (Bedard & Johnstone, 2010; Harber & West, 2017; ICAA, 2015). Interviews of South African audit partners by Harber (2016) found that significant cost increases to the audit firm and the audit client were expected from the implementation of MAFR. This position is derived from concerns that while client information is stored in the audit workpapers, each new engagement partner faces a certain amount of information asymmetry due to less history of client interaction (Bedard & Johnstone, 2010). In addition, a new audit team, with less familiarity of the clients operations, would require more time from the client's management to perform the audit and produce sufficient and appropriate audit documentation (Harber, 2016). This comes back to one of the primary arguments against MAFR – it may result in a significant degree of loss of client-specific knowledge (Knechel et al., 2013; Stefaniak et al., 2009). A loss of client-specific knowledge and experience will require the incoming auditor to spend time and resources in the early years of the audit engagement in order to upskill and familiarise themselves with the new client. This has cost implications for both the client and the audit firm.

Kwon et al. (2014), using South Korean audit fee and audit hour data, explore the association between rotation, engagement hours and audit fees. Audit fees and engagement hours after MAFR adoption for mandatorily rotated engagements were found to be significantly larger than before adoption. The study also suggested that costs can rise during, and even after, the repeal of MAFR. Bedard and Johnstone (2010) in a US context find that planned engagement effort increases following partner rotation, suggesting that new audit partners invest significant effort to gain client knowledge in the first year on the engagement. This effort comes from additional time and resources
employed by the audit partner and audit team, hence may increase the cost of the audit. Corbella, Florio, Gotti and Mastrolia (2015) provide evidence from Italy that following audit firm rotation, the total amount of fees paid to the auditor was lower for companies audited by a Big Four and unchanged for companies audited by a non-Big Four audit firm. Corbella et al. (2015:47) explain that:

…both the audit firm and the company invest significant effort and time (cost) following a change in audit firms. This impact will be even larger for consolidated entities that require statutory audits in many countries. In a mandatory audit firm rotation environment, these startup costs are more likely to be spread over fewer years, increasing the overall cost of the audit function for both the audit firm and the audit client.

Cameran et al. (2015) in an Italian context provide evidence that the incoming auditors charge less in the first year even though they have abnormally higher engagement hours in the first year. The audit fees after the first year were then found to be abnormally higher and exceed the initial fee discount. This is evidence of the low-balling of fees in the first year in order to obtain the appointment, meaning that the auditor offers a deceptively or unrealistically low fee in the hopes of a successful appointment, with the intention of increasing it in subsequent years. Thus, Cameran et al. (2015) indicate that the costs of mandatory rotation are nontrivial. These studies described above suggest that audit fees and engagement effort are influenced by MAFR, affecting both the auditor and the client.

According to Harber (2016), audit partners, arguing against MAFR, have claimed that the additional efforts required by the incoming auditor may increase the risk of inappropriate audit conclusions (due to unfamiliarity) and increased audit fees payable by the client (due to increased audit hours required). Increased costs, resulting from increased audit hours required, if not compensated for by increased audit fees, may result in a decrease of profitability in the audit industry. Audit practitioners have argued that this is likely, and will lead to a deterioration in the ability of firms to perform high-quality audits as they are forced to cut back on experienced staff and investment in key areas such as information technology and professional practice support (Harber, 2016; Harber & West, 2017). Some
practitioners have claimed that this decreasing profitability of the audit firms will therefore have the effect of deteriorating audit quality over the longer term. In support of this supposition, according to Knechel et al. (2013), a number of studies, mostly in Australia, have found that there is a positive association between the size of a client – which proxies for revenue opportunity and fees – and audit quality. In addition, Trompeter (1994) finds that firms with a large profit sharing pool had higher audit quality than firms where profits were shared locally. Using actual tax return data of Swedish audit partners, Knechel et al. (2013) find a negative association between client significance to a partner’s personal income and wealth and audit quality, proxied by likelihood of issuing a going concern opinion. Thus, some evidence exists suggesting that partner compensation affects audit outcomes.

In addition to the findings of Harber (2016), other research provides evidence that the audit profession believes that rotations have the effect of increasing engagement costs and this can negatively impact audit quality (Bedard & Johnstone, 2010). Chapter 5 provides a summary of the South African audit profession’s responses to the IRBA in response to the 2016 consultation paper on MAFR. Many audit practitioners identified various cost pressures that would be arise from MAFR, such as the need to upskill and learn the business of the new client, but also the need to engage in more tenders to obtain audit appointments, which was described as a significant cost and necessary result of forced firm rotations (Harber & West, 2017). Fontaine et al. (2016:496), through interviews with Canadian AC members on MAFR, found that all participants emphasised “the tremendous time and effort involved with changing audit firms”, partly due to the significant time and resources required to assess bids (tenders) for appointment. However, these participants said that these additional ‘switching costs’ would not influence their decision to change audit firm.

The results of partner rotation research by Daugherty et al. (2012) suggest that rotation can increase partners’ workloads, the likelihood of partners needing to relocate and even decrease their quality of work life. Although these are not financial costs, these possible
implications and unintended consequences also need to be considered in the MAFR debate. Based on this analysis of the cost implications from MAFR in the literature, there is a need to better understand the nature of costs imposed by MAFR in South Africa, both to the audit firm, the audit practitioner and the client.

3.5.1 Critical links to the empirical study

From the discussions above, the following critical aspects regarding the possibility of cost implications with MAFR were established:

- Increased costs to the audit firm, resulting in decreased profitability, may have the effect of deteriorating audit quality over the longer term.
- A primary argument against MAFR is that it results in a significant degree of loss of client-specific knowledge, which is developed by the audit firm over time. The newly appointed auditor has to upskill and familiarise themselves with a new client. MAFR, according to some, may have the effect of increasing costs in the profession and the need for investment of significant time and resources to learn the operations and financial processes of new clients in the early years of appointment.
- This may have cost implications for the client and the audit firm in terms of client time and engagement hours billed. The additional effort required may increase the risk of inappropriate audit conclusions, insufficient audit work and increased audit fees payable by the client.
- In order to secure appointment, incoming auditors may low-ball fees in the first years and subsequently increase them after the first year.
- Additional costs imposed by MAFR, including the consequences of auditors potentially needing to upskill and familiarise themselves with a new client, as well as the need to engage in more tenders to secure appointments, may reduce audit quality.
- Non-financial cost implications must also be considered. MAFR may impact partners' workloads, the need to relocate and the perceived quality of work life or job satisfaction.

The above critical aspects are linked to the following study objectives:

- To determine whether MAFR is considered an adequate tool to improve the quality of audits.
- To determine whether there are likely unintended consequences from the implementation of MAFR.

Refer to Hypotheses 6, 7, 8, 9 and 10

Hypothesis 6: Stakeholders perceive that MAFR will reduce audit partners’ quality of work life.

Hypothesis 7: Stakeholders perceive that MAFR will require audit partners to undergo significant efforts to upskill and retrain themselves for new industries.

Hypothesis 8: Stakeholders perceive that MAFR will reduce the appeal, in the minds of chartered accountants, of the auditing profession in comparison to other career options.

Hypothesis 9: Stakeholders perceive that MAFR will significantly increase costs to audit firms.

Hypothesis 10: Stakeholders perceive that MAFR will significantly increase costs to companies in the form of increased audit fees.
3.6 CONCLUSION

This chapter focused on auditor tenure and auditor rotation literature, establishing important links in the MAFR debate. Long auditor tenure is believed to impair auditor independence. This belief is the reason for audit partner and audit firm rotation regulations, as auditor rotation regulation is designed to limit this tenure and thereby limit the threats to auditor independence that may develop over time as the auditor-client relationship lengthens. The primary argument in favour of rotation was presented, namely, that as tenure lengthens a familiarity develops between auditor and management which may cause the auditor to lose independence and professional scepticism. However, the literature showed that auditor tenure may have the positive effect of increasing the auditors’ understanding of a clients’ complex business. This argument around potentially losing auditor skill and experience upon rotation is the primary argument against MAFR.

The literature indicates that long audit firm tenure does not necessarily impair auditor independence and could even improve audit quality through the increasing skill and experience of the audit firm with respect to the business and financial processes of the client. However, at an audit partner level, tenure is negatively associated with audit quality. This provides evidence in favour of partner rotation and not MAFR, although the mixed nature of the findings and the variety of the nature of the research, warrants caution is coming to conclusions with certainty.

Qualitative methodologies using interviews and surveys have proven useful in both partner rotation and MAFR research. These methodologies have potential to expose additional aspects of the debate and weigh up the merits of the pros and cons of rotation arguments. The studies on stakeholder perceptions to date have shown broad push-back against MAFR from ACs and audit partners. Important contributions have been provided to the complexities of the debate from these studies. Studies examining MAFR using measurable proxies for audit quality show some mixed results but are generally not in
favour of the idea that MAFR can improve audit quality. Whereas proxy-based research can be employed in South Africa to study voluntary firm rotations, it cannot be employed pre-implementation if the 2023 effective date for MAFR. Lastly, the potential impact of MAFR on costs to the auditor, the audit firm and the client was reviewed. The potential for unmanageable and unintended costs resulting from MAFR adoption is an important aspect of the debate and needs to be better understood and analysed.

In the following chapter, literature on the role of the AC, as those charged by shareholders with managing the auditor-client relationship, will be reviewed in the context of auditor rotation. The auditor-client relationship in a large company is overseen and managed by the company’s AC, which comprises non-executive directors of the company. Therefore, the AC represents a key stakeholder and active participant in the audit process. Codes of good corporate governance and company legislation provide guidance and laws for the AC to apply in managing the auditor’s appointment, role and audit findings. This aspect of the audit function and process is important within the context of the MAFR debate.
CHAPTER 4: THE ROLE OF THE AUDIT COMMITTEE IN THE OVERSIGHT OF AUDITOR INDEPENDENCE

4.1 INTRODUCTION

ACs have, in recent years, been a key component of corporate governance regulation and there is a growing emphasis on AC regulation and an intensification of research on the subject (Ghafran & O’Sullivan, 2013). The AC is a key component of corporate frameworks and is responsible for the appointment, compensation and oversight of external auditors (IoDSA, 2016; Marx, 2009a). This is also reflected in South African company law, with the legislated duties of the AC (RSA, 2008). Interview studies involving external auditors (Cohen et al., 2010; Harber, 2016) and AC members (Beasley, Carcello, Hermanson & Neal, 2009; Fontaine et al., 2016) indicate that the importance of the AC’s role in monitoring auditors and financial reporting quality has increased in the post-SOX period. Understanding AC perspectives on auditor independence and objectivity is critical since the AC is charged with overseeing financial reporting and disclosure (Fontaine et al., 2016). ACs are authorised to make audit firm selection decisions and could voluntarily implement a firm rotation programme if they so desire. A common criticism of the IRBA’s decision to implement MAFR in South Africa is that it neglects the important role that a company’s AC plays in maintaining the independence of the auditor from company management influence (Harber, 2016; Harber & West, 2017). As expressed by Shango (2017:4), the CEO of PwC Southern Africa:

The audit committee fulfils an important role in a properly functioning capital market like South Africa in overseeing the external audit process and making the auditor appointment decision. MAFR undermines this responsibility and takes away the audit committee’s freedom to decide which accounting firm best meets the needs of the company and its shareholders. It conflicts with their statutory responsibilities under the Companies Act. As such MAFR reduces the audit committee’s ability to fully discharge its oversight responsibilities and in turn disenfranchises shareholders’ ability to obtain the highest quality audit in the most efficient way.
According to Ghafran and O’Sullivan (2013), ACs have been subject to more prescriptive regulation since the Enron scandal (2001) and this has motivated a vast amount of research focusing on very specific aspects of AC characteristics and operations, with a move towards how these characteristics impact specific aspects of the financial reporting process. The aspects that are relevant to this study on MAFR include the following key roles of the AC:

- Assessing the appropriateness and independence of the auditor, which precedes the recommendation by the committee of an auditor for formal appointment by shareholders;
- Approving the nature and extent of non-audit work to be provided by the auditor;
- Discussing and approving the audit plan as presented by the auditor;
- Approving the audit fee and other terms and conditions of the engagement, on behalf of the organisation;
- Reviewing the outcomes of the audit process, as communicated by the auditor and recommending to management the implementation of changes in response, especially with regards to financial reporting risks; and
- Managing the relationship and interactions between auditor and management of the organisation.

The above roles are consistent with the recommendations of the King IV Report on Corporate Governance in South Africa as well as the requirements of the Companies Act, 2008 (Act No. 71 of 2008), as they relate to the function of the AC. It has been established that the external auditor is an important factor mitigating the risks posed by the agency problem. Therefore, insofar as the AC is responsible to some degree for oversight of the audit process and the auditor-client relationship, the effectiveness of such a committee has a bearing on the quality of the audit.
According to Marx (2009a:i):

…accurate, credible and reliable financial reporting is critical for the effective functioning of the world’s capital markets and the protection of the interests of stakeholders, who rely on such information for their decision making. Audit committees will thus only be of value if they are properly constituted, are functioning effectively and if their role is clearly understood by all the parties concerned.

This chapter will focus on the literature that addresses the role of the AC in overseeing and managing the auditor-client engagement as well as its responsibility to safeguard the quality of the financial reporting process. As the key other party to the audit engagement and considering the AC’s important role in ensuring audit quality, the MAFR debate must include consideration of the AC in maintaining the independence of the auditor.

4.2 THE EFFECTIVENESS OF THE AUDIT COMMITTEE

Just as capability and independence are important auditor characteristics necessary for the production of high-quality audits (Tepalagul & Lin, 2015), the AC, as individual members and as a collective, requires certain characteristics in order to function appropriately. Arguably the most important factor in the effectiveness of the AC are the qualities possessed by the members themselves who comprise the committee. According to Marx (2009a), ACs are found to be more effective when composed of members who are independent and possess specific technical knowledge regarding accounting and financial issues and have adequate time to devote to fulfilling their duties. This conclusion is consistent with the recommendations of the King IV Report on Corporate Governance in South Africa as well as the requirements of the Companies Act, 2008 (Act No. 71 of 2008), which require independent and competent AC members.
Research by Marx (2009a:i) in a South African context found that:

…audit committees are well established, properly constituted, have the authority and resources to effectively discharge their responsibilities and consist of members who act independently and who have the right mix of appropriate experience, financial literacy and financial expertise amongst their members. The audit committee’s role was found to be generally well understood and supported by the board and the chief financial officers.

These findings are significant to the MAFR debate in South Africa considering that ACs are charged in terms of legislation and corporate governance codes to safeguard auditor independence and the quality of financial reporting. If the composition and functioning of South African ACs is generally of a high standard, this should result in an effective professional judgement regarding when to change auditors. If management, especially the CFO, understand the separation of roles between AC and management, this contributes to an independent assessment of the independence of the auditor by the AC. Therefore, an effectively functioning AC may provide reasoning against the need for MAFR in South Africa.

Ghafran and O’Sullivan (2013), performing a review of AC literature, found evidence in the research that larger and more independent ACs, as well as those with financial expertise, were more likely to seek a higher level of external audit coverage and assurance. In addition, there is evidence that more independent ACs are associated with the purchase of lower levels of non-audit services from auditors, thereby seeking to preserve the independence of the external audit process. These findings in an international context are consistent with those of Marx (2009a) and emphasise the importance of considering the role of the AC in safeguarding the independence of the external auditor and the MAFR debate. In South Africa, the role of the AC in this regard is also a statutory responsibility. In terms of section 94 of the Companies Act, 2008 (Act No. 71 of 2008), an AC of a public interest entity is required to formally assess the independence of the external auditor from management as well as approve the nature and extent of any non-audit services provided. An important function of the AC is also to
maintain and improve the quality of the company’s financial reporting (Ghafran & O’Sullivan, 2013; Knechel et al., 2013; Marx, 2009a).

Cohen et al. (2010) provide evidence that ACs have become considerably more active and diligent in the post-Sarbanes Oxley Act era. ACs are again seen as having sufficient expertise and power to fulfill their responsibilities, with members playing important roles in overseeing internal controls, focusing on reporting quality, identifying risks, asking challenging questions and overseeing the whistle-blowing process (Cohen et al., 2010). ACs are increasingly taking responsibility for the quality of corporate financial reporting and research shows that increased independence and expertise on ACs is resulting in improved financial reporting quality (Ghafran & O’Sullivan, 2013).

Research on the association between various characteristics of ACs and financial statement fraud reveals the positive impact these characteristics have on reducing the likelihood of fraud (Owens-Jackson, Robinson & Shelton, 2009). The occurrence of financial statement misstatement and fraud is not only costly to investors, but also has reputational consequences for AC members (Srinivasan, 2005), and as such there is reputational incentive to monitor the independence of the external auditor. Interestingly, according to the literature review of Cohen et al. (2010), many auditors report that management continues to be the dominant player in auditor appointment and dismissal decisions and only about half of the auditors felt ACs play an important role in resolving auditor disputes with management.

From the above literature review, it can be concluded that Cohen et al. (2010) in a US context and Marx (2009a) in a South African context, provide evidence that ACs are increasingly effective in their ability to assess and manage auditor independence. However, Cohen et al. (2010) do identify the problem that management may still have undue influence over auditor appointment and dismissal, which is a concern of the IRBA in South Africa, and one of their reasons for the implementation of MAFR (IRBA, 2016e).
Some of the South African audit partners interviewed by Harber and McGregor (2017) expressed concerns regarding the independence of ACs, although the majority believed that ACs were effective and independent with respect to exchange-listed (JSE) companies. The link between the AC and its independent role in the external audit function (independence from management) is an important consideration in the MAFR debate.

4.3 AUDITOR-CLIENT NEGOTIATIONS REGARDING FINANCIAL REPORTING

Negotiation is often required between the auditor and the company regarding the financial statements because for many financial statement accounts, uncertainty exists about the true value to report, and different incentives exist for managers and auditors (Ng & Tan, 2003; Wang & Tuttle, 2009). The International Standard on Auditing (ISA) 260 (Revised), “Communication with Those Charged with Governance”, requires the auditor to present and discuss all material disagreements (with management) and differences that were uncovered during the audit, to the board or the AC (those charged with governance). The role of the AC is therefore very important in the quality of financial reporting.

Uncertainty and the need to apply professional judgement in many areas of financial reporting implies that a range of possible and reasonable values exists regarding amounts and disclosures. In this context, differing incentives can lead management of the company and auditors to prefer different values within the range of possibilities. The responsibility of the AC is to act as the primary and independent party (independent from management) acting on behalf of the company in these negotiations with the auditor (IoDSA, 2016; Marx, 2009b). A potential problem identified in the US by Cohen et al. (2010) and in South Africa by Harber and McGregor (2017) is that the AC may sometimes acquiesce to management preferences regarding financial reporting issues raised by the auditors.
A study by Wang and Tuttle (2009) on audit firm rotation, building on the findings of Dopuch, King and Schwartz (2001), but incorporating negotiation theories, investigated the process differences in auditor-client negotiations under conditions with and without MAFR. Where uncertainties arise, 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 & Tuttle, 2009). Management have the incentive to apply accounting standards and provide estimates in such a manner so as to increase financial position and financial performance, in comparison to auditors (IFAC Code, 2016; Wang & Tuttle, 2009). 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 MAFR, 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). This provides evidence in support of MAFR as it indicates that ACs apply increased judgement, not only to the independence of the auditor, but also to the areas of disagreement between company management and the auditor, the so-called ‘audit misstatements’ that the auditor presents to the AC.

Hatfield, Jackson and Vandervelde (2011) contributed to the debate on audit partner and audit firm rotation by 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). These results 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 provided to management and the AC. This is a similar conclusion to Laurion et al. (2015).

The research by Chen and Zhou (2007) is particularly significant to the South African MAFR debate. Chen and Zhou (2007) studied the role of the AC and board of directors on the auditor switch decisions by Arthur Andersen’s clients before the collapse of Enron. Chen and Zhou (2007) found that companies with more independent ACs, committees with greater financial expertise and ACs with larger boards, dismissed Arthur Andersen earlier. On the other hand, companies with larger and more active ACs were more likely to choose a Big Four firm as the successor auditor. There was also evidence that firms with more independent boards were more likely to dismiss Arthur Andersen earlier and to choose a Big Four successor auditor. As this relates to the South African MAFR debate, the larger companies (listed and public interest entities) are likely to have more independent and competent ACs, capable of safeguarding the independence of the audit function and financial reporting quality. This evidence strengthens the anti-MAFR position. In addition, on rotation of the audit firm under a system of MAFR, the findings of Chen and Zhou (2007) indicate that ACs will replace Big Four firms with another Big Four firm. This will have the effect of further concentrating the market, counter to the intentions of the regulator (Harber & West, 2017; IRBA, 2016e).

From the above research it can be concluded that there is a risk that the AC may acquiesce to management preferences regarding the oversight of the external auditor and negotiation with them on matters arising from the audit. In support of MAFR, newly appointed auditors may adopt less co-operative negotiation strategies, providing results closer to the preference of the auditor than that of the client. In addition, evidence suggests that auditors who have no involvement in prior period audit adjustment propose current period audit adjustments that are larger, and perhaps therefore more
conservative, than auditors who had prior involvement. This also supports the strengthening of auditor negotiation in a system of MAFR. However, there is also evidence that ACs with greater financial expertise and with larger boards, such as those of exchange-listed companies, are more effective (Chen & Zhou, 2007; Marx, 2009b). This does not provide support for MAFR.

4.4 THE MANAGEMENT-AUDIT COMMITTEE DIVIDE

A significant concern regarding auditor independence is that the auditor may advocate for management, rather than viewing the market, the shareholders or the public as the real client (Buffet & Clark, 2006). This is a problem that theoretically would be solved by a competent, experienced and effective AC, as discussed above. Ghafran and O’Sullivan (2013) performed an extensive review that synthesised international empirical research on the AC’s role in corporate governance. Much of the findings of Ghafran and O’Sullivan (2013) fall in support of regulatory strengthening of AC 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 ACs 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 ACs are susceptible to poor oversight of the external audit process. Applying these findings to the South African MAFR question which targets large listed companies, these company ACs are likely to be operating with a higher degree of expertise and independence from management as well as requesting less non-audit services from the auditor. The results of this literature review by Ghafran and O’Sullivan (2013) are consistent with the South African findings of Marx (2009a).

The dominant view in both academic literature and the auditing profession, including regulation, is that the AC ‘owns’ the auditor appointment process and has primary
responsibility in assessing the independence and suitability of the auditor before making the appointment decision (Bedard & Johnstone, 2010; Cohen et al., 2010; Fiolleau et al., 2013; Ghafran & O’Sullivan, 2013). As an example, in South Africa these obligations of the AC 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 US leave in place power relations resulting in management acting as the dominant party who hires both the auditor and the directors on the AC. Due to management becoming the dominant party, the AC’s actions have the risk of becoming ceremonial rather than substantive (Cohen et al., 2010).

Case-study based research by Fiolleau et al. (2013), using a large US public company, illustrated this problem of a lack of independence and involvement by the AC. The research explored the validity of the divide between AC and management as it relates to the auditor decision. The listed company analysed was perceived by the investing public to have a good quality and regulatory-compliant AC. Fiolleau et al. (2013) investigated how the AC interpreted and executed its legislative mandate in appointing an independent external auditor and the role of management in these responsibilities. The findings of Fiolleau et al. (2013) were concerning, showing a limited involvement of the AC in the appointment process and decision. The AC 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 AC 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, they 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). Although this is a case study of just one company, it does serve to show the importance
of an independent and effective AC and the risk of the committee abdicating its responsibilities and simply agreeing with management decisions on issues over which it should exercise control.

These results, contrary to the findings of Marx (2009) in South Africa, show a potential for the AC 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 AC, 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-AC dependence (Fioleau et al., 2013). According to the findings of Fioleau 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, Fioleau et al. (2013) suggest that client-management power, rather than audit industry politics, may be an important factor in undermining regulatory reforms.

Of the audit partners interviewed by Harber and McGregor (2017), some did share experiences whereby the AC merely ‘rubber-stamped’ the decisions of management in matters that should have been the prerogative of the committee. However, this was not commonly expressed, nor was it deemed a pervasive problem by the experienced auditors who described such scenarios.
Based on the above research, there is a valid concern in the MAFR debate regarding the undue influence of management on the AC in dealing with the auditors. According to Hay (2015:168), research indicates "that management still has some influence over the auditor, even when the audit committee is formally responsible". The findings of Fiolleau et al. (2013), although covering only one company, show the potential for an ineffective AC that bows to management preferences in dealing with the auditor. In addition, the auditors with the least experience and lowest fee were appointed, despite management and the AC stating that the price was not a primary criterion or motivation for the decision. There may be incentives for auditors to low-ball audit fees and build compromising relationships with management in order to secure appointment. The less effective the AC, the stronger the argument for forcing the rotation of auditors through regulation (MAFR) in order to bring back the 'fresh look' and professional scepticism to the audit engagement.

4.5 CRITICAL LINKS TO THE EMPIRICAL STUDY

From the discussions above, the following critical aspects regarding the role of the AC and its impact on the MAFR debate were established:

- Due to the nature of its responsibilities, AC effectiveness impacts the independence of the auditor and audit quality. Hence, the role and effectiveness of ACs in South Africa must be considered in the MAFR debate.

- ACs will only be of value if they are properly constituted, are functioning effectively and if their role is clearly understood by all the parties concerned, including management of the organisation.

- Evidence has been provided showing that South African ACs of exchange-listed companies are well established, properly constituted and have the authority and resources to effectively discharge their responsibilities. International studies show similar results, i.e. improved committee effectiveness, especially in the past couple of decades.
• Research into the opinions of auditors in South Africa indicates that audit partners also generally believe that ACs are functioning effectively in South Africa. Some partners expressed concern that MAFR will reduce (or even eliminate) the role of the AC in applying professional judgement to assess auditor independence. There was widespread acceptance of the idea that further strengthening the expertise of ACs was a viable alternative to MAFR in South Africa.

• However, there are findings that show the potential for the AC to represent the wishes of management, rather than provide an independent oversight. This compromise of independence and effectiveness may lead to reduced financial reporting quality and reduced ability to detect and prevent financial misconduct in the organisation.

• ACs are required to negotiate financial reporting outcomes, including differences of opinion, with auditors. In addition, it is important that the committee is independent of management in order to objectively assess matters raised by the external auditor and influence management response to such issues.

• There may be incentives for auditors to low-ball audit fees and build independence-compromising relationships with management in order to secure appointment.

• The perceptions of AC members themselves with regard to the above issues are an important contribution to the MAFR debate in South Africa.

The above critical aspects are linked to the following study objectives:

• To critically assess whether auditor independence and audit quality are considered a problem in South Africa.

• To determine whether MAFR is considered an adequate tool to improve the quality of audits.

• To recommend possible credible alternatives as well as changes to current proposals, including transitional provisions that will allow MAFR to better achieve its stated objectives.

• To critically assess and contrast the perceptions and arguments of key stakeholder groups and individuals within the broad ambit of the South African MAFR debate.
Refer to all Hypotheses, but especially Hypothesis 11

Hypothesis 11: Stakeholders perceive that MAFR will reduce the ability and/or incentive of the audit committee to apply professional judgement to assess auditor independence and to find the audit firm best able to provide them with a high-quality audit.

As a key participant in the audit engagement, the perceptions of audit committee members with regards to testing all hypotheses is relevant in this study.

4.6 CONCLUSION

This chapter focused on the nature of the responsibilities of the AC and established its importance with regards to its impact on the issues relevant to the MAFR debate. The effectiveness of the committee could potentially affect the independence of the auditor and audit quality. Whereas evidence suggests that ACs in South Africa are effective, there are findings internationally that show a potential for the AC to not be effective in its role, to represent the wishes of management with regards to financial reporting and to lack the independence needed for its important oversight role. This compromise of independence and effectiveness may lead to reduced financial reporting quality, perceptions of lacking auditor independence and reduced ability to detect and prevent financial misconduct in the organisation.

Stakeholders in the audit function may believe that ACs are functioning effectively in South Africa and that MAFR could reduce the role of the AC in applying professional judgement to assess auditor independence. Furthermore, strengthening the expertise of ACs may be an alternative to MAFR, or something that needs to be done in addition to
MAFR. As a key participant in the audit engagement, the perceptions of AC members with regards to testing all hypotheses are relevant in this study.

The following chapter discusses the specific South African context to the MAFR debate, including details of the MAFR ruling and key stakeholder responses to the IRBA consultation paper. In addition, the unique additional South African objectives for MAFR, namely, transformation and market concentration, are explored and contextualised.
CHAPTER 5: THE SOUTH AFRICAN CONTEXT TO THE MAFR DEBATE

5.1 INTRODUCTION

In June 2017 the South African audit regulator (IRBA) ruled in favour of MAFR (Board Notice 100 of 2017, Government Gazette No. 40888) in addition to the existing regulations and frameworks that are designed to safeguard the independence of the auditor. This ruling was made after a period of stakeholder consultation and debate, which included public hearings before the South African Parliament Standing Committee on Finance (SCoF). This period of consultation revealed significant resistance to the intentions of the IRBA, with perhaps the Big Four audit firms and large exchange-listed companies in South Africa expressing the greatest concerns over the proposed ruling.

The purpose of this chapter, which follows the review of academic literature in the preceding chapters, is to outline the South African debate as it has occurred leading up to the June 2017 ruling by the IRBA. The existing regulations and frameworks which are in place to manage auditor independence and auditor tenure are explained and a review is conducted of the arguments and opinions of key stakeholders who responded to the IRBA’s request for feedback. These views were expressed by those who submitted responses to the IRBA consultation paper issued in October 2016, which requested comments by affected parties. This section is, however, limited by the public availability of the letters sent to the IRBA in response to the IRBA consultation paper. The important aspects of the South African MAFR debate surrounding racial transformation and market concentration are also explained and contextualised.
South Africa is considered a leading jurisdiction for the development of stakeholder protection frameworks, regulation and legislation. Despite experiencing some deterioration in ranking in the latest 2016/2017 report, the World Economic Forum Global Competitiveness Reports show that South Africa’s ‘strength of investor protection’, ‘strength of auditing and reporting standards’ and ‘efficacy of corporate boards’ are among the best internationally and comparable to more developed countries (World Economic Forum, 2015; 2017). For seven years in a row, South Africa was ranked best in the world for ‘strength of auditing and reporting standards’ (Agulhas, 2017). In addition, South Africa has what are considered world-leading corporate governance codes; it was also the pioneering nation for developing integrated reporting in organisations (de Villiers et al., 2014). An integrated report “is a concise communication about how an organisation’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value over the short, medium and long term” (IIRC, 2013:7). As such, Integrated Reporting is a practice that promotes the furtherance of achieving organisational goals beyond financial indicators, to the benefit of broader concepts of value creation for stakeholders other than just the shareholder. In South Africa integrated reporting is a JSE listing requirement and guidelines for integrated reporting were being developed before the formation of the International Integrated Reporting Council (IIRC). Unlike South Africa, integrated reporting practices are not mandatory in any other country (de Villiers et al., 2014).

A possible reason for South Africa’s focus on regulations to protect company stakeholders and investors is due to its history. The system of apartheid that existed before democracy was instituted in 1994 was based on entrenched social and economic inequalities which the new government was determined to correct. According to de Villiers and van Staden (2006), at a country rather than organisation level, after the end of apartheid, South African businesses were increasingly called to account for their non-financial performance. During the negotiations from 1990 to 1994 to establish a new order
following apartheid, existing elements of the economic and social order were questioned, including the right of companies to operate and make a profit. This scepticism of the social and economic order that had produced political as well as financial exclusion and inequality, provided the backdrop for South Africa to form a progressive framework of regulations and legislation that prioritised investor and stakeholder protection (Marais, 2010). This history also resulted in racial transformation initiatives becoming national policy in order to move capital markets and organisations towards becoming more demographically representative of the population (BEE Commission, 2001; Ponte et al., 2007). It is in this context that the IRBA is seeking to implement MAFR, firstly as a means of protecting the investing public by improving audit quality, but also to drive transformation and competition in the South Africa audit industry.

5.2 STATUTORY REQUIREMENTS FOR THE JUNE 2017 MAFR RULE

The ruling, effective April 2023, requires that audit firms must serve for a maximum of ten years before rotating off the client for a cooling-off period of five years, before being eligible to audit the client again. According to the IRBA, based on recommendations made in submissions received during the consultation process, the rule has been extended beyond auditors of listed entities to incorporate auditors of public interest entities (PIEs) which would include, for example, non-listed pension funds and organisations that operate in the public interest (IRBA, 2017b). The ruling also has transitional provisions for cases where joint auditors are appointed to ensure that both audit firms need not become ineligible at the same time at the effective date (IRBA, 2017b). This ruling is therefore similar to those enacted in the EU in 2014, as discussed in more detail in Chapter 6.

The October 2016 IRBA consultation paper as well as the official communications prior to this described the MAFR ruling as applying only to all listed companies in South Africa (IRBA, 2016e). The fact that the IRBA intended to make it effective in 2023 was due to
the necessity of aligning MAFR with section 90(2) of the Companies Act, 2008, which prohibits an auditor from having conducted certain non-assurance services to a company within the past five financial years. These services include a broad range of accounting and related services such as “a person who, alone or with partners or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs the related secretarial work” (section 90(2)(b)(iv)). Many audit firms in South Africa offer a broad range of accounting services to companies where they are not the appointed auditor, and by doing so, are not eligible for appointment as auditor for five years after they cease performing such non-audit work. This is a law intended to safeguard the independence of the auditor, to avoid placing “auditors in the problematic role of auditing their own work” (Francis, 2004:363). The IRBA, by implementing the MAFR rule in 2023, will allow audit firms who currently perform such accounting services for companies, and who wish to tender for appointment as auditor under MAFR, to resign from these accounting service engagements, to make them eligible for appointment as auditor when the MAFR rules are effective, which is more than five years from 2017.

However, the actual ruling on 5 June 2017 caught many by surprise, in at least the following two significant areas which were not communicated prior to June 2017, and not described as the IRBA’s intention in the 2016 consultation paper:

- MAFR will apply to public interest entities (PIEs) in South Africa as well as listed companies. PIEs are “as defined in section 290.25 to 290.26 of the amended IRBA Code of Professional Conduct for Registered Auditors” (IRBA, 2017b:1). Per the amendments to the IRBA Code of Professional Conduct for Registered Auditors, the definition of PIEs resulted in the inclusion of public companies, banks, pension funds, insurers, collective investment schemes, medical aid schemes and other financial services companies (IRBA, 2016a).
MAFR applies not only to the audit firm, but also to the “network firm as defined in the IRBA Code of Professional Conduct for Registered Auditors” (IRBA, 2017b). The entire network of firms is required to rotate off the client, not just the local firm where the engagement partner and audit team are located. As explained by the IRBA in subsequent clarification of ‘network firm’, this includes all member firms of a network. For example, all of Deloitte Inc., 220,000 employees in 150 countries, is part of the Deloitte network and therefore not eligible for appointment after rotation. Even non-Big Four firms such as BDO, Grant Thornton, RSM etc. have an international network of branded firms. Some audit firms may belong to a network whereby separate brands are included, such as Sizwe Ntsaluba Gobodo Inc., where member firms carry separate firm names. The ruling still applies to networks such as these (IRBA, 2017a:11).

The above two changes are significant and have the effect of broadening the scope of MAFR applicability. Both rules were not contained in the MAFR consultation paper and have caused a degree of further unhappiness in those opposed to MAFR in South Africa (Peyper, 2017).

5.3 EXISTING MEASURES IN SOUTH AFRICA TO SAFEGUARD AUDITOR INDEPENDENCE

Currently South Africa follows a system similar to the US with regards to auditor rotation. The MAFR ruling, effective in 2023, will be similar to that implemented recently in the EU, as described in the preceding chapter. This current system in South Africa requires individual audit partner rotation every five years, with a cooling-off period of two years, as prescribed by section 92 of the Companies Act, 2008 (Act No. 71 of 2008). In addition to this legislation, the audit profession in South Africa also places a large degree of reliance on the profession’s ethical standards in order to internally assess (or self-assess) threats to its independence as auditor. These standards are contained in the ISAs as well as the
Code of Ethics for Professional Accountants issued by the IFAC (the IFAC Code of Ethics). In terms of this code, the engagement audit partner on a publicly listed entity should rotate off the client after no longer than seven years (IFAC Code, Section 290:154, 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 AC of public interest entities to assess the independence of the auditor. This is legislated by section 94 of the Companies Act, 2008 (Act No. 71 of 2008). In terms of this statute, the AC must judge whether the auditor and the audit firm are suitably independent of the company and must formally approve all non-audit services provided by the audit firm, such as advisory or tax-related services. Therefore, the AC is considered to be a key gatekeeper of auditor independence. Guidance is also provided to ACs in the King IV Report on Governance (King IV), which is the South African best practice guidance on issues of corporate governance. King IV recommends that the AC manages the relationship between management and the auditor and continually assesses the appropriateness and independence of the auditor, recommending them for appointment to the shareholders (IoDSA, 2016). The AC also retains the right to place the audit engagement out for tender into the market. However, the legislation, regulations and recommended practices in South Africa, including those of the JSE, stop short of requiring mandatory audit firm tendering or MAFR as is now being implemented in the EU and the UK.

In its response against the regulator’s position on MAFR, Deloitte Inc., one of the large international audit firms, outlined concisely the range of existing measures in South Africa aimed at audit quality and auditor independence. This was provided as part of Deloitte Inc.’s arguments against the need for MAFR in South Africa, but here serves as a succinct summary of existing policies, regulations and controls in a South African context to mitigate the threats to the independence and lack of professional scepticism of auditors:
• Engagement partner rotation.
  Comment: This is required every five years for PIEs in terms of section 92 of the Companies Act, 2008.

• Independent audit committees to ensure auditor independence.
  Comment: The Companies Act, 2008, section 94, requires only non-executive directors to comprise the audit committees of PIEs. In addition, the King IV Report on Governance recommends that only independent directors comprise the audit committee. The audit committee is responsible for assessing the independence and suitability of the auditor annually.

• Appointment of the external auditor by the shareholders.
  Comment: At the annual general meeting, shareholders must appoint the auditor in terms of section 90 of the Companies Act, 2008. The recommendation of the audit committee is to recommend the auditor for appointment in terms of section 94 of the Act.

• Pre-approval of non-audit services by the board and audit committee.
  Comment: This is a requirement of section 94 of the Companies Act, 2008. The audit committee is therefore responsible for considering whether any non-audit services to the company compromise auditor independence due to conflicts of self-interest, self-review, familiarity etc.

• The prohibition of certain non-audit services.
  Comment: Certain services by the auditor are prohibited by section 90(2) of the Companies Act, 2008, as well as the IFAC Code of Professional Conduct, in order to promote independence and professional scepticism in the auditor. Examples of prohibited services by the auditor include the preparation of the financial statements or the maintenance of the accounting records.

• Independent Regulatory Oversight - regular external inspections of audit firms by the IRBA, as well as the PCAOB (the US regulator), which have resulted in positive changes to audit firm oversight and improvements in audit quality.

• Internal engagement quality control reviews in terms of ISQC 1 (an international auditing standard) which strengthens audit quality.

Source: Researcher’s own construction based on the Deloitte Inc. response to the IRBA consultation paper (Bam, 2017)
This represents a sufficient summary of the existing regulations and principles that currently govern the independence and objectivity of the auditor in South Africa. In the view of Deloitte Inc. as well as the other large international audit firms (refer below to section 5.5), the above measures and principles are sufficient to ensure auditor independence.

5.3.1 Critical links to the empirical study

The above existing legislation, regulations and frameworks are used by audit industry participants to argue that MAFR is not necessary (Harber & West, 2017). The audit partners interviewed in the study by Harber (2016) are of the opinion that the current system is sufficient. The detailed analysis of the development, status and functioning of ACs at large listed companies in South Africa by Marx (2009a) also suggests that the role of the AC is sufficient, together with other regulations, to ensure that the auditors are appropriate and independent. Therefore, this study seeks to further understand the views of key audit industry participants on the necessity of MAFR and the sufficiency and appropriateness of existing legislation, regulations and frameworks to regulate auditor independence. A particular focus is placed in this study on the effectiveness of the role of the AC in ensuring auditor independence.

The above critical aspects are linked to the following study objectives:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
- To determine whether MAFR is considered an adequate tool to improve the quality of audits.
- To recommend possible credible alternatives as well as changes to current proposals, including transitional provisions, that will allow MAFR to better achieve its stated objectives.
To critically assess and contrast the perceptions and arguments of key stakeholder groups and individuals within the broad ambit of the South African MAFR debate.

Refer to Hypotheses 12

Hypothesis 12: Stakeholders perceive that, in addition to the current measures in place, there are better solutions than MAFR to address the concerns raised by the IRBA.

5.4 THE IRBA CONSULTATION PAPER

In October 2016 the IRBA issued a consultation paper detailing the regulator’s reasons for implementing MAFR as well as the intended rotation periods and other criteria. Interested and affected parties were then asked to submit written comments on the paper by 20 January 2017. The consultation paper explained that the regulator had considered various alternatives for regulatory change to improve auditor independence but had resolved that the most appropriate measure to be introduced was MAFR, with the possibility, in certain circumstances, to implement MAFR in conjunction with joint audits. At the outset of the paper the regulator recognised that its “ultimate responsibility is to protect the investing public, and to contribute to ensuring a reliable financial market which will generate confidence and promote investment and growth” (IRBA, 2016b:4) and that MAFR was the best means of ensuring this. The consultation paper outlined that the IRBA had begun research on the topic in July 2015, concurrently with a consultation process undertaken to engage in dialogue with a broad range of stakeholders. The range of stakeholders included audit firms, regulatory bodies, business forums and JSE-listed company representatives.
5.4.1 The intended rotation period

The paper made the details of the intended rotation periods clear. An audit firm will not be eligible to serve as the registered auditor of a listed company for more than ten consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as registered auditor after the expiry of at least five financial years (the cooling-off period). This is similar to the ten-year rotation period implemented in the EU. The IRBA’s intention is for legislation to be amended and these requirements to be effective for financial years commencing on or after 1 April 2023. Transitional provisions were also provided, for example, if there are joint auditors at the date the legislation becomes effective.

5.4.2 The IRBA’s reasons for MAFR

The IRBA’s reasons for the implementation of MAFR were stated in the consultation paper and other official correspondence to the market. In previous communications from the IRBA, the main reasons for considering further measures to strengthen auditor independence through MAFR were 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, 2015c; Ziady, 2016)
The IRBA consultation paper did state that auditor independence, to ensure public protection, was the reason for pursuing MAFR. However, the consultation paper also made it clear that the other two objectives were also important. This is consistent with other communication issued by the IRBA in respect of MAFR, such as in a newsletter (Issue 37) published in 2017:

Transformation of the profession has also been brought into the spotlight in recent months and has been further elevated by the parliamentary hearings into MAFR that took place in February and March. The IRBA as an organ of state and a regulator is compelled to drive transformation and ensure that the auditing profession is transformed in a fair, equitable and competitive manner (IRBA, 2017b:2).

The consultation paper was clear that MAFR was to be adopted in response to several concerns and threats. For example, the paper stated that there was a “risk of failure of one of the major audit firms” because the audit industry was too concentrated around the Big Four firms. Consequently, it was stated that any failure of a Big Four firm, as happened with Arthur Andersen, would necessarily permeate into other economies and jurisdictions, exaggerating the damage and financial loss (IRBA, 2016b:12). In order to illustrate this reality, the paper quoted the Financial Times (London) that “only two FTSE 100 companies are not audited by the Big Four: Sports Direct, which retained the services of Grant Thornton after earning promotion to the FTSE 100 in 2013, and Randgold Resources, which has used BDO since 2007”. The paper also quoted the Institute of Chartered Accountants England and Wales (ICAEW) as follows: “At the end of 2014, the Big Four audited 95 per cent of the world’s 500 largest companies” (IRBA, 2016b:12).

The IRBA is concerned with the high degree of concentration on Big Four firms auditing the large exchange-listed companies in South Africa and the risk this poses to the economy and the investing public.

The paper clarified the regulator’s position regarding its intention to use MAFR to promote black-economic transformation (racial transformation) by stating that “MAFR is not intended to address transformation but rather to strengthen auditor independence” (IRBA, 2016b:29). However, the paper admitted that transformation was an intended benefit of
MAFR by conceding “that the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity” (IRBA, 2016b:29).

From the above it is clear that the IRBA is pursuing MAFR as a means of meeting multiple objectives, not just as a means of improving audit quality. However, it is correct to conclude that improving audit quality through increased auditor independence is the primary objective. Of particular importance, especially when considering the responses received by various stakeholders to this paper, are the reasons given by the IRBA for why they believed auditor independence was a concern. The paper highlighted the following ‘threats and concerns’ relating to the independence of auditors:

1. Familiarity threats between CFOs and incumbent auditors which impair independence;
2. Familiarity threats between AC chairs and incumbent auditors;
3. The regulator’s inspection findings relating to ethical requirements at audit firms;
4. The long audit tenures of many audit firms with listed companies in South Africa; and
5. The state-owned Public Investment Corporation, which is the largest asset manager in South Africa, as well as the Auditor-General, expressed concerns regarding the independence of AC members and audit firms.

(IRBA, 2016b:15)

The paper did not provide much research to justify the concerns raised and this was a significant criticism of the paper as will be further discussed. However, some evidence was provided for points 3 and point 4 above, as follows:

**Evidence provided for point 3 (IRBA inspection findings):** The results of the 2014/2015 IRBA annual inspections on selected audit firms were disclosed (refer to Figure 5.1 below). These inspections evaluate the performance of a selection of audit
engagements over the period as well as the design and effectiveness of their quality control policies and procedures. The annual report provides an analysis of key findings arising from firm and engagement inspections performed by the Inspections Department of the IRBA. The report cited in the consultation paper 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)

The IRBA is concerned that a significant portion of the findings relate to relevant ethical requirements, and more specifically, issues where impaired independence may be considered the root cause. The IRBA described a cause for these ethical contraventions as being a “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:13).

Figure 5.1: Summary of 2014/2015 IRBA Public Inspections Report findings

Source: IRBA 2014/2015 Public Inspections Report
Figure 5.1, extracted from the 2014/2015 Public Inspections Report, indicates a significant breach by auditors in South Africa of ethical requirements, both relative to other issues but also in the comparison made to the International Forum of Independent Audit Regulators (IFIAR) Inspections Workshop. The IFIAR inspection findings are based on a survey of 29 member countries and present as a percentage the number of inspected firms with deficiencies found per ISQC1. It should be noted that the IFIAR results represent the six largest global network firms, whereas the results for South Africa span the entire population of large, medium and small auditing firms which were inspected.

As explained in the IRBA newsletter 32, the Inspection Committee reported on 37 audit firms and 375 audit engagement inspections for the year (IRBA, 2015b). Most firms showed one or more deficiencies, including ethics (namely independence), engagement performance and monitoring, which required urgent improvement. A significant number of individual audit engagement files also showed deficiencies that needed 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 non-compliance 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. Based on the above findings, there clearly seems to be a problem with ethical contraventions by South African audit firms that needs to be addressed.

The results of these Public Inspections Reports, such as the report summarised above, form the background to the concern raised in point 3 above. Clearly the results show areas of concern regarding the items tested.

Note: since the publication of the IRBA consultation paper in October 2016, subsequent IRBA Public Inspections Report Findings such as the 2015/2016 report and the
2016/2017 report, indicated similar results (IRBA, 2017c, 2018a), i.e. “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:13). These findings by the regulator provide an argument in favour of MAFR. This study specifically requests comment from survey participants in this regard.

**Evidence provided for point 4 (Auditor tenure on the JSE):** Regarding the concern raised in point 4 above, namely the length of audit tenures of many audit firms with listed companies in South Africa, the consultation paper contained a table detailing the periods which some audit firms have provided audit services to JSE-listed companies. There were 30 companies which had audit tenures exceeding 20 years and 20 companies with tenures between 10 and 19 years. According to the paper, Deloitte Inc. had been the appointed auditor of Murray & Roberts Holdings Ltd. for 114 years, PwC Inc. of Naspers Ltd. for 101 years and KPMG Inc. of AECI Ltd. for 91 years, to name the three longest tenures (IRBA, 2016b:19). The paper implied that these long audit tenures were a significant threat to auditor independence. As was documented in the review of literature in Chapter 3, there are mixed results regarding the impact of audit firm tenure on auditor independence, however, most studies concluded that increased audit firm tenure does not impair independence. Indeed, it may even improve audit quality through the increasing skill and experience of the audit firm with respect to the financial reporting of the client. However, at an audit partner level, tenure is negatively associated with audit quality (Ball et al., 2015; Knechel et al., 2013; Stefaniak et al., 2009; Tepalagul & Lin, 2015). Therefore, the literature does not support this reasoning provided by the IRBA. This study specifically requests comment from survey participants on the effect of long firm tenures on auditor independence.
5.4.3 Critical links to the empirical study

From the discussions above, the following critical aspects regarding the regulator’s stated objectives for MAFR in South Africa were established:

- Improving auditor independence and thereby audit quality, in order to protect the investing public, is the primary reason for implementing MAFR.
- However, there are two secondary objectives, namely, increasing racial transformation in the audit industry and lowering the concentration of the Big Four firms.
- IRBA annual inspections have identified concerning evidence of a lack of professional scepticism and independence controls and documentation, designed to overcome potential threats arising from auditors’ relationship with clients.
- There are many auditor-client tenures of JSE-listed companies that span many decades. The IRBA believes that these long audit tenures pose a significant threat to auditor independence.

The above critical aspects are linked to the following study objectives:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
- To determine whether longer audit firm tenure is perceived to impair auditor independence in practice.
- To determine whether it is believed that MAFR will produce positive effects on transformation in the South African audit industry as well as lower market concentration.
The IRBA collected responses to the consultation paper, with the deadline date of 20 January 2017. A brief analysis of some of the official key stakeholder responses will now be provided. As noted already, only the stakeholder responses that have been made publicly available or that have been obtained by the author have been reviewed. The following section reviews the responses submitted by:

- The IFAC (International Federation of Accountants)
- The JSE (Johannesburg Stock Exchange)
- The CFO Forum
- The SAICA (South African Institute of Chartered Accountants)
- The ASISA (Association for Savings and Investment South Africa)
- The Big Four audit firms (PwC Inc., Deloitte Inc., EY Inc. and KPMG Inc.)

### Refer to Hypotheses 2 - 5

Hypothesis 2: Stakeholders perceive MAFR not to have a significant impact on auditors’ independence and professional scepticism.

Hypothesis 3: Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.

Hypothesis 4: Stakeholders perceive MAFR to increase the degree of market concentration by the Big Four firms in the audit profession.

Hypothesis 5: Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession.

## 5.5 RESPONSES TO THE IRBA CONSULTATION PAPER
5.5.1 Summary of the IFAC response

**Stakeholder 1: The International Federation of Accountants (IFAC)**

The IFAC is the global organisation for the accountancy profession, comprising over 175 members and associates in more than 130 countries (including South Africa) and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry and commerce. The IFAC Board established the IESBA. The IESBA is the independent standard-setting body that serves the public interest by setting robust, internationally appropriate ethics standards, including auditor independence requirements, for professional accountants worldwide. The IESB compiled the Code of Ethics for Professional Accountants which is the basis of the accountant and auditor ethics codes in South Africa. The response from the IFAC was written by Fayez Choudhury, the CEO of the IFAC.

The IFAC was expressly neutral on whether MAFR was appropriate in South Africa, making it clear that they believed the most effective approach to regulation would vary between jurisdictions and therefore there was no ‘one single approach’ that could be applied internationally. However, the IFAC cautioned the IRBA not to try replicate arrangements from another jurisdiction and apply them to their own, without careful consideration and analysis of whether the arrangements would be the most effective and appropriate (Choudhury, 2017). This caution was in response to the emphasis the IRBA placed on the European rulings on MAFR.

Significant concern was expressed that MAFR was being pursued by the IRBA for multiple reasons, and not only to improve audit quality. The concern in this regard was for competing objectives not to impede the outcomes of initiatives (Choudhury, 2017). The IFAC emphasised the fact that evidence does not clearly support the notion that MAFR will enhance audit quality. Further research is needed, including research into the impacts of audit partner rotation, to determine whether it has led to an improvement in
audit quality (Choudhury, 2017). The fact that the consultation paper lacked supporting evidence for its conclusions was of primary concern.

The IFAC attempted to correct the IRBA’s assertion that there are increasing demands for auditors to be more independent. The IFAC argued that this is not true (Choudhury, 2017). The demands are for enhanced audit quality, not simply auditor independence, and this distinction is very important.

5.5.2 Summary of the JSE response

Stakeholder 2: The JSE (Johannesburg Stock Exchange)

The JSE is the stock exchange where most of the largest companies in South Africa are listed. The exchange is owned and operated by the JSE Ltd. The response from the JSE was written by Nicky Newton-King, the CEO of the JSE Ltd.

The JSE was expressly neutral on whether MAFR was appropriate in South Africa, preferring rather to provide the IRBA with summary arguments provided to the JSE as a result of its own consultation process with companies listed of the JSE exchange. However, the JSE letter did state that it believed “that an alternative course of action is necessary” (Newton-King, 2016).

The JSE claimed that 63 JSE-listed companies, representing 45% of the exchange by market capitalisation, provided it with comment. The overwhelming majority of these comments raised serious concerns about the regulator’s decision to implement MAFR. According to the summary comments provided in the JSE letter, the companies were concerned that the research was insufficient to arrive at the conclusions that the IRBA had made and that MAFR was not necessary in South Africa considering the international reputation of its audit standards.
The following comment, made by the financial services group Sanlam, was chosen specifically as a quote in the JSE letter:

We conduct on average 150 investor meetings a year, which include most of the global institutional investors. In many of these meetings SA corporate governance, standards of financial reporting and quality of auditing are applauded and ranked as amongst the best in their experience dealing with companies globally. This provides support that South Africa should not blindly follow other countries in applying MAFR as our governance are already more stringent than many other jurisdictions (Newton-King, 2016:2).

A particularly important point made by the JSE was that it believed that the IRBA public inspections report, which the IRBA uses as a key reason for the need to implement MAFR, indicated problems of audit quality and not auditor independence. Therefore merely rotating the audit firms without addressing any underlying concerns with the audit firm would be inappropriate (Newton-King, 2016). This reasoning is significant as audit quality is not only the product of auditor independence, as shown in Figure 1 of Tepalagul and Lin (2015). Audit quality concerns, as raised by the IRBA in the public inspections reports and summarised in Figure 5.1 above, could be the result of deficiencies in auditor capabilities, not auditor independence. If this is the case, as the JSE suggests, then MAFR would be an inappropriate response to the problem.

The JSE recommended that the IRBA start the consultation process afresh and commence by issuing a response to the many concerns being raised after the issue of the consultation paper in October 2016. The JSE further recommended that all public hearings and comments received should be a matter of public record and not kept confidential (Newton-King, 2016).
5.5.3 Summary of the CFO Forum response

Stakeholder 3: The CFO Forum

The CFO Forum describes itself as a high-level discussion group formed and attended by the CFOs of major JSE-listed and larger state-owned companies with broad sectoral coverage, ranging from financial services, mining, retail, media, telecoms, medical services to paper/packaging. Its aim is to contribute positively to the development of South Africa’s policy and practice on financial matters that affect business on behalf of its members, who represent a significant part of South African business. The CFO Forum was created in 2011. The response from the CFO Forum was written by KC Ramon, the Chairperson of the CFO Forum, CFO and executive director of AngloGold Ashanti Ltd. and a non-executive director on the boards of MTN Group Ltd. and Lafarge (France).

As is seen above in Table 5.1 below, the considerable majority of JSE companies is against the implementation of MAFR. Importantly, the CFO Forum response made the point that there was no clear demonstration of the magnitude and extent of research conducted on MAFR in South Africa, together with supporting evidence, to substantiate the views and conclusions reached in the consultation paper. The following claims were argued to be unsubstantiated:

- There are fundamental concerns with auditor independence in South Africa.
- The current measures in place (Code of Professional Conduct, mandatory audit partner rotation, prohibition on non-audit services and disclosure of audit tenure rule) have failed to address concerns with auditor independence.
- The extent of IRBA inspections conducted and the quality of the evidence obtained provided sufficient substantial proof to conclude that there are significant deficiencies in auditor independence in South Africa.
- MAFR will be the best solution to address the significant threats to auditors’ independence that have been identified.
The proposed MAFR’s effectiveness in addressing the identified issues can be evidenced by the research and findings.

(Ramon, 2016:1-2)

In addition to the lack of evidence supporting the above conclusions, the CFO Forum specifically objected to many details and statements made in the consultation paper, going so far as to label some of them incorrect and misleading. The consultation paper referred to the audit failures in companies such as Regal Bank, LeisureNet, Randgold and other businesses. The CFO Forum challenged that the paper failed to demonstrate that these failures could have been avoided had MAFR been in place.

The role of professional judgement and company decision-making was also stated as an argument against MAFR. The CFO Forum was of the opinion “that the IRBA should not find itself entering an area where it effectively regulates companies and decisions made by companies” (Ramon, 2016:3). MAFR was seen as regulating an aspect of company affairs, namely audit firm appointment, which should remain the discretion of the company and its stakeholders, and not regulated by the audit regulator.

5.5.4 Summary of the SAICA response

Stakeholder 4: The South African Institute of Chartered Accountants (SAICA)

SAICA is a professional accountancy body in South Africa, representing chartered accountants. All the registered auditors in South Africa are chartered accountants who are members of SAICA, since to become a registered auditor, it is first necessary to qualify as a chartered accountant, satisfying SAICA’s training requirements. SAICA is an active organisation in the audit industry of South Africa. The response from SAICA was written by its CEO, Terence Nombembe.
SAICA is not explicitly for or against implementing MAFR in South Africa. However, it is against implementing it within the timeframe proposed by the IRBA i.e. in 2023. The SAICA response cautioned the IRBA to rather wait and understand the impact that recent changes to the audit report will have on audit quality, such as the new auditor report format required by the international standards (effective December 2016) and the inclusion of the period of tenure in auditor reports (SAICA, 2017). The new audit report format allows the users of financial statements to better understand the audit work performed, especially through the disclosure of key audit matters, which was not previously provided to the public by the auditor. The auditor tenure rule is a South African (not international) regulation that now requires the auditor to publicly disclose in the auditor report the number of years for which they have been appointed as auditor for the company.

Echoing other stakeholder responses to the consultation paper, SAICA also requested the IRBA to extend the public consultation process and commission additional independent research on the feasibility, impact and cost-benefit of any additional regulations on auditor independence (SAICA, 2017).

SAICA presented to the IRBA the key feedback which it had received from its members, who represent the chartered accountants and auditors in South Africa, as well as the key feedback from an ‘MAFR Indaba’ that it hosted to allow frank debate and discussion with various stakeholders on the topic. In terms of the feedback from SAICA’s members, collected via an extensive survey of the chartered accountant profession, there was a considerable degree of mixed opinion. However, the following generalisations can be made:

- The overwhelming majority of SAICA members agreed that further strengthening auditor independence was the most important objective of the IRBA reform process.
- Respondents expressed support for the IRBA’s objectives, however, the majority was of the opinion that MAFR may not necessarily achieve the IRBA’s intended objectives.
- Possible challenges, concerns or disadvantages exceeded the potential benefits or advantages, and there should be a greater focus on enhancing measures that already exist rather than adding additional measures.
- The issues involved in implementing a measure such as MAFR are complex and cannot necessarily be reduced to a quantitative ‘Yes’ or ‘No’ answer.

(SAICA, 2017:5)

After the MAFR Indaba SAICA stated that there was an “overwhelming request” for greater consultation, transparency of information and research on MAFR before any final decisions are made to change legislation (SAICA, 2017:5). The reasons provided by the IRBA consultation paper were not persuasive and significantly lacking in evidence. Again, the call for further research was clear in the response to the IRBA.

5.5.5 Summary of the ASISA response

Stakeholder 5: The Association for Savings and Investment South Africa (ASISA)

The ASISA is an association that represents the majority of South Africa’s institutional investors, namely, asset managers, collective investment scheme management companies, linked investment service providers, multi-managers and life insurance companies. According to ASISA’s website, the members are considered the custodians of the bulk of the nation’s savings and investments and are among the country’s biggest contributors to the national GDP. Companies regulated by the Financial Services Board (FSB) that offer savings and investment products and manage assets of R5 billion or more are allowed as voting members of ASISA. As such, using the ASISA to communicate with the industry is considered the most appropriate means of understanding South African investment managers’ views on MAFR. The fund managers
at the ASISA’s member organisations manage billions of rands in a fiduciary capacity, much of these funds invested in public interest company equity and corporate debt issuances. For this reason, investment managers represent a significant stakeholder in the audit industry, as institutional shareholders and investors. The response from ASISA was written by Leon Campher, the CEO of ASISA, on behalf of its members, after significant consultation with member organisations.

The ASISA was against the adoption of MAFR and believes it will actually reduce the quality of audit engagements, and will not be cost-effective (Campher, 2017). The primary reasons provided were as follows:

- The World Economic Forum rankings of South Africa as first in regard to the strength of South Africa’s auditing and financial reporting standards.
- The lack of justification by the IRBA that audit failures are a result of independence concerns. In addition, the ASISA argues that the examples of failure are negligible in comparison to the examples of high-quality audit engagements.
- There are many existing safeguards to protect auditor independence in South Africa.
- The IRBA does not have jurisdiction for such legislation, binding on ACs and companies, as the IRBA is not the company regulator. Hence, ASISA argues, incorrect process was followed, and this type of regulation should be handled through the Department of Trade and Industry’s Specialist Committee on Company Law.
- The loss of experience and knowledge of the client due to rotation of the firm, as well as the steep learning curve for the newly appointed firm, will result in reduced audit quality.
- There are superior alternatives to MAFR on a cost-benefit analysis.

(Campher, 2017:2-3)
5.5.6 Summary of the ‘Big Four’ audit firms’ response

Stakeholder 6: The ‘Big Four’ Audit Firms, namely, PwC Inc., Deloitte Inc., EY Inc. and KPMG Inc.

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

- ‘Big Four’ audit firms refers to the largest four accounting and audit firms globally, namely, Deloitte Inc., PricewaterhouseCoopers Inc. (PwC), Ernst & Young Inc. (EY) and KPMG Inc. 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 in terms of resources (ICAEW, 2016; Rapoport, 2016).

All of the Big Four audit firms provided an official response to the IRBA. The responses were written by Dion Shango (CEO of PwC Southern Africa), Lwazi Bam (CEO of Deloitte Africa), Michael Bourne (EY South Africa Professional Practice Director) and Michael Oddy (KPMG South Africa Head of Audit).

The Big Four audit firms each provided a detailed response letter to the IRBA consultation paper. All four firms rejected the conclusion of the IRBA, claiming that the regulator did not present a balanced and substantiated argument in favour of MAFR. All four firms were of the opinion that MAFR would decrease audit quality in South Africa. The following statements in some of the response letters serve as an appropriate summary of all four firms’ aversion to MAFR:
From PwC Inc.:

We do not believe that MAFR increases auditor independence or enhances audit quality. There is no empirical evidence that it does. In addition, it does not improve market concentration. MAFR has been implemented and repealed in many other markets, due to not achieving on these objectives and in having unintended consequences including having counter effects than intended (Shango, 2017:5).

From EY Inc.:

Forcing changes in the appointment of audit firms will more likely increase instances of the types of deficiency that IRBA maintains it is aiming to resolve. We believe that it would be more appropriate to first try other available and less interventionist solutions before taking the more heavy-handed approach of introducing MAFR which is expected to significantly alter the efficiency of audit markets in South Africa in a manner that will affect not only audit firms but also the users of audit services in our capital markets (Bourne, 2017:4).

From Deloitte Inc.:

We support any measure that enhances audit quality and auditor independence, however there is insufficient evidence that a problem currently exists. Furthermore, there is insufficient evidence that the introduction of the said measure will result in the desired outcome of enhanced quality as a result of improved auditor independence. We do not believe that the IRBA has provided compelling evidence that there is an auditor independence problem in South Africa and that this is negatively impacting the profession in terms of poor audit quality and a challenge to companies in the preparation of annual financial statements (Bam, 2017:1).

From KPMG Inc.:

Based on the current information included in the consultation paper there is no evidence to support that MAFR enhances auditor independence given the extensive governance measures already in place in South Africa. Based on the information provided in the consultation paper we firmly believe that:

- The consultation process has been flawed and rushed;
- Evidence of research conducted on the viability of MAFR is lacking;
- An impact analysis around the unintended consequences of any possible implementation of MAFR needs to be performed;
• Any proposed MAFR provisions need to be dealt with in the Companies Act, as the greatest impact is beyond the auditing profession, and a thorough stakeholder consultation process is thus required;
• MAFR will negatively impact audit quality; MAFR will not enhance auditor independence;
• MAFR will add huge costs to an economy that is already under significant pressure; and
• MAFR will greatly complicate the process of appointing consistent global auditors for multinational companies.

(Oddy, 2017:15)

**Important conclusions:**

Based on the clear statements of the managing partners of the audit firms above, it can be concluded that the Big Four firms are strongly against the implementation of MAFR in South Africa. These opinions of the firms’ managing partners are consistent with the subsequent research of partner opinions by Harber (2016).

It is submitted that, based on the above views expressed, the detailed summary provided below and the findings of the audit partner interviews conducted by Harber (2016), that all study objectives and hypotheses are established with respect to the audit partner stakeholder group in this study.

The following sections will explore in more detail the opinions of the above audit firms as contained in their letters to the IRBA.

**5.5.6.1 Transformation and market concentration**

The four firms were all in agreement as to the need to pursue transformation in the audit industry but were concerned that MAFR was an inappropriate means to do so. There was some confusion, based on previous communication by the IRBA, read together with the
consultation paper, whether and to what extent transformation and market concentration were still stated objectives of the IRBA with MAFR.

The firms provided statistics that prove the progress they have made in transformation objectives over recent years, indicating that MAFR should not be used as a tool to transform the audit industry (Bam, 2017; Bourne, 2017; Oddy, 2017; Shango, 2017). Transformation would be best achieved within the firms and with existing regulations, as is being done in other industries.

There was an appeal for the IRBA to provide evidence to support its belief that MAFR will “solve market concentration concerns” (Shango, 2017:3). The PwC Inc. response letter quoted a FTSE 100 Auditors Survey to make the argument that MAFR would not substantively change the market share of the Big Four firms:

> Despite changes to UK audit rules requiring more frequent audit tendering by listed companies, there has not been any substantive change in the share of FTSE 100 audits outside the Big Four firms. Even allowing for the audit switches which have been announced, but will not come through until subsequent year-ends, there has not been a radical shift (Shango, 2017:3).

According to Bourne from EY Inc. (2017), the small- and medium-sized audit firms will be forced to compete with larger firms to win new engagements, as has been seen in the UK, India, Italy and Brazil. In the UK FTSE 250, according to Bourne (2017), non-Big Four firms have seen a net loss of five audits which is around 30% of their market share in the last couple of years. Oddy from KPMG Inc. (2017) states that preliminary evidence in Europe indicates that market concentration in the EU has increased rather than decreased as a consequence of MAFR.
5.5.6.2 **Negative impact on the audit profession**

The four firms are concerned about the impact of MAFR on the people attracted to and retained in the audit profession. They expressed a need to grow the pool of audit resources and skills in the country and this will have an effect on audit quality in the years ahead. According to Shango (2017) from PwC Inc., MAFR will reduce the ability of the profession to attract and retain the best talent which will, in turn, have a negative impact on audit quality.

An appeal was made to the IRBA to recognise that both large and mid-tier audit firms are facing staffing issues and struggling to retain and grow talent in an accounting field that is becoming less appealing to chartered accountants. This was especially true of retaining black chartered accountants in the profession. The degree of risk and regulation in the audit industry was described as not being attractive to a new generation of auditors and financial professionals and that this will only be exacerbated as accounting continues to be the top degree in demand by employers. MAFR would, in the opinion of these firms, heighten the auditing skills shortage, create more pressure on auditing staff and demand of the firm’s resources that do not exist, placing more strain in what one firm described as a ‘fatigued profession’. Ultimately these pressures will result in a reduction in audit quality. According to Shango from PWC Inc. (2017:3), *“there is a substantial human element in imposing MAFR”*. Bourne from EY Inc. (2017:7) agrees, making the link to audit quality by stating that *“the implications of MAFR for talent retention, people, staffing, and resources make it more difficult to manage risks and to ultimately deliver sustainable audit quality”*. According to Bourne from EY Inc. (2017:7):

…attracting and then retaining highly talented personnel at the critical partner level is already a challenge given the regulatory and declining margin environment in which auditors are operating. We are convinced that by adding MAFR we will find over time that the quality of work delivered in an increasingly
complex technical and litigious environment by a profession which proudly associates itself with the number one ranking in the world, will decline.

The firms explained that if MAFR was implemented, companies would have to put audits out for tender when the time to rotate approaches. There would therefore be a significant added cost to the audit firms to tender more regularly to secure appointments. These costs would be varying, depending on many factors such as the size and complexity of the company, however, they would be considerable. Some firms emphasised that this additional cost to the firms would be unmanageable from a business perspective.

In addition to the burden on the audit profession, Bourne from EY Inc. (2017) was of the opinion that MAFR would introduce significant additional costs and administrative burdens to the wider South African economy. Oddy from KPMG Inc. (2017) explained that MAFR would result in regular audit tenders being required, each of which would absorb significant amounts of investment in time of boards, ACs and executive management in the tender process as well as evaluation of the prospective auditor. This valuable management time was considered to be a distraction from running the business.

Some of the firms provided estimates of the costs that would be incurred. Shango from PwC Inc. (2017) described the total transition costs (proposal costs plus costs to perform the audit) of a new listed audit client have equated to more than the first year's audit fee. Bam from Deloitte Inc. (2017) stated that in their experience, the securing of an audit tender for a top 100 JSE company costs approximately 30% of the annual audit fees. For clients outside the Top 100, they estimate the costs at approximately R500,000 per tender (Bam, 2017). Further to this Bam from Deloitte Inc. (2017) explained that in their experience, in the first year of the audit, an additional 30% to 50% of the audit fee was spent on set-up cost to understand the client’s business, a cost not borne by the client but by the audit firm. Oddy from KPMG Inc. (2017) estimated tender/proposal costs for new appointments to be in the region of 10% to 30% of the first year's audit fees. Oddy (2017) went on to explain that this meant that in instances where a number of firms
tendered for a new audit (which would normally be the case), the collective cost of tendering could amount to as much as the entire first year audit fee. Transitioning costs in the first year typically amounted to between 40% and 70% of the first year’s audit fees.

The firms explained that these costs would have a negative impact on the ability of firms to invest in methodologies, transformation and attracting talent. According to Bam from Deloitte Inc. (2017), the firms had a very limited ability to absorb these costs and it would require spending from areas such as training and bursaries to be redirected to tendering for work, given the pressure on financial results.

This would ultimately lead to a deterioration in audit quality. The nature of the costs was described by Oddy (2017:4) as follows:

- Senior resource time investment in getting to know the client;
- Time spent on meetings both locally and internationally with management;
- Time spent on understanding the business and industry;
- Industry specialist involvement including technical input;
- Marketing and proposal presentation costs; and
- National and international travel costs.

Bourne from EY Inc. (2017) stated that available evidence shows the estimated cost of introducing MAFR in the EU may exceed 16 billion euros, and while the expected cost to South African companies would be lower, the costs associated with changing auditors would come at a time when companies were struggling to grow in an economic environment which is expected to continue to be sluggish for the next few years. Affected companies would also incur increased costs, principally due to the loss of management time relating to both the tender process and the steep learning curve of the incoming auditor.
Oddy from KPMG Inc. (2017) raised an interesting point, claiming that MAFR would promote a sales culture rather than a focus on audit quality. This would result in auditors directing more experienced resources to winning new audits rather than focusing expertise on performing a quality audit.

5.5.6.3 Comparison with similar markets

The firms were quick to note, as were other respondents to the IRBA paper, the ranking of South Africa’s auditing and accounting standards in the World Economic Forum (WEF) annual rankings. For example, in 2016 South Africa was ranked number one for the seventh year in a row by the World Economic Forum for its strength in auditing and reporting standards (Oddy, 2017; Shango, 2017; WEF, 2015). This was argued to be a reason not to pursue changes to current regulations in South Africa.

However, PwC Inc. pursued this reasoning further, noting that of the top twenty markets ranked by financial market development by the WEF, of which South Africa was placed eleventh, thirteen countries decided not to adopt MAFR (refer to Chapter 6, Table 6.1). Of the remaining six countries, five have had to adopt MAFR as a result of being part of the EU, all of which had not applied MAFR before or had rejected it. According to Shango from PwC Inc. (2017), none of the top ten countries apply MAFR except those that are forced to apply MAFR by virtue of being part of the EU (Finland, Norway and Sweden). The argument was simply that other comparably advanced capital markets have chosen not to adopt MAFR.

5.5.6.4 The role of other regulators and legislative change

An important point raised by the audit firms and also by the CFO Forum was that since the Companies Act regulates the appointment and removal of auditors, audit partner
rotation and the responsibilities of the AC, the Companies Act is the most appropriate statute to also consider the implementation and regulation of MAFR. The Companies Act contains a range of measures to regulate the appointment of auditors (it sets out the process (section 90), provides for the disqualification of the auditor where certain non-audit services are provided (section 90(2)), regulates the rotation of the designated auditor partner (section 92) as well as the resignation of the auditor and vacancies (section 91 and section 89)). Considering this, MAFR should be a debate lead by the Specialist Committee on Company Law, and involve a much wider consultation process and legislative change, rather than be a regulation issued by the IRBA (Bam, 2017; Ramon, 2016; Shango, 2017). The ASISA raised this same concern in its response to the IRBA.

According to Bourne from EY Inc. (2017), it would be inappropriate to drive changes in areas that are more appropriately addressed through a review of the primary legislation which is the Companies Act. Such changes ought to be led by the Department of Trade and Industry (DTI) as the government department responsible for administering the Companies Act. This should be done as part of a legislative review conducted with full transparency and public participation which is normally required for all amendments to legislation.

Deloitte Inc. made the argument that the introduction of MAFR would inevitably affect the rights of shareholders to appoint an auditor of their choice and impact the rights and responsibility of the AC to act in the best interest of the company and nominate an independent auditor of their choice. Therefore, in effect, the introduction of MAFR amounts to the regulation of companies, their shareholders and AC, rather than the regulation of auditors (Bam, 2017).
5.5.6.5 **Response to IRBA’s Public Inspections Report findings**

The audit firms expressed disagreement with the conclusion of the regulator that its public inspections reports findings could be used as an argument in support of MAFR. The argument was made that the IRBA inspection report findings do not all relate to independence concerns and that the report provides no contextualisation as to whether or not these findings relate to listed company audits. If the findings relate to unlisted public and/or private companies performed by smaller audit firms, then the MAFR proposal would not address those concerns (Bam, 2017). According to Shango from PwC Inc. (2017), less than 5% of all investigations related to allegations of breaches of independence, and very few sanctions have been imposed by the regulator for breaches of independence in the period since 2001. Therefore, the audit firms are of the opinion that the public inspection findings do not alone warrant a conclusion that the current measures in place to ensure auditor independence do not work.

EY Inc. made the argument that the consultation paper casts undue scepticism and uncertainty about the quality of the work of larger audit firms, creating a perception in the public’s mind that there is a lack of independence in these firms. However, the evidence does not allow these conclusions and the paper unnecessarily serves to undermine public confidence in Registered Auditors (Bourne, 2017).

5.5.6.6 **Professional judgement versus regulation**

All four firms pointed out that MAFR would regulate an area that was best kept as a matter of professional judgement. The professional judgement exercised by the AC especially, with respect to appointing the external auditor and assessing the independence and suitability of the audit partner and audit firm, was put forward as a reason not to regulate firm rotation. MAFR was seen as undermining this responsibility and removing the AC’s freedom to decide which audit firm best meets the needs of the company and its
shareholders. MAFR would conflict with the section 94 statutory responsibilities of the AC under the Companies Act. According to Shango from PWC Inc. (2017), “MAFR reduces the audit committee’s ability to fully discharge its oversight responsibilities and in turn disenfranchises shareholders’ ability to obtain the highest quality audit in the most efficient way” (Shango, 2017:4).

As per the current regulations and principles governing auditor independence in South Africa, the shareholders are ultimately responsible for appointing the audit firm, under the judgement and guidance of the AC, comprising independent non-executives. In addition, the auditor self-assesses their degree of independence as a matter of professional judgement. According to Bourne from EY Inc. (2017), MAFR would disenfranchise shareholders and undermine the authority of those charged with corporate governance. By forcing companies to change auditor, ACs and shareholders are unable to retain the best available firm for the job.

KPMG Inc. made two important points with regard to professional judgement. Firstly, MAFR would undermine the AC’s ability to choose the best auditor for the job as well as to determine whether a change in auditor, and the associated timing of this decision, is in the best interest of the company and its stakeholders. Secondly, MAFR would remove an important mechanism of an indication of issues at a company and therefore conceal problems between a company and its auditor (Oddy, 2017). This is because, as stated by Oddy (2017), the audit firm’s decision not to accept a re-appointment might indicate concerns regarding the integrity of management or the operations of the company. Therefore, this aspect of professional judgement of both sides of the engagement may be lost or at least diminished under a system of MAFR.

The Institute of Directors in South Africa publicly expressed its views to this effect via a letter to the IRBA in September 2016. This letter was written by Professor Mervyn King SC, the chairman of the King Committee, responsible for the production of the King Codes
on Corporate Governance. The Institute of Directors in South Africa is also against the implementation of MAFR. According to the Institute, MAFR would, among other problems, conflict with the directors’ duty to act in the best interest of their company if they believed the incumbent would provide a better quality audit than other available firms (King & Natesan, 2016).

5.5.6.7 Loss of institutional knowledge

Although this sentiment was mentioned by the other firms, it was a key argument in the EY Inc. letter. According to Bourne from EY Inc. (2017), it is self-evident that audits in the early years of the audit relationship struggle to attain the quality standard of the audits in later years, especially in complex, multinational companies. As the auditor and the audit team gain experience of the client, quality increases. More frequent firm rotation through MAFR will consequently give rise to reduced audit quality. Bourne (2017) makes the point that auditors of insurance companies and banks will attest to the fact that it takes at least three years, if not as much as four or five years, to obtain an adequate knowledge of the client and industry. Oddy from KPMG Inc. (2017) claimed that AC chairs have indicated that this learning curve can take up to three years.

Rotation of the whole firm in a small country like South Africa will result in a completely new team with virtually no knowledge of the client’s systems, people and business, conducting audits of lesser quality for at least the first two to four years (Bourne, 2017:7).

A related issue was the idea that MAFR would undermine industry specialisation. Many of the JSE-listed entities are complex and specialised businesses, such as banks, insurers, mining or telecommunications companies, which also come with complex, industry-specific regulations. The argument was that MAFR would make it difficult for a firm to build up industry specialisation during the ten-year rotation period and this would negatively affect the quality of the audit of complex and large businesses (Bourne, 2017; Oddy, 2017).
5.5.6.8 Preferred alternatives to MAFR

All the firms believed that existing regulations and standards were sufficient and that MAFR was unnecessary and potentially damaging to audit quality. The current regulation considered most important was the existing Key Audit Partner rotation rules, which required rotation every five years. These were expressed as “more than adequate” to bring “fresh eyes and ears” to the audit engagement (Bourne, 2017:8). However, some constructive recommendations were provided if changes were to be made. EY Inc. aptly expressed the common opinion of the Big Four firms, proposing the following measures as better means of preserving auditor independence:

- Continued development and enforcement of the Code of Professional Conduct.
- Further development of robust Independent Regulatory Oversight.
- Examples of such regulators were the IRBA through the public inspections process and the JSE through the listing requirements. Continued investment was recommended in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.
- Effective and independent Engagement Quality Control Review (EQCR).
- The EQCR process within audit firms plays a significant role in ensuring audit quality by providing an independent evaluation of the key judgments made. This task is carried out by the engagement quality control reviewer who is experienced and whose role is to challenge the opinion of the key audit partners.
- Stronger AC Oversight of Auditors.
- ACs that are truly independent and financially experienced will constitute an objective challenge to management and apply professional judgement, as is required in terms of the Companies Act, to assess the independence of the auditor. Improving the role and functioning of listed company ACs would provide the IRBA with the controls they are seeking to promote auditor independence.

(Bourne, 2017:2-3)
5.5.6.9 Conclusion of response from Big Four firms

Again, some comments of the Big Four firms in this regard show the extent of disagreement and contention with the IRBA position presented in its consultation paper:

From PwC Inc.:

Given the low instances of independence breaches documented and sanctioned by the IRBA, the adverse effect of MAFR does not appear proportionate to the objective it seeks to achieve, and the purpose may be achieved by less restrictive means, yet probably more impactful (Shango, 2017:13).

From Deloitte Inc.:

The Paper presents a biased argument in favour of MAFR. There seems to be no independent and objective evaluation of the arguments for or against the introduction of MAFR, the positive and/or negative experiences in other jurisdictions, or any alternative measures in lieu of MAFR (Bam, 2017:6).

From KPMG Inc.:

The consultation process has been flawed and rushed [and] evidence of research conducted on the viability of MAFR is lacking (Oddy, 2017:5).

All of the Big Four firms are strongly against the adoption of MAFR in South Africa, providing numerous arguments in favour of their position and against the arguments of the IRBA position. Of particular importance to note is their position regarding each of the three primary objectives of the IRBA with regards to MAFR. As stated in its consultation paper and various official communications and speeches, the IRBA has made clear the main reasons why MAFR is believed to be the most appropriate measure to strengthen
auditor independence. There are three objectives clearly articulated by the IRBA, as follows:

- MAFR will strengthen auditor independence and so protect the public and investors, which is part of the IRBA’s strategy; (i.e. promote good quality audits)
- MAFR will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality; and
- 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.

(IRBA, 2016e, 2017b, 2017c; Ziady, 2016)

The Big Four firms are claiming that not only is MAFR not the best means of achieving these three objectives, but contrary to the IRBA’s intention, MAFR will actually reduce audit quality, increase market concentration and hinder transformation.

These claims and arguments need to be properly understood and analysed, which is the purpose of this study.

5.5.7 Summary comparison of key issues

The Table 5.1 below provides a high-level summary comparison of the six stakeholders reviewed in section 5.5.
Table 5.1: Summary of key issues

<table>
<thead>
<tr>
<th>Position</th>
<th>Source: Researcher’s own construction based on a content analysis of the respective letters of response to the IRBA consultation paper.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Position:</strong></td>
<td><strong>1</strong> Disagrees with the IRBA that MAFR will achieve the objective of improving audit quality.</td>
</tr>
<tr>
<td><strong>2</strong></td>
<td>Criticised the IRBA Consultation Paper for its lack of supporting evidence and research to justify its conclusions on MAFR.</td>
</tr>
<tr>
<td><strong>3</strong></td>
<td>Identifies that research conducted internationally does not support the notion that MAFR will improve audit quality.</td>
</tr>
<tr>
<td><strong>4</strong></td>
<td>Concerns raised regarding the IRBA’s desire to achieve multiple objectives with MAFR, namely improved audit quality, transformation goals and reduced audit industry concentration. The concern is that pursuing multiple objectives with MAFR is not appropriate.</td>
</tr>
<tr>
<td><strong>5</strong></td>
<td>Calls for further research regarding the link between MAFR and audit quality before implementing the MAFR in South Africa.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Position:</th>
<th>The IFAC</th>
<th>The JSE</th>
<th>The CFO Forum</th>
<th>SAICA</th>
<th>PWC Inc.</th>
<th>EY Inc.</th>
<th>Deloitte Inc.</th>
<th>KPMG Inc.</th>
<th>ASISA</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 N1 N2 N3 N4 N5</td>
<td>Neutral (N2) Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>The JSE</td>
<td>Neutral (N2) Yes</td>
<td>No comment (N1) Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>The CFO Forum</td>
<td>Neutral (N2) Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>SAICA</td>
<td>Neutral (N3) Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>PWC Inc.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>EY Inc.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Deloitte Inc.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>KPMG Inc.</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>ASISA</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

**Note:**

- **N1** The JSE summarised responses received from 63 JSE-listed companies. In these comments from companies there was overwhelming push-back against MAFR stating that research to date was insufficient and highlighting the internationally recognised strength of South Africa’s auditing and reporting standards. However, these were not the opinions of the JSE but rather those who responded to the JSE’s request for comment from listed companies.

- **N2** The response letter did not agree nor disagree with IRBA’s opinion that MAFR would improve audit quality. However, it did express multiple concerns regarding the deficiencies of the IRBA consultation process and the unsustained claims and significant lack of evidence supporting the conclusions reached by the IRBA in the consultation paper.

- **N3** SAICA did not agree nor disagree with IRBA’s opinion that MAFR would improve audit quality. However, SAICA was against implementing it within the timeframe proposed by the IRBA. SAICA’s suggestion was to wait to understand the impact that recent changes (such as the new auditor report and the inclusion of the period of tenure in auditor reports) have had in the South African context, as well as to perform further research on MAFR.
5.5.8 Critical links to the empirical study

From the discussions above summarising the responses of the IFAC, the JSE, the CFO Forum, the SAICA, the ASISA and the Big Four audit firms, the following critical aspects regarding this study were established:

- There is widespread disagreement by audit industry stakeholders with the reasoning provided by the IRBA for implementation of MAFR in South Africa.
- Many respondents criticised the IRBA’s lack of sufficient justification and evidence in support of MAFR. There have been numerous calls for more research on the need for additional regulation as well as possible alternatives for and consequences of, MAFR in South Africa.
- There is criticism regarding the IRBA’s multiple objectives for MAFR. The respondents express concern that the IRBA intends to pursue MAFR as a means of improving racial transformation and market concentration, in addition to improving auditor independence.
- Specifically, a detailed description was provided of the arguments submitted by the Big Four audit firms which are strongly against the implementation of MAFR as proposed by the IRBA. The reasons provided are extensive and consistent with the interview research findings of Harber (2016).

It is submitted that the above critical aspects are linked to all the study objectives and hypotheses identified in this study.
5.6 MARKET CONCENTRATION AND TRANSFORMATION CONSIDERATIONS

The IRBA has expressly stated that its primary intention for the implementation of MAFR is to address concerns regarding the independence of auditors or public interest entities in South Africa, and thereby to improve audit quality and protect the interests of the investing public (IRBA, 2016e, 2017c). However, as secondary objectives, the IRBA has made it clear that MAFR will also seek to achieve the following:

- It will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality;
- 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, 2015:2).

Per the public hearings on MAFR before the Parliament’s Standing Committee on Finance (SCoF) in 2017, it was clear that the government and the IRBA still consider improving transformation and decreasing market concentration as positive potential outcomes for MAFR. These two additional objectives are unique to the South African MAFR debate. The US and the EU, for example, being two large jurisdictions, which have debated the possibility of MAFR in recent years, confine the discussion to the impact of the regulation on audit quality. This is why, in the South African context, specific attention needs to be paid to the market concentration and transformation effects of MAFR.

The IRBA believes that while additional measures to drive transformation will be required to address government’s concerns regarding de-concentration of the audit market and transformation, MAFR

- …is a first step which will force a break in closed and restricted markets which will allow opportunities for black auditors to participate, but it also noted that greater transparency was required with regards to audit firm ownership, transformation policies and performance (IRBA, 2017d:1).
When referring to a highly concentrated market in South Africa, the IRBA is referring to the concentration of listed companies in South Africa audited by the Big Four and the risk that the loss of one auditing firm, due to an audit failure, would have on the economy. According to the (IRBA, 2016f:12), “the potential collapse of one of these firms could therefore possibly disrupt stability in the financial market and damage investor confidence”. With regards to transformation, the IRBA is concerned by the small portion of non-white audit partners responsible for signing off listed company audits in South Africa. This is a product of South Africa’s unique colonial and apartheid history of racial segregation, which, despite independence and democracy in 1994, still impacts the socio-economic landscape (Marais, 2010; Ponte et al., 2007). According to the IRBA, as of 2016, there were only 9 black African partners out of 353 signing off on listed companies and this signalled a lack of significant transformation in the industry. The perceived slow pace of transformation has prompted the IRBA to state:

...creating the opportunity for access to work as companies become due for rotation, will help more firms participate in a more meaningful way. It {IRBA} concedes that the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity (IRBA, 2016f:29).

With regards to market concentration and transformation, in a 2017 newsletter the CEO of the IRBA stated it clearly:

It is time to move beyond the numbers and focus on real empowerment. It is time for the profession to take stock not only regarding transformation, but to also focus on more than just the de-racialisation and de-concentration of the market for it to contribute meaningfully to the growth of the economy and the empowerment of its people (IRBA, 2017b:3).

The purpose of this chapter is therefore to provide more context to these additional South African objectives for MAFR, including a discussion of the literature available. This will establish a basis to address the market concentration and transformation study objectives.
5.6.1 Market concentration and MAFR

Market concentration refers to the degree to which smaller companies account for the total market. A highly concentrated market therefore means that few companies comprise the majority of the market share, or sales volume. Market concentration may be considered one measure of the degree of competition or rivalry between companies in a market. However, competition and concentration are not equivalent terms and this is commonly misunderstood. Competition intensity depends on many parameters and not only on the number of suppliers and their individual market shares. As a result, the connection between audit market concentration and competition remains unclear (Velte & Stiglbauer, 2012).

**Figure 5.2:** Market concentration of listed company audits in South Africa (measured by company market capitalisation)

*Source: IRBA (2016b:12)*
Figure 5.2 above illustrates that the market for JSE-listed company audit services is highly concentrated among the Big Four audit firms. A stated objective, or at least potential benefit, of MAFR, as described by the regulator (IRBA) is to reduce the concentration of the Big Four on the audits of the listed and public interest entities in South Africa. By reducing the degree of concentration of the Big Four, the IRBA intends to:

1. Reduce the risk that the loss of one auditing firm would have on the economy. An audit failure could “possibly disrupt stability in the financial market and damage investor confidence” (IRBA, 2016b:12); and
2. Provide an opportunity for other audit firms to tender and compete for the audits of listed companies and public interest entities. This objective is closely linked to the transformation objective outlined below.

The IRBA supports the fact that creating the opportunity for access to work as companies become due for rotation, will help more firms participate in a more meaningful way. It concedes that the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity (IRBA, 2016b:29).

The high degree of concentration in South Africa is not unique to South Africa. Internationally, regulators have raised concerns over the concentration of supply by the Big Four accounting firms and the potentially adverse effect this concentration may have on audit markets and the quality of audits in these legal jurisdictions (Francis et al., 2013). Velte and Stiglbauer (2012:156) believe that audit market concentration “is a permanent, worldwide phenomenon” and is caused “by economies of scale, growing needs of the clients regarding business establishments across national boundaries of the audit firms and prior mergers of audit companies”. Over the past 25 years the audit market has undergone a progressive concentration, moving from the ‘Big Eight’ to the ‘Big Five’ to the current ‘Big Four’, as shown in Figure 5.3 below.
Most audit engagements with, and almost all audit fees from, publicly traded companies in the US involve just the Big Four. In the US in 2010, the Big Four had 67% of audit engagements and collected over 94% of audit fees (Gerokos & Syverson, 2015). Velte and Stiglbauer (2012) found that audit markets in many other developed economies show similar concentration amongst the Big Four. According to the Financial Times, “only two FTSE 100 companies are not audited by the Big Four... At the end of 2014, the Big Four audited 95 per cent of the world’s 500 largest companies” (Agnew, 2016b:1). In 2018 the question of the appropriateness of audit industry concentration and domination by the Big Four firms in the UK was revisited by UK lawmakers in the wake of the financial collapse and insolvency of Carillion plc, a London Stock Exchange (LSE) facilities management and construction services company.

A report on the debacle by British MPs, which was released this month (May 2018), savaged everyone from the firm’s executives to its regulators. But the MPs reserved special bile for the Big Four accounting firms—not just KPMG,
which audited Carillion’s accounts for 19 years, but also its peers, Deloitte, EY and PwC, each of which extracted fees from the company, before and after its fall. The MPs have called for a review into the audit market and asked it to say whether the Big Four’s British arms should be broken up. The row is local, but concerns about the industry are global. (The Economist, 2018a:1)

Audit market concentration has also been widely discussed in the US following the Enron scandal and the collapse of the audit firm Arthur Andersen. According to Francis et al. (2013), the Sarbanes-Oxley legislation mandated a study of US audit market concentration. The study concluded that domestically and globally, there were only a few large firms capable of auditing large public companies, which raises potential choice, price, quality and concentration risk concerns (General Accounting Office Report, 2003). While the report found no evidence of negative consequences arising from Big Four market domination, it warned that “the significant changes that have occurred in the profession may have implications for competition and public company choice, especially in certain industries, in the future” (Francis et al., 2013:326). However, despite these concerns that competition has reduced due to increasing concentration of audit firms, it is not evident that these concerns were part of the audit firm rotation debate in the US.

The dominant audit firms have been characterised as high quality, differentiated suppliers which command higher audit fees (Chu et al., 2015). Gerokos and Syverson (2015) assert that the market’s supply side in the audit industry is highly concentrated. Furthermore, Velte and Stiglbauer (2012) contend that this concentration of suppliers on the audit market is often assessed negatively from a competition policy perspective for the following reasons:

- The incentives to ensure cost-efficiency and appropriate audit quality are decreasing;
- Higher barriers of entry for small- and medium-sized audit firms exist; and
- A strong influence from the Big Four on the development of international accounting and audit standards (IFRS and ISA) must be assumed.
Further still, Velte and Stiglbauer (2012) posit that, consistent with research on the effects of declining competition in a market, this lack of competition may result in oligopolistic pricing, a decline in the quality of audits and other services provided by audit firms and a decrease in the stability of capital markets and investor confidence. High concentration around a limited number of audit firms also raises the risk and potential impact of another large public accounting firm failure on the economy, as well as investor confidence in the audit function (Cabán-García & Cammack, 2011). These risks are acknowledged by other audit market research (Chu et al., 2015; Francis et al., 2013). Chu et al. (2015) find evidence that audit fees decrease as the size difference between the largest audit firm in a market and a client’s incumbent audit firm increases, suggesting that dominant audit firms charge higher audit fees because of their significant local competitive advantage over smaller audit firms. This implies that market concentration by the large firms may keep audit fees lower as the Big Four compete with each other, rather than with smaller firms.

Velte and Stiglbauer (2012) conclude that MAFR may have the unintended effect of significantly increasing audit firm transaction costs and price dumping strategies (low-balling), which in turn will endanger audit quality. Velte and Stiglbauer (2012) also question the ability of medium-sized audit firms (with limited capacities) to audit large, multinational companies. The question arises of whether or not smaller firms have the resources, including staff, and experience to service large, complex groups of companies. If not, then this will negatively affect audit quality. The result may be a significant increase in audit risk and decreased independence as medium-sized firms are highly dependent on fees from one client. As can be seen in the framework provided by Tepalagul and Lin (2015) in Figure 1.1, high dependence on a client may result in impaired independence and reduced professional scepticism due to the fear of losing the client based on a disagreement with management over financial reporting issues or fraud.
The findings of Chen and Zhou (2007) indicate that, on rotation of the audit firm under a system of MAFR, audit committees will replace Big Four firms with another Big Four firm. This will have the effect of further concentrating the market, counter to the intentions of the regulator (Harber & West, 2017; IRBA, 2016e).

5.6.2 Interviews with South African audit partners

These findings by Velte and Stiglbauer (2012), Chu et al. (2015) and Chen and Zhou (2007) regarding transaction costs, oligopolistic pricing, low-balling fees, capability of medium-sized firms to service large companies and fee dependence mirror concerns expressed by South African audit partners in the interview research performed by Harber (2017). The audit partners expressed concerns that small- and medium-sized firms do not have the resources and experience to audit the larger South African companies.

Interviews with audit partners in South Africa by Harber (2016) revealed that many partners are unhappy with the IRBA attempting to interfere with competition in the market using a policy tool designed to promote auditor independence and thereby increase audit quality. Some audit partners expressed annoyance with pursuing MAFR for any reason other than audit quality, pointing out that many industries in South Africa exhibit high degrees of market concentration, such as the banking industry (Harber, 2016). In addition, partners interviewed were of the opinion that MAFR would actually increase market concentration because ACs and shareholders of the large listed companies are unlikely to want to appoint non-Big Four audit firms to provide assurance services, considering the size, complexity and geographic spread of multinational company operations. The choice of audit firm under an MAFR regime would effectively be reduced from four to three, as the outgoing audit firm would not be eligible for reappointment upon rotation. This sentiment was expressed by all of the Big Four firms in their official responses to the IRBA consultation paper (Bam, 2017; Bourne, 2017; Oddy, 2017; Shango, 2017). Many interviewees also expressed concern that audit firm costs would increase significantly and
that MAFR could encourage firms to quote fees that are too low, endangering the ability of the firm to produce a quality audit (Harber, 2016). These perceptions of South African audit partners echo the literature discussed above on audit market concentration, namely, that market concentration is a natural and commonly experienced phenomenon and that MAFR may introduce significant transaction costs, resulting in further concentration of the market and perhaps even encouraging low-balling fee strategies.

Commenting on the adoption of MAFR in China, a professor of accounting in Peking, as quoted in a report by the Hong Kong Institute of Certified Public Accountants in 2013, stated that MAFR did not appear to be reducing concentration: “The early evidence is not encouraging... What happened was mostly a swap of clients among the Big Four.” (Russell, 2013:17). This is consistent with the findings of Chen and Zhou (2007), which indicate that ACs desire to replace Big Four audit firms with another Big Four firm rather than with a smaller firm. Audit partners are of the opinion that large companies will not risk appointing a non-Big Four firm as auditor, considering the superior reputation of the Big Four firms and the greater resources and geographical footprint required to service large, multinational companies (Harber, 2016). This will have the effect of further concentrating the market, counter to the intentions of the regulator (Harber & West, 2017; IRBA, 2016e).

According to the letters sent by the the Big Four firms to the IRBA as part of the MAFR consultation process, it is clear that they do not believe that MAFR will reduce market concentration significantly. The PwC Inc. response letter quoted a FTSE 100 Auditors Survey to make the argument that MAFR would not substantively change the market share of the Big Four firms:

> Despite changes to UK audit rules requiring more frequent audit tendering by listed companies, there has not been any substantive change in the share of FTSE 100 audits outside the Big-four firms. Even allowing for the audit switches which have been announced, but will not come through until subsequent year-ends, there has not been a radical shift (Shango, 2017:3).
According to Bourne from EY Inc. (2017), small- and medium-sized audit firms will be forced to compete with larger firms to win new engagements, as has been seen in the UK, India, Italy and Brazil. In the UK FTSE 250, according to Bourne (2017), non-Big Four firms have seen a net loss of five audits which is around 30% of their market share in the last couple of years. Oddy from KPMG Inc. (2017) states that preliminary evidence in Europe indicates that market concentration in the EU has increased rather than decreased as a consequence of MAFR.

5.6.3 Critical links to the empirical study

From the discussions above, the following critical aspects with respect to the link between market concentration and MAFR were established:

- Market concentration is a concern for the IRBA and addressing it is a secondary objective for MAFR. The concern relates specifically to the risk of such reliance on a few firms in the event of an audit firm ceasing to exist, however, it also relates to a desire by the IRBA for non-Big Four firms to compete for the audits of larger companies. This objective is therefore linked to the IRBA transformation objective.

- The highly concentrated nature of the exchange-listed company audits being dominated by the Big Four firms is not unique to South Africa and has become a standard market characteristic in most jurisdictions internationally.

- There are potential negative consequences to a highly concentrated audit industry, such as disincentives to ensure cost-efficiency and high audit quality, barriers to entry for other firms and dominance by the Big Four firms in standard setting.

- However, MAFR may produce negative consequences as smaller firms compete for audit engagements. Examples include higher transaction costs, oligopolistic pricing and low-balling of fees.

- There is also a concern that smaller firms (outside of the Big Four) may not have the capacity or experience to audit large companies and as such, ACs may not consider them for appointment. These firms may also be highly dependent on the
fee of one client which could reduce independence. These factors may result in MAFR not reducing market concentration or resulting in reduced audit quality.

The above critical aspects are linked to the following study objectives:

- To determine whether it is believed that MAFR will produce positive effects on transformation in the South African audit industry as well as lower market concentration.
- To determine whether there are likely unintended consequences from the implementation of MAFR.

Refer to Hypotheses 4, 5 and 7

Hypothesis 4: Stakeholders perceive MAFR to increase the degree of market concentration by the Big Four firms in the audit profession.

Hypothesis 5: Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession.

Hypothesis 7: Stakeholders perceive that MAFR will require audit partners to undergo significant efforts to upskill and retrain themselves for new industries.

Also, any hypothesis linked to an unintended consequence.

5.6.4 Transformation and MAFR

In 1994, the South African apartheid system of institutionalised racial segregation and discrimination was abolished. Whilst South Africa entered an inclusive democracy, the apartheid era left a legacy of economic racial inequality in its wake (Ponte et al., 2007). Inequality was not limited to income and wealth, but included access to education, healthcare, housing, sanitation and other basic human needs. The constrained access to resources resulted in the inability of the previously oppressed to make use of their newly
found political freedom. According to Mar (2009a:228), this presents a unique South African business responsibility, namely, to redress the imbalances of past discrimination under the apartheid regime. Following the end of apartheid and the start of democracy in South Africa, it was decided by the government that direct intervention in the redistribution of assets and opportunities was needed to resolve the economic disparities created by apartheid policies (BEE Commission, 2001). Black Economic Empowerment (BEE) intended to transform the economy to be representative of the demographics, specifically the race demographics, of the country. BEE was defined in the 2001 Commission Report as follows:

It is an integrated and coherent socio-economic process. It is located within the context of the country’s national transformation programme, namely the RDP (Reconstruction and Development Programme). It is aimed at redressing the imbalances of the past by seeking to substantially and equitably transfer and confer the ownership, management and control of South Africa’s financial and economic resources to the majority of its citizens. It seeks to ensure broader and meaningful participation in the economy by black people to achieve sustainable development and prosperity (BEE Commission, 2001:2).

A central objective of the RDP is to deracialise business ownership and control completely through focused policies of Black Economic Empowerment. These policies must aim to make it easier for black people to gain access to capital for business development. The democratic government must ensure that no discrimination occurs in financial institutions (BEE Commission, 2001:1).

A clear mandate was therefore declared by the government to redress the inequalities of the past in every sphere: political, social and economic. Since then, the South African government has embarked on a comprehensive programme to provide a legislative framework for the transformation of South Africa’s economy. In 2003, the Broad-Based Black Economic Empowerment Amendment Act was implemented (amended in 2013) (RSA, 2013). The fundamental objective of the Act is to advance economic transformation and enhance the economic participation of black people in the South African economy and to provide a legislative framework for the outworking of ‘transformation’ in South Africa.
Black economic empowerment (transformation / affirmative action) is therefore a specific priority in the economy, acknowledged by both business and government as an ethical and urgent national priority (Marais, 2010; Ponte et al., 2007). 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 as ‘transformation’ in the audit industry is considered by the IRBA to be at least partly addressed by firm rotation. MAFR will, according to the IRBA, provide the opportunity for smaller audit firms to tender and compete for the appointment as auditor of listed companies (IRBA, 2016e). In the words of the IRBA:

Transformation of the profession has also been brought into the spotlight in recent months and has been further elevated by the parliamentary hearings into MAFR that took place in February and March. The IRBA, as an organ of state and a regulator, is compelled to drive transformation and ensure that the auditing profession is transformed in a fair, equitable and competitive manner. So, we agree with the Standing Committee on Finance that transformation in the auditing profession requires a closer examination.

The harsh reality is that of the 4,283 registered auditors in South Africa, 74.8% are white and only 10.5% are black Africans. We believe that, while some initiatives have been implemented, more must be done. It is not just about increasing the number of black trainee accountants; it is about giving black accountants and auditors long-term prospects in the profession – prospects that are equivalent to those of their counterparts. This requires a cultural shift and a more inclusive approach that will provide black accountants with a positive experience at the firms, resulting in higher retention.

More focus should be given to long-term career prospects, including equity partnerships as well as senior management and executive responsibility. Transformation is not about the de-racialisation of the overall profession; it is about financial inclusion, ownership and access to markets and opportunities (IRBA, 2017:2-3).
5.6.5 Response from the audit profession regarding transformation

Interview research by Harber (2016), exploring audit partner perceptions of MAFR showed that it is a common opinion of audit partners, regardless of audit firm size, that MAFR will not necessarily improve transformation in the South African audit market. The primary reason given for this was that rotation of audit firms for listed companies will most likely only result in another Big Four firm being appointed, not a smaller firm. In addition, it was believed that MAFR would significantly increase costs incurred by audit firms, to such a degree that it would force firms to reduce spending on bursary programmes and other transformation initiatives.

In the letters of response to the IRBA consultation paper, the four firms were all in agreement on the need to pursue transformation in the audit industry but were concerned that MAFR was an inappropriate means to do so. The firms were quick to show statistics that prove the progress they have made in transformation objectives over recent years, indicating that MAFR should not be used as a tool to transform the audit industry. Transformation would be best achieved within the firms and with existing regulations, as is being done in other industries. There was an appeal for the IRBA to provide evidence to support their belief that MAFR will solve market concentration and transformation concerns (Shango, 2017).

The four firms are concerned about the impact of MAFR on the people attracted to and retained in the audit profession (Bam, 2017; Bourne, 2017; Oddy, 2017; Shango, 2017). They expressed a need to grow the pool of audit resources and skills in the country as this will have an effect on audit quality in years ahead. According to Shango (2017) from PwC Inc., MAFR will decrease the ability of the profession to attract and retain the best talent, which will have a negative impact on audit quality and transformation of the profession.
Regarding the potential of MAFR to increase costs, the large audit firms explained that these costs will undermine their ability to invest in methodologies, transformation and attracting talent. According to Bam from Deloitte Inc. (2017), the firms have a very limited ability to absorb these costs and it would require spending in areas such as training and bursaries to be redirected to tendering for work, given the pressure on financial results.

5.6.6 Diversity and performance in an organisation

Racial transformation within an organisation is a specific aspect of diversity in general. However, most research on the impact of diversity on performance within an organisation tends to focus on gender diversity. Literature specifically on racial diversity and organisational performance is sparse, especially regarding the theoretical mechanisms to explain why racial diversity may relate to firm performance (Andrevski, Richard, Shaw & Ferrier, 2014). According to Ferreira (2015), concluding on the effect of diversity on organisational performance is tenuous at best as it is very hard to disentangle ‘diversity effects’ from the effects of other individual and group characteristics that correlate with measures of diversity. However, a study by Andrevski et al. (2014) provides evidence that racially diverse management is able to “compete more intensively and perform better” in certain circumstances. Andrevski et al. (2014:821) also explain that literature provides evidence that “racially diverse groups bring alternative perspectives that stimulate creativity and innovation”, and thus “firms with racially diverse management are likely to consider more options and generate more ideas for launching new competitive moves”. As it relates to the MAFR debate, this implies that a more racially transformed audit industry could produce better quality audit outcomes. However, as will be described in Chapter 8, many key stakeholders in the debate, especially the Big Four audit firms, are of the opinion that MAFR will decrease the ability of the industry to transform (Harber, 2016; Shango, 2017).
5.6.7 Critical links to the empirical study

From the discussions above, the following critical aspects with respect to the link between transformation and MAFR were established:

- Transformation is an accepted government and business policy to address the socio-economic consequences of South Africa’s history of segregation and oppression. There is a legislative framework within which to design means of empowering previously disadvantaged race groups and transform society.

- A secondary objective or intention of the IRBA for MAFR is to increase transformation in the audit industry by allowing smaller firms to compete for larger company audits and increase the number of black professional accountants in the audit market. The IRBA is seeking to ensure that the auditing profession is transformed in a fair, equitable and competitive manner.

- There is research that indicates that a more racially transformed audit industry could produce greater quality audit outcomes.

- Concerns have been raised, predominantly by the Big Four firms, that MAFR will reduce their ability to pursue transformation within their organisations for various reasons, the main reason being the added costs imposed by firm rotation.

- In addition, Big Four firms have warned that MAFR may have a negative impact on the ability of the profession to attract and retain the best talent, which will consequently reduce audit quality over the longer term.

The above critical aspects are linked to the following study objectives:

- To determine whether MAFR is considered an adequate tool to improve the quality of audits.

- To determine whether it is believed that MAFR will produce positive effects on transformation in the South African audit industry as well as lower market concentration.
To determine whether there are likely unintended consequences from the implementation of MAFR.

Refer to Hypotheses 5, 8 and 9

Hypothesis 5: Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession.

Hypothesis 8: Stakeholders perceive that MAFR will reduce the appeal, in the minds of chartered accountants, of the auditing profession in comparison to other career options.

Hypothesis 9: Stakeholders perceive that MAFR will significantly increase costs for the audit firms.

Also, any hypothesis linked to an unintended consequence.

5.7 INTERVIEWS OF SOUTH AFRICAN AUDIT PARTNERS

A foundational exploratory study was conducted by Harber (2016) titled “An analysis of audit partner perceptions regarding the state of auditor independence in South African audit firms”. The findings of this exploratory study provide a value contribution to the South African MAFR debate and have been incorporated into this literature review – refer to sections 1.9 and 3.4.1.2 for example.

Firstly, Harber (2016) conducted open-ended interviews with the following audit and corporate governance experts regarding MAFR:

- The CEO of the IRBA – Bernard Agulhas, CA (SA).
The Chairman of the King Committee on Corporate Governance in South Africa – Professor Mervyn King SC.

Following this, Harber (2016) conducted open-ended interviews with 14 senior audit partners based in Cape Town and Johannesburg. The following is a description of the fourteen practitioners interviewed:

- All the partners were considered senior and highly experienced, with between 7 and 33 years as a practicing audit partner. The average number of years as a practicing 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. 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 the Johannesburg and Cape Town offices of the network firms, two of South Africa’s largest cities.
- Of the 14 partners, 2 were women.
- Five partners were from the Big Four international audit firms. The remaining partners were from the mid-tier audit firms which also perform audit services to public interest entities.

Table 5.2 below provides a description of the audit partner participants interviewed, including the number assigned for the purposes of analysing the results of the interviews, i.e. ‘Audit Partner 1’, ‘Audit Partner 2’ etc.
Table 5. 2: Description of the audit partners interviewed

<table>
<thead>
<tr>
<th>Designation of Participant in Analysis of Results</th>
<th>Big Four or Mid-tier firm</th>
<th>Position</th>
<th>Years as Practicing Audit Partner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Partner 1</td>
<td>Big 4</td>
<td>Senior partner</td>
<td>25</td>
</tr>
<tr>
<td>Audit Partner 2</td>
<td>Big 4</td>
<td>Managing Partner</td>
<td>20</td>
</tr>
<tr>
<td>Audit Partner 3</td>
<td>Big 4</td>
<td>Senior partner</td>
<td>25</td>
</tr>
<tr>
<td>Audit Partner 4</td>
<td>Big 4</td>
<td>Senior partner</td>
<td>9</td>
</tr>
<tr>
<td>Audit Partner 5</td>
<td>Big 4</td>
<td>Senior partner</td>
<td>23</td>
</tr>
<tr>
<td>Audit Partner 6</td>
<td>Mid-tier</td>
<td>Managing Partner</td>
<td>22</td>
</tr>
<tr>
<td>Audit Partner 7</td>
<td>Mid-tier</td>
<td>Managing Partner</td>
<td>23</td>
</tr>
<tr>
<td>Audit Partner 8</td>
<td>Mid-tier</td>
<td>Senior partner</td>
<td>29</td>
</tr>
<tr>
<td>Audit Partner 9</td>
<td>Mid-tier</td>
<td>Managing Partner</td>
<td>32</td>
</tr>
<tr>
<td>Audit Partner 10</td>
<td>Mid-tier</td>
<td>Managing Partner</td>
<td>17</td>
</tr>
<tr>
<td>Audit Partner 11</td>
<td>Mid-tier</td>
<td>Senior partner</td>
<td>16</td>
</tr>
<tr>
<td>Audit Partner 12</td>
<td>Mid-tier</td>
<td>Managing Partner</td>
<td>33</td>
</tr>
<tr>
<td>Audit Partner 13</td>
<td>Mid-tier</td>
<td>Managing Partner</td>
<td>28</td>
</tr>
<tr>
<td>Audit Partner 14</td>
<td>Mid-tier</td>
<td>Senior partner</td>
<td>7</td>
</tr>
</tbody>
</table>

The findings of these interviews by Harber (2016) have been integrated throughout the literature review chapters (Chapters 2 to 6). Refer specifically to Chapter 3, section 3.4. The research methodology chapter (Chapter 7) further describes how the findings from these interviews influence the research design used in this study. Refer specifically to Figures 7.3 and 7.4.

5.8 THE PERSPECTIVE OF A LARGE SOUTH AFRICAN ASSET MANAGER

Section 5.5 above discussed the official responses of key organisational stakeholders to the IRBA consultation paper. This included the perspective of the ASISA, the association that represents the majority of South Africa’s institutional investors, namely, asset managers. The ASISA is clearly against the implementation of MAFR. In contrast to this, an article published by one of South Africa’s largest investment managers, Coronation Fund Managers, provides a contrasting opinion to that of the ASISA (of which Coronation is a member).
The following important points, relevant to this study, were expressed by this asset management company:

- A number of financial scandals in South Africa in recent years have involved alleged wrong-doing by Big Four audit firms.
- Listed companies do tend to want only the larger (Big Four), ‘prestigious’ audit firms to act as appointed auditors. The reason for this is the perceived capacity to conduct the audit and the perceived independence of the firm due to its large fee base, in comparison to smaller audit firms. Coronation questions, despite this reasoning, whether it is sufficient to mitigate the risk of poor quality audits.
- The problem of improving audit quality is complex and the solutions are not obvious. The IRBA seems to be “woefully understaffed to deal with the number of challenges it currently faces” and address the problem, often investigating alleged audit failures long after the incident, due to resource constraints. The regulation of the audit profession needs to be improved and is part of the problem.
- As an attempt to help address the problem of perceived deteriorating audit quality in South Africa, Coronation is currently requesting all the companies in which they invest to rotate audit firms on a ten-year basis, i.e. before the 2023 adoption of MAFR. Their opinion is that this will indeed allow the benefits of a ‘fresh eye’ and incentivise existing auditors to maintain standards, while at the same time mitigate the cost burden of having to rotate too often.
- An additional concern which Coronation believes firm rotation will address, is that the auditor wrongly sees the company as the client, whereas it is the shareholders of the company that are the true client who charge the audit firm with their duty. It is the shareholders, not the executives, who appoint the auditor.
- Coronation acknowledge the problem of limited choice of firms large enough to appropriately audit the listed companies. There remains a significant problem to solve in that the smaller firms do not have the skilled resources to adequately audit the larger companies yet they are not able or not willing to hire the necessary staff until being appointed to the audit. This provides a ‘Catch-22’ situation that needs
to be addressed. There is also the concern that the listed companies expect one audit firm to audit the entire group of companies, across many jurisdictions and countries. This is an impediment to the appointment of a non-Big Four firm.

- Coronation is not against using regulations to break the concentration of the Big Four firms and promote the growth of other firms to allow them to sufficiently and appropriately audit the largest of companies. This may be seen by some as unfair, yet it is in the best interests of company stakeholders.

- A potential partial solution could be found in reorganising the distribution of liability within global audit firm networks and making the finances and governance structures of these firms more transparent and consistent with the latest principles applicable to normal companies.

(Chester, 2018)

There is clearly a problem. The issue is how do the users of financial statements resolve it?... The fact that so many organisations, tasked with the important societal role of confirming the accuracy of company accounts, are either complicit in fraud or unable to identify inappropriate controls and accounting policies is truly breathtaking. Over the past 10 years, as white-collar crime has soared alongside state capture and theft of public assets, it appears that the entire country’s moral compass has shifted. What is required is a complete reset of values and a strong sense of accountability among members of the profession. The very definition of profession is ‘any type of work that needs special training or a particular skill, often one that is respected because it involves a high level of education’. It is time that the auditing profession starts to show us how it will once again earn our respect (Chester, 2018:10-11).

It is clear from the above that Coronation is in favour of MAFR as one of the solutions necessary to improve the quality of audits in South Africa. This is in contrast to the ASISA position, which suggests that there are mixed opinions in the asset management industry on the matter. In addition, it can be concluded that Coronation, in their experience as a large South African asset manager, believes that auditor independence and audit quality are a concern and regulatory intervention is required.
5.8.1 Critical links to the empirical study

From the discussions above, the following critical aspects with respect to the position of asset managers has been established:

- There are mixed opinions regarding MAFR in the asset management industry and the state of auditor independence.
- Concerns have been raised about the ability of smaller firms to service the larger companies as auditors. If a solution is not found to this concern, ACs and shareholders are unlikely to appoint non-Big Four firms.
- Possible alternatives and solutions could include a restructuring of audit firm governance structures and oversight as well as increased shareholder activism in the governance of companies.

The above critical aspects are linked to the following study objectives:

- All study objectives are affected. The asset management industry represents the largest category of shareholder in South African companies (Harber, 2017b), and as such needs to be considered as a key stakeholder in the audit industry.
- This study includes equity fund managers as one of the key stakeholders to be surveyed (refer to Chapter 7 for the research methodology).
- As such, all hypotheses are relevant and apply to this participant group in the study.

5.9 CONCLUSION

This chapter has described the context of the South African MAFR debate in detail, analysing the following areas of the debate:

- The existing regulatory, legislative and framework environment with regards to audit quality and auditor independence;
• The IRBA position and reasoning for MAFR, as contained in the IRBA consultation paper and other official communication;

• Key stakeholder responses provided to the IRBA’s request for comment on its consultation paper. The key stakeholder responses reviewed were as follows: the IFAC, the JSE, the CFO Forum, the SAICA and the Big Four audit firms;

• The specific secondary IRBA objectives for MAFR, namely, to reduce market concentration and increase racial transformation in the audit industry; and

• Specific opinions of interviewed audit partners and one large asset manager.

It is submitted that the description of the MAFR debate in South Africa contained in this chapter provides critical links to all the objectives and hypotheses in this study. In addition, this chapter established the IRBA’s emphasis on market concentration and transformation concerns in the audit industry. The IRBA believes that MAFR will have a positive impact on the high degree of concentration of the Big Four firms in the audits of large organisations. Similarly, the IRBA believes that MAFR will increase the slow rate of transformation in the industry. The literature regarding these two factors was reviewed and applied to audit firm rotation. In addition, some of the reservations of audit partners and potential negative consequences of MAFR with respect to market concentration and transformation were discussed. While audit partners of Big Four firms are in favour of improving transformation statistics in the audit industry, it appears that they do not believe MAFR is the right mechanism to achieve this. There was therefore some unhappiness expressed by audit partners about using MAFR as a tool to address these additional objectives. This study on MAFR in South Africa must incorporate these considerations and secondary objectives of the regulator for MAFR. The links to the study and hypotheses were therefore established.

In the following chapter, a review of the state of MAFR regulation internationally will be provided, explaining the nature and extent of its adoption in other countries.
CHAPTER 6: INTERNATIONAL DEVELOPMENTS WITH REGARDS TO MAFR REGULATIONS

6.1 INTRODUCTION

The purpose of Chapters 2 to 4 was to establish the academic basis for the study objectives, with a primary focus on the link between auditor independence, audit quality and MAFR. Chapter 5 analysed the South African context to the MAFR debate, including the IRBA’s objectives and rationale, the details of the MAFR ruling in June 2017, key stakeholder responses to the ruling and the unique South African aspects of transformation and market concentration. This chapter describes the state of auditor rotation regulations in other countries. Particular attention is given to the larger economic jurisdictions of the US, the EU and China, as it is not feasible to provide detailed descriptions of every country’s position on auditor rotation. However, a summary of rotation regulations of different countries has been compiled.

According to Fontaine et al. (2016), MAFR has received a great deal of attention in recent years, due in part to the highly publicised debate on the topic in the US and the decision to implement it in Europe. Regulators and policy makers who witnessed the global financial crisis (2007-2009) and have since experienced periodic corporate failures in their economies, similar to the Enron collapse of 2001, have once again started raising doubts regarding the credibility of audited financial statements and the independence of auditors (Hakwoon et al., 2015). The purpose of this chapter is to outline international developments with respect to auditor rotation rules generally and MAFR in particular. As stated by Hay, (2015:159), “auditing is relatively unusual compared to other accounting disciplines because of the high proportion of research that is linked to professional concerns”. This topic of MAFR is a highly debated professional concern internationally. As such, it is appropriate to address the high-level developments of MAFR in the larger economic jurisdictions before looking more closely at the South African context.


6.2 DEVELOPMENTS IN THE UNITED STATES

In recent years, most notably since the collapse of Enron in 2001, US regulators have expressed concerns about auditor independence and have taken actions to mitigate those concerns (Laurion et al., 2017). These include the passing of the 2002 SOX Act, also known as the Public Company Accounting Reform and Investor Protection Act. This is US legislation which, among many other requirements, prohibits the auditor (in the US) from providing most non-audit services to its clients. More specifically, SOX imposes a one-year ‘cooling-off period’ for former auditors taking on employment at their previous audit clients and requires audit partners to rotate off the client as engagement partner every five years. In other words, an auditor cannot be the engagement partner, responsible for signing the audit report, for a period greater than five consecutive years. The partner must then rotate off the client entirely for a period of at least five years (the ‘cooling-off period’) before being eligible to become the engagement partner again. This is a regulation that is designed to mitigate the independence threats that arise due to long audit tenures, such as familiarity with the client company’s management. In terms of SOX, the US shifted from a seven-year rotation with a two-year cooling-off period (before SOX), to the stricter five-year rotation and five-year cooling-off period for audit engagements. The AC is required to ensure that the requisite rotation actually takes place (Tepalagul & Lin, 2015). SOX therefore does not go so far as to require MAFR, only partner rotation.

The Public Company Accounting Oversight Board (PCAOB), created in 2002 by the SOX Act, oversees audit firms that audit public companies and sets and enforces the rules governing public company audits (Rapoport, 2016). The PCAOB is similar in function to the IRBA in South Africa. The PCAOB inspection reports amount to official assessments of how auditing firms are performing, which is comparable to the IRBA’s inspection report process in South Africa. The inspections are intended to help the firms improve their work; any audit deficiencies that the board finds do not result in penalties for the firms. In the period since the inception of the PCAOB as the audit regulator, it has favoured various regulations aimed at improving auditor independence, other than those already legislated
in the SOX Act. According to Cameran, Negri and Pettinicchio (2015), the US has always been somewhat different from other countries when it comes to audit firm rotation. The US has had a long experience with partner rotation, introducing seven-year audit partner rotation in 1978, amended by the SOX Act in 2002 to require a stricter five-year rotation and five-year cooling-off period. However, these regulations stop short of audit firm rotation (MAFR).

After significant debate and disagreement between the PCAOB and various stakeholders regarding appropriate independence regulations, other than those already established by the SOX Act, the PCAOB suggested in 2011 that firm rotation would be the best way to ensure the desired, high level of professional scepticism (Cameran et al., 2015). This suggestion sparked much push-back from the profession and business community. In March 2012 the PCAOB conducted two days of hearings on the pros and cons of MAFR. According to Casterella and Johnston (2013), the hearings featured several former regulators who addressed the costs and benefits of MAFR and there was little consensus. While former Federal Reserve Chairman Paul Volcker said his experience “does suggest to me the importance of requiring rotation”, former SEC Chairman Richard Breeden seemed less convinced, saying that “mandatory rotation would benefit some companies and it would probably harm others.” (Casterella & Johnston, 2013:108). Finally, former SEC Chairman Harvey Pitt expressed concern that with MAFR, “the cure could turn out to be worse than the disease, depending on the amount of time people would be required to rotate off” (Casterella & Johnston, 2013:108). Two years later, in July 2013, the US Congress ruled against the possibility of audit firm rotation. In the end, after three years of work, in February 2014 the PCAOB chairman announced that the PCAOB had ended its project to further the possibility of MAFR legislation. This decision represented the second time in ten years (firstly in 2003) that US regulators formally considered and then rejected MAFR. As such, the US continues with partner rotation on a five-year rotation basis, similar to the current regulations in South Africa.
6.3 DEVELOPMENTS IN THE EUROPEAN UNION AND THE UNITED KINGDOM

The EU is treated here as a single jurisdiction because, during the last decade, the European Commission has issued a number of different guidelines that concern all EU member states. Before the 2014 change in regulations, under the EU guidelines, the key audit partner rotation was mandated after seven years in public interest entities (Directive 2006/43/EC), with a cooling-off period of two years (KPMG, 2014; Cameran et al., 2015). However, changes resulted from the audit reform processes that have been widely debated between 2011 and 2014. 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, 2014). These new rules force European companies to hire new audit firms at 10- to 24-year intervals, depending on certain criteria, bringing MAFR 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 legislation came into effect in June 2016, with many transitional arrangement applicable (PwC Inc., 2016). Between June 2014 and June 2016, EU member states were permitted to adopt MAFR rules earlier and could even shorten the tenure of audit term. For example, in the UK, it was introduced on 1 January 2015 and the Netherlands made it effective from 1 January 2016.

The European regulations are complex and controversial. Many, including the IFAC, have recognised that the decision in Europe in favour of MAFR was “divisive and confrontational” and “an especially politically-driven process” (Choudhury, 2017).
According to the IFAC, the European legislation provides over 80 options for member states to consider, and has resulted in there being even more fragmented regulatory arrangements, with 28 different arrangements - one for each member state - being implemented across Europe (Choudhury, 2017).

The UK has been impacted by this European legislation, despite its decision to leave the Eurozone in 2016. The UK’s invocation of Article 50 of the Treaty on European Union happened on 29 March 2017 (as a result of a national referendum held in June 2016), and it began the UK’s withdrawal from the EU, commonly referred to as Brexit. The invocation of Article 50 is the act of giving formal notice to the European Council of a member state’s intention to withdraw from the EU to allow withdrawal negotiations to begin, as required by the Treaty on European Union. The outcome of these negotiations and particularly its impact on MAFR as implemented in the EU, is uncertain at this stage.

Before the Brexit decision in 2017, public interest entities the UK had taken up an EU member state option to extend the 10-year rotation period to the maximum period allowed of 20 years. This was provided that the audit is subject to a public tendering process, carried out at least every 10 years, whereby the incumbent audit firm is allowed to tender and be reappointed (Agnew, 2016b; Choudhury, 2017). As discussed, before the 2014 regulation changes in Europe, the EU required partner rotation every seven years and a cooling-off period of two years, in compliance with the IFAC Code of Professional Conduct. The UK required a five-year-on, five-year-off partner rotation policy for listed audits before the 2014 EU directive (Titley, 2015). For Financial Times Stock Exchange (FTSE) Top 350 listed companies there is an additional requirement for mandatory audit tendering (not MAFR), every ten years. How these UK-specific regulations will be implemented together with the EU directive for MAFR, considering Brexit and the invocation of Article 50, is yet to be determined.
Based on the above description of the state of European rotation regulations, it is clear that there was significant resistance to MAFR and the resultant regulations are complex and fragmented in their applicability to member states.

6.4 DEVELOPMENTS IN CHINA

China represents the world’s second largest national economy after the US (third if one considers the entire EU), even though it is considered an emerging market (WEF, 2017). MAFR was adopted by Chinese regulators in 2010, whereby financial institutions and state-owned enterprises (therefore not all public interest companies) must have a rotation of audit firm every five years, together with an audit tender process every three years (Lennox, Wu & Zhang, 2014; Cameran et al., 2015). According to Percy (2014), the Big Four firms did not lose their concentration of the market after adoption, but rather there was a simple rotation of companies among the Big Four firms, with limited increase in market share for the smaller firms. Before MAFR was adopted in 2010, Chinese regulation required audit partner rotation every five years, a requirement that was implemented in 2004 (Bandyopadhyay et al., 2014).

6.5 A REVIEW OF OTHER COUNTRIES

As discussed above, the most significant countries or jurisdictions, in terms of GDP, which currently have MAFR regulations in place are China and the EU, including the UK. The US has decided against its adoption. The countries that have adopted MAFR regulations are in the minority, especially when it is noted that many countries have adopted MAFR in a limited scope, for example, only banks or financial institutions. Overall, while only a few countries have decided to adopt audit firm rotation, many support the idea of partner
rotation (Cameran et al., 2015). **Annexure 2** contains a list of countries and their current position with regards to audit firm rotation\(^{10}\).

There are also a number of examples of countries where MAFR has been effective in the past and then rejected, usually in favour of partner rotation. For example, in Canada, MAFR was introduced much earlier than it was in other countries and was in place until 1991 when it was removed with the revision of the Bank Act, which blamed the switching costs borne by the incoming auditor as not offsetting the benefits (Cameran et al., 2015). In other countries, such as Spain, firm rotation was required every nine years from 1988 to 1995. The first nine-year term of the audit firm tenure had not even expired when the rule was abolished (Ruiz-Barbadillo et al., 2009). Singapore also introduced mandatory rotation in 2002 for banks, only to ‘temporarily suspend’ it in 2008. This was justified on the basis that the regulators did not wish to place further cost burdens on banks during the last financial crisis. The Singapore regulator recently stated that, in their opinion, “research studies conducted thus far internationally did not provide conclusive evidence linking mandatory firm rotation with an improvement in audit quality” (Choudhury, 2017:2). According to Cameran et al. (2015), the case of Costa Rica is emblematic: audit firm rotation was introduced in 2005, appealed in 2006, ejected in 2007 and re-implemented in 2010.

The 2015-2016 Global Competitiveness Index (GCI) report published by the World Economic Forum (WEF) provides a ranking of countries by the efficiency and advancement of their respective financial markets. According to the WEF, financial market development refers to how efficiently a financial sector allocates the resources saved by a nation’s population, as well as those entering the economy from abroad, to the entrepreneurial or investment projects with the highest expected rates of return rather than to those with political connections (WEF, 2015). After studying 140 countries, South Africa was ranked 12\(^{th}\) in terms of financial market development by the WEF. New

\(^{10}\) Author’s own construction based on information from Casterella and Johnston (2013), Cameran, Negri and Pettinicchio (2015), Hakwoon, Hyoik and Jong Eun (2015), Fontaine, Khemakhem and Herda (2016), IRBA (2016) and SAICA (2016).
Zealand and Singapore were first and second, while Hong Kong was listed in third position.

Table 6.1 below presents the top 20 countries ranked in terms of financial market development by the WEF, and their respective regulatory position on MAFR. It is significant to note that, according to this list, only China has implemented MAFR. A key international argument against MAFR, which also features in the South African debate, is that the efficiency and effectiveness of a country’s existing markets and regulations should provide sufficient assurance that the degree of auditor independence is adequate.

Table 6.1: Countries ranked by the WEF for financial market development (2015-2016 Global Competitiveness Index)

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank</th>
<th>Regulatory Position</th>
</tr>
</thead>
<tbody>
<tr>
<td>New Zealand</td>
<td>1</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Singapore</td>
<td>2</td>
<td>Considered, implemented and repealed</td>
</tr>
<tr>
<td>US</td>
<td>3</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>4</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Finland</td>
<td>5</td>
<td>Did not apply MAFR – now apply by virtue of being under the EU</td>
</tr>
<tr>
<td>Australia</td>
<td>6</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Canada</td>
<td>7</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Switzerland</td>
<td>8</td>
<td>Do not have MAFR</td>
</tr>
<tr>
<td>Norway</td>
<td>9</td>
<td>Did not apply MAFR – now apply by virtue of being under the EU</td>
</tr>
<tr>
<td>Sweden</td>
<td>10</td>
<td>Did not apply MAFR – now apply by virtue of being under the EU</td>
</tr>
<tr>
<td>South Africa</td>
<td>11</td>
<td>Do not have MAFR – now considering</td>
</tr>
<tr>
<td>Panama</td>
<td>12</td>
<td>Do not have MAFR</td>
</tr>
<tr>
<td>Malaysia</td>
<td>13</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>14</td>
<td>Did not apply MAFR – now apply by virtue of being under the EU</td>
</tr>
<tr>
<td>China</td>
<td>15</td>
<td>Do apply MAFR</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>16</td>
<td>Did not apply MAFR – now apply by virtue of being under the EU</td>
</tr>
<tr>
<td>Japan</td>
<td>17</td>
<td>Do not have MAFR</td>
</tr>
<tr>
<td>Guatemala</td>
<td>18</td>
<td>Do not have MAFR</td>
</tr>
<tr>
<td>Israel</td>
<td>19</td>
<td>Considered MAFR and rejected</td>
</tr>
<tr>
<td>Germany</td>
<td>20</td>
<td>Did not apply MAFR – now apply by virtue of being under the EU</td>
</tr>
</tbody>
</table>

Source: Shango (2017)

From the above table it is clear that no consensus exists internationally regarding the ability of MAFR to improve or preserve audit quality. The jurisdictions that have abolished
MAFR or decided not to adopt it are doing so because of the perceived negative consequences of such legislation and perhaps because there is a belief that there is no need to change the current policy of audit partner rotation (Tepalagul & Lin, 2015; Fontaine et al., 2016). The Singapore authority, as quoted above, is hesitant to pursue MAFR, considering the lack of research indicating that it will improve audit quality. The IFAC agrees that international research does not clearly favour MAFR, as demonstrated by this quote from the CEO of IFAC:

On audit quality, however, IFAC points out that evidence does not clearly support the notion that mandatory audit firm rotation will enhance audit quality. Academic research is at best mixed, and practical examples are too often confounded by other elements (Choudhury, 2017:2).

6.6 CRITICAL LINKS TO THE EMPIRICAL STUDY

From the discussions above, the following critical aspects with respect to the international adoption of MAFR regulations were established:

- There appears to be no consensus internationally regarding which auditor rotation rules are best suited to safeguarding audit quality. However, there is currently a preference, in terms of numbers of countries, to require audit partner rotation, similar to that recommended in the IFAC Code of Ethics for Professional Accountants.
- There are some jurisdictions that have implemented and then abolished MAFR while others such as the US, have decided not to adopt it. Many indicate that the reason for doing so is because the perceived negative consequences of such legislation outweigh the benefits, in comparison to alternative regulations to safeguard auditor independence.
- Of the more significant economic jurisdictions, the US has rejected MAFR regulations while China and the EU have adopted it. Many countries in Europe which had decided against it, such as Germany and France, will now be required to adopt it by virtue of being part of the EU.
The above critical aspects are linked to the following study objectives:

- To critically assess whether auditor independence and audit quality are considered a problem in South Africa.
- To recommend possible credible alternatives as well as changes to current proposals, including transitional provisions that will allow MAFR to better achieve its stated objectives.
- To critically assess and contrast the perceptions and arguments of key stakeholder groups and individuals within the broad ambit of the South African MAFR debate.

The above critical links are relevant to all of the study objectives and Hypotheses 1 to 12 in a South African context.

6.7 CONCLUSION

This chapter briefly described the state of affairs internationally with respect to auditor rotation. A specific emphasis was placed on the larger economic jurisdictions of the US, the EU (including the UK) and China. There is no international consensus with respect to MAFR and it may perhaps be concluded that what is right for one country, given its specific socio-economic context and business environment, is not necessarily right for another. It can, however, be concluded that currently the countries that have adopted MAFR regulations are in the minority and the EU process of deciding on MAFR was highly controversial, with accusations that it was a politically driven agenda. There are also a number of countries that have adopted MAFR and then subsequently repealed it. Therefore, there is need for more country-specific research to be conducted, as is being performed in this study. It is also important to note, as described in preceding chapters, that the South African context does ‘bring to the table’ the added dimensions of market concentration and transformation, unlike other jurisdictions. The IRBA correspondence
on MAFR and the public debate before the South African Parliamentary Standing Committee on Finance (Harber, 2017a) have made it clear that MAFR is intended to address these two concerns, as well as improve audit quality.

Chapters 1 to 6 constitute the literature chapters of this study. Chapter 1 outlined the research problem and the study objectives. The next chapter will describe the research methodology used in the study and the hypotheses developed from the literature. Throughout Chapters 2 to 6, sections titled ‘critical links to the empirical study’ have linked the literature to both the study objectives and the hypotheses.
CHAPTER 7: DESCRIPTION OF THE EMPIRICAL RESEARCH METHODOLOGY

7.1 INTRODUCTION

The purpose of this chapter is to describe the mixed-methods research methodology adopted in this study. The preceding chapters have reviewed the literature regarding key concepts related to the MAFR debate such as auditor independence, auditor tenure, rotation of audit partner and firm as well as the important concept of audit quality. It has been established that, in jurisdictions where MAFR has been implemented, an appropriate method is to attempt to measure changes in audit and financial reporting quality over the periods of the rotation. As outlined in section 3.4.2 and Annexure 3, this has been performed in countries such as Italy, Spain and South Korea. In a paper explaining the current state of auditing research, Hay (2015) notes that although there is substantial research on auditor rotation, there is scant research on the effectiveness and consequences MAFR. This is mostly since there are so few practical situations where MAFR has been enforced and its effects can be measured. As a result of these complexities, “there is no clear evidence about whether it is effective” and more research is needed (Hay, 2015:162). This research can be conducted within jurisdictions which have not yet implemented MAFR, such as South Africa, by attempting to properly understand the opinions and arguments for and against MAFR by experienced key stakeholders in the audit industry. Similar qualitative and mixed methods survey-based designs have been used to better understand audit regulations, providing significant contributions to the research and regulators. Examples of such studies include Cohen et al. (2010), Daugherty et al. (2012), Fontaine et al. (2016) and Harber (2016).
As stated in Chapter 1, section 1.7, the research problem is as follows:

**Audit quality and auditor independence may not be a problem in South Africa and the reasons and objectives for the implementation of MAFR may not be sufficient or appropriate in the South African context.**

To explore the above research problem, the study aim can be articulated as follows:

**To critically assess the perceptions and arguments of key stakeholders in the South African MAFR debate, with specific consideration of audit quality, socio-economic transformation and market concentration factors, in order to provide recommendations with regards to implementation and possible unintended consequences.**

The methodology consists of a mixed methods approach. Qualitative and quantitative data was obtained through specifically tailored surveys (questionnaires) of four identified key stakeholders in the South African MAFR debate. These stakeholders are (1) individual South African audit partners, (2) CFOs, (3) AC chairs and (4) equity fund managers. The nature of these stakeholder groups is described more fully in this chapter.

The mixed methods approach builds on the literature review of Chapters 2 to 6, which includes the South African context to the MAFR debate (Chapter 5) and the interview findings of Harber (2016) whereby experienced senior South African audit partners were interviewed in 2016 with regards to MAFR (refer to section 5.8). In this chapter the approach to the empirical study and the research methodology that was followed are discussed in detail. The findings of the empirical study are then presented and discussed in Chapter 8.
7.2 RESEARCH PARADIGMS

A research paradigm is a “set of beliefs and practices that guide a field” during the research process (Doyle, Brady & Byrne, 2009:161). A synonym for the concept of ‘research paradigm’ would be the term ‘methodological paradigm’ (Johnson, Onwuegbuzie & Turner, 2007:130). This study adopts what is termed a ‘mixed methods’ research paradigm as opposed to a purely qualitative or purely quantitative paradigm.

Mixed methods research is one of the three major research paradigms, namely, quantitative research, qualitative research and mixed methods research (Johnson et al., 2007). According to Tashakkori and Creswell (2007:4), mixed methods may be defined as “research in which the investigator collects and analyses data, integrates the findings and draws inferences using both qualitative and quantitative approaches or methods in a single study”. Mixed methods research is not restricted to the use of a traditional approach to data collection but is guided by a foundation of enquiry that underlies the research activity (Creswell, 2013). At its core, a mixed methods study is simply one that includes a qualitative and quantitative dimension, however, the reality is rather more complex than that insofar as difficulties often arise when the researcher attempts to articulate and provide rationale on how the two elements relate to one another (Creswell, 2013; Tashakkori & Creswell, 2007). Johnson et al. (2007) propose that there might not be a single criterion of demarcation for mixed methods research but that there are several important criteria for thinking about mixed methods research in a narrow or pure sense as well as in a broader or highly inclusive sense. Added to this is the reality that there is sometimes an inconsistency among researchers about what constitutes mixed methods research (Bryman, 2007; Creswell, 2013; Tashakkori & Creswell, 2007).

Some interpretations advocate that a mixed methods approach is simply the collection and analysis of both quantitative and qualitative data. However, more contemporary developments and proponents of this methodology have sought to develop an understanding of the importance of complete integration of the two approaches, rather
than simply considering them as separate but linked (Bryman, 2007; Creswell & Plano Clark, 2011). Tashakkori and Creswell (2007) argue that as mixed methods research is still evolving, the discussion of what it actually is should be kept open. Similarly, Johnson et al. (2007) suggest that the definition of mixed methods research will change over time as this research approach continues to grow.

### 7.2.1 The research paradigm debate: Positivist vs. Interpretivist

According to Morgan (2007), much of the discussion in social science research methods has focused on the distinction between qualitative research and quantitative research. These have traditionally been the two dominant approaches to social science research, with a relatively recent alternative approach, this being mixed method research, which, depending on who is asked, either combines, integrates or mixes qualitative and quantitative methods.

The worldview of the researcher is greatly influenced by what is often termed ‘the positivist paradigm’ or scientific approach (quantitative research) versus the ‘naturalistic, constructivist or interpretive tradition’ (qualitative research) to which they align themselves. According to Bryman (2007), some would even argue that these paradigms are fundamentally different and a combination of the two is not possible. Traditionally, researchers have made a forced choice between the positivist scientific model of research associated with quantitative methods (positivism) and the interpretative model associated with qualitative methods (Howe, 1985).

Positivism contends that there is a single reality and therefore seeks to identify causal relationships through objective measurement and quantitative analysis (Firestone, 1987). In the positivist paradigm, the researcher is considered independent and objective using larger, statistically representative samples, to test carefully constructed hypothesis. The prevailing wisdom is that the researcher in the positivist tradition can put aside values to
avoid bias in a process of inquiry (Creswell, 2013). Constructivism or interpretive approaches emerged as an alternative to this positivist form of inquiry as researchers sought to examine the context of human experience. This is why mixed methods research has emerged as a dominant paradigm in social science, particularly in healthcare research in recent years (Creswell, 2013; Doyle, Brady & Byrne, 2009). An interpretivist approach proposes that there are multiple realities and different studies may yield different interpretations. Those interpretations are shaped by particular circumstances that exist as a study unfolds. Researchers who work within the interpretivist (constructivist) paradigm seek to illuminate the reality of others through the process of detailed descriptions of their experiences (Creswell, 2013; Doyle, Brady & Byrne, 2009). In the interpretative paradigm, the researcher is subjective with the focus directed at deeper understanding of what is happening with a smaller sample.

Mixed methodologies seek to combine or integrate the two, the deductive and the inductive, the objective and the subjective, the positivist and the interpretive. It is proposed that mixed methods may be the third paradigm, capable of bridging the gap between the quantitative and qualitative positions (Johnson et al., 2007). Today, the primary philosophy of mixed research is that of pragmatism. According to Johnson et al. (2007), mixed research, in its recent history in the social, behavioural or human sciences, started with researchers and methodologists who believed both qualitative and quantitative viewpoints and methods were useful as they addressed their research questions. This is what is meant by pragmatism in the research context – the methodology that best addresses the research question is the one employed, and may be a combination of methods. Johnson et al. (2007) share their aspirations that the field of mixed methods research will move beyond quantitative versus qualitative arguments and will instead focus on recognising the usefulness of both paradigms and identifying how these approaches can be used together in a single study to maximise the strengths and minimise the weaknesses of each other. They further contend that taking a non-purist position allows researchers to design research studies that combine methods that offer the best chance of answering their research questions (Johnson et al., 2007).
The philosophy of pragmatism, focusing on the best means of answering the research question, underpins a mixed methodology approach and advances the notion that the consequences are more important than the process. Therefore there is a belief by the researcher who uses a mixed methodology that “the end justifies the means” (Doyle, Brady & Byrne, 2009:178). A mixed method advocates eclecticism and “a needs-based or contingency approach to research method and concept selection” (Johnson et al., 2007:17), so that researchers are free to determine what works to answer the research questions. According to Morgan (2007) the pragmatic approach to research is informed by a belief that the practicalities of research are such that it cannot be driven by theory or data exclusively and the research may need to move back and forth between induction and deduction through a process of inquiry.

### 7.2.2 Application to accounting research

Mixed methodologies have an application to accounting-related fields of research. Modell (2009) states that mixed methods research, combining qualitative and quantitative approaches, has a long history in management accounting and has recently attracted increasing attention, although the dominant methodology remains positivist. Ahrens (2008:292) claims that “a growing body of interpretive management accounting studies, often based on fieldwork, is continuing to develop approaches that seek to overcome that distinction by exploring the various ways in which accounting can become part of the contexts in which it operates”. According to Ahrens, the conclusions of Kakkuri-Knuuttila, Lukka and Kuorikoski (2008) contain an important message for all accounting researchers who should be careful about drawing strict distinctions between objective and subjective approaches. According to Kakkuri-Knuuttila et al. (2008:267), the view of sociological paradigms as necessarily mutually exclusive “does not hold water”. Interpretive research, including accounting research, straddles the two dominant paradigms. Interpretive (qualitative) research, certainly and necessarily, includes subjectivist elements, yet it must be recognised that it also encompasses objectivist features. On the other hand, more
positivist accounting research, given the nature of management and the social science elements often contained within accounting and financial management disciplines, cannot be an objective “mirror of reality” (Kakkuri-Knuuttila et al., 2008:267). Ahrens (2008:292) is of the opinion that accounting research will always “remain tied to the understandings of individuals” and as such, the experiences, perceptions and arguments of accounting practitioners form a valid and important contribution to research in accounting.

7.2.3 Application to this study

For the purposes of this study, it is submitted that a mixed method approach is most appropriate. An appropriate mix of positivist and interpretive methods is applied to the research question. Combining the review of theoretical and empirical literature by Greene, Caracellii and Graham (1989) with a later review by Bryman (2006) and Creswell (2013), the following seven benefits of mixed methods research designs were identified. In the description below of these benefits, an application to this study is made.

1. **Triangulation**

   **Description:** According to Creswell (2013), triangulation design is the most common and well-known approach to mixed methods research. The purpose is to obtain different yet complementary data from qualitative and quantitative techniques to best understand the research problem as well as benefit from the strengths and weaknesses of each approach. This allows for greater validity in a study by seeking corroboration between quantitative and qualitative data.

   **Application:** This study relies on an academic literature review and an understanding of the South African professional debate on MAFR as the basis for construction of theoretical models and hypotheses. An understanding of the historical, professional debate was only possible from a review and summative content analysis of the IRBA communications with regards to MAFR (most notably the 2016 IRBA
consultation paper and subsequent 2017 ruling) and the responses of industry stakeholders to this communication. This content analysis of the South African MAFR debate was provided in Chapter 5. Following this, the four questionnaires were designed to collect both qualitative and quantitative data. The analysis of this data therefore uses both quantitative and qualitative techniques.

2. **Completeness**
   
   **Description:** Using a combination of research approaches provides a more complete and comprehensive picture of the study phenomenon.
   
   **Application:** Combining the literature review, together with the content analysis of the South African MAFR debate, the questionnaires produce a more detailed exploration of the perceptions of these key stakeholder groups. The validity of the questions and statements in the questionnaires is more likely to be established. As the four questionnaires were designed to collect both qualitative and quantitative data, including the capturing of written perceptions, feelings and opinions, a more wholistic picture of the study topic is obtained.

3. **Offsetting weaknesses and providing stronger inferences**
   
   **Description:** The limitations of each approach may be neutralised while strengths are built upon thereby providing stronger and more accurate inferences.
   
   **Application:** The weakness of the qualitative analysis in the content analysis of the MAFR debate (Chapter 5) and in the written responses in the questionnaires is the risk of incompleteness or non-validity of content. The limitation of qualitative data is that no inferences about the population groups can be made due to the lack of application of inferential statistics. Using Likert scale responses (quantitative), for example, allows statistical inference techniques to be applied. Therefore, a combination and comparison of the two methods
provides stronger and more accurate conclusions to be drawn and inferred.

4. **Answering different research questions**
   
   **Description:** Creswell and Plano Clark (2011) argue that mixed methods research helps to answer the research questions that cannot be answered by either quantitative or qualitative methods alone and provides a greater repertoire of tools to meet the aims and objectives of a study. This is an appeal to the pragmatic argument mentioned earlier, which calls for an approach best suited to answering the research question.

   **Application:** As stated above, the combination of content analysis (Chapter 5), qualitative data (text boxes in survey) and quantitative data (Likert scale responses in survey) allows comparison, contrast and inference, which is not possible by one method alone. This will allow all study objectives and hypotheses to be addressed.

5. **Explanation of findings**
   
   **Description:** Mixed methods studies can use one research approach (i.e., quantitative or qualitative) to explain the data generated from a study using the other research approaches. This is particularly useful when unanticipated or unusual findings emerge.

   **Application:** As explained above, the mixed methods design allows the detailed comparison of qualitative and quantitative data on a complex subject that may yield many unanticipated results.

6. **Illustration of data**
   
   **Description:** Using a qualitative research approach to illustrate quantitative findings can help paint a better picture of the phenomenon under investigation. Bryman (2006) suggests that this is akin to putting ‘meat on the bones’ of dry quantitative data.

   **Application** As explained above. The opinions of stakeholders and respondents will shed light on the quantitative findings.
7. Hypotheses and instrument development and testing

Description: A qualitative phase of a study may be undertaken to develop hypotheses to be tested in a follow-up quantitative phase.

Application: As explained above. This study relies on the academic literature review and an understanding of the South African professional debate on MAFR (through qualitative content analysis), as the basis for construction of theoretical models and hypotheses.

These seven advantages describe the usefulness of a mixed methods approach in answering a particular research question. As applied to this study of MAFR in South Africa, the qualitative and quantitative aspects will be clearly linked and integrated to produce one logically consistent methodology.

7.3 MIXED METHODS DESIGN EMPLOYED

The specific design used in this study is referred to as sequential mixed methods design as this study has been developed to further the research in South Africa conducted to date on MAFR and the outcome of the professional MAFR debate as it has occurred leading up to the June 2017 MAFR ruling by the IRBA. The sequential aspect to the design refers specifically to the summative content analysis performed in Chapter 5 to properly understand the context of the South African professional debate.

Content analysis is a widely used qualitative research technique; it involves the study of documents and communication in a replicable and systematic manner (Hsieh & Shannon, 2005). Without performing this analysis of the IRBA consultation paper and the response letters provided by key stakeholders, it is submitted that it would have been inappropriate to design a theoretical model and hypotheses to address the research problem. Chapter 5 therefore forms a critical first stage of the research design adopted in this study. According to Creswell (2013), a sequential design is required when the various
themes, categories and breadth of the debate must first be understood and documented before further exploration can be conducted into the topic on a larger scale. These themes, categories and breadth of opinions have been described in the literature review generally, but specifically in the analysis of the South African professional context to the debate in Chapter 5. Without these themes, categories and breadth of opinions, it would not have been possible to develop an appropriate questionnaire (survey) to collect a more representative, detailed and nuanced understanding of stakeholder perspectives to the MAFR debate.

7.3.1 Diagrammatic representation of the research design

Figure 7.1 below, known as the ‘Instrument Development Model’ of the sequential mixed methods design, diagrammatically presents the design used in the study. The flow of the design from qualitative analysis to quantitative and qualitative data analysis in the questionnaires is shown.

Figure 7.1: Instrument development model (mixed methods)

Source: Creswell (2013)

According to Doyle et al. (2009), this design in Figure 7.1 is used for developing and testing instruments, hence it is termed the ‘Instrument Development Model’ in mixed methods designs. The design starts with qualitative data that enables a topic or phenomenon to be properly understood. Then it builds to a second, quantitative (and also qualitative) phase that builds on the results of the qualitative phase by developing an instrument, identifying variables or stating propositions for testing based on an emergent theory or framework (Creswell, 2013; Doyle et al., 2009).
The Instrument Development Model sequential design involves developing and implementing a quantitative instrument (such as an index or scale system) based on qualitative findings. In this design, the researcher first qualitatively explores the research topic and uses this data to build an instrument, which is then used quantitatively to validate the instrument and also collect quantitative data. The qualitative and quantitative methods are connected through the development of the instrument items.

Daugherty et al. (2012) provide an example of accounting research that uses a sequential mixed methods design. The topic being studied was the effect of the US SOX Act of 2002 on the reduction of audit partner rotation periods from seven years to the stricter five-year term. The researchers first used structured interviews (qualitative) of experienced practicing audit partners who would have been affected by the reduced rotation periods, together with an analysis of the regulatory environment and professional debate on the topic (qualitative), followed by Likert-type surveys (quantitative) of the much broader population of practicing audit partners. Before the construction of the survey, a theoretical models and hypotheses were developed, which was the ‘instrument development’. This model developed by Daugherty et al. (2012) is shown in Figure 3.1 in Chapter 3. The perceptions of the participants with regard to mandatory partner rotation, its impact on audit quality as well as any direct or indirect consequences on audit partners’ quality of life were assessed.

Figure 7.2 below represents an application of this design to the current study.
QUAL: summative content analysis

Following the academic literature review, this first stage consists a qualitative summative content analysis of the IRBA communications with regards to MAFR (most notably the 2016 IRBA consultation paper and subsequent 2017 ruling) and the responses of industry stakeholders to this communication. This is critical to properly orientate the study in the specific South African context of MAFR, which includes the unique aspects of the debate with regards to racial transformation and supplier concentration in the South African audit market.

This content analysis of the South African MAFR debate was provided in Chapter 5.

Develop theoretical model, hypotheses and research instrument

The literature review has been linked to the study objectives and hypotheses throughout Chapters 2 to 6 in sections titled “critical links to the empirical study”. The literature, including the summative content analysis, forms the basis for the theoretical model and set of hypotheses derived in Chapter 7. The questionnaires for each of the four stakeholder groups have thereby been derived. The link between hypotheses and questionnaires is described in Annexure 5.

Qualitative and quantitative data was obtained through specifically tailored questionnaires of the following four key stakeholders in the South African MAFR debate, namely: individual South African audit partners; CFOs; AC members; and equity fund managers.

The questionnaires employ a variety of input fields and question formats, most notably Likert-type statements and comment text boxes. This facilitates the capturing of both qualitative and quantitative data.

QUAN and QUAL: data collection, analysis and results

The quantitative data was analyzed using appropriate descriptive and inferential statistical techniques. The qualitative data will be organized thematically with reference to the hypotheses and categorization of the issues raised. The results of each stakeholder group will be first interpreted and analyzed in isolation, followed by a comparative analysis between the groups.

Figure 7. 2: Research design used in the study
7.4 DEVELOPMENT OF THEORETICAL MODELS AND HYPOTHESES

Chapters 1 to 6 constitute the literature chapters of this study. Throughout Chapters 2 to 6, sections titled ‘critical links to the empirical study’ have linked the literature to both the study objectives and the hypotheses. Based on the review of academic literature (Chapters 2 to 6), a review of auditor rotation and MAFR regulations internationally (Chapter 6) and a detailed review of the IRBA consultation paper and official responses from key stakeholders (Chapter 5), the following theoretical models and hypotheses have been formulated.

![Diagram of theoretical models and hypotheses](image)

**Figure 7.3**: Model of direct effects of MAFR

**Source**: Researcher’s own construction from the academic literature and professional debate on MAFR
Figures 7.3 and 7.4 illustrate the various potential impacts of MAFR in South Africa and its resultant potential effect on audit quality. The impacts have been divided into direct and indirect effects, similar to the study on audit partner rotation by Daugherty et al. (2012), as represented in Chapter 3 Figure 3.1, and consistent with the findings of the literature chapters (Chapters 2 to 6).

The direct impacts of MAFR (Figure 7.3) are based on the following reasoning:

- The primary argument in favour of MAFR is that it will improve auditor independence by limiting audit firm tenures and thereby improve the quality of audit
outcomes (Casterella & Johnston, 2013; Fontaine et al., 2016; Hakwoon et al., 2015; Ruiz-Barbadillo et al., 2009).

- The primary argument against MAFR is that it will result in a loss of client-specific knowledge, experience and expertise, gained over the years that the audit firm has been engaged with the client. Opponents thereby claim that MAFR will impair audit quality (Casterella & Johnston, 2013; Fontaine et al., 2016; Hakwoon et al., 2015; Ruiz-Barbadillo et al., 2009).

- In the South African MAFR, there are clearly two secondary objectives for MAFR regulations, as outlined by the IRBA in its consultation paper, subsequent communications and the public parliamentary hearings before the Standing Committee on Finance. These additional objectives are as follows:
  - To increase racial transformation (black economic empowerment) within the audit industry (Harber, 2016; IRBA, 2016e, 2017c); and
  - To reduce the concentration of the large public interest entities audited by the Big Four audit firms, allowing opportunities for the smaller firms to compete to provide assurance services to large exchange-listed companies (Harber, 2016; IRBA, 2016e, 2017c).

The **indirect impacts** of MAFR (Figure 7.4) are based on the potential consequences of MAFR as identified in the review of audit quality and MAFR literature in Chapters 2 to 6.

### 7.4.1 Theoretical contribution

The theoretical models presented in Figures 7.3 and 7.4 diagrammatically link MAFR to the concept of audit quality and thereby establish the hypotheses. Throughout Chapters 2 to 6 the “Critical links to the empirical study” establish how the theoretical model has been derived from the theory and the literature. Agency theory (Bosse & Phillips, 2016; Eisenhardt, 1989) provides the context and purpose for the external audit function. The external audit acts to mitigate the risk of improper financial reporting and conduct by those charged with governing and managing the organisation. However, in order to provide a high quality audit service that can be trusted by the shareholders and other organisational
stakeholders, the auditor must be both capable and independent in their role as assurance provider (Tepalagul & Lin, 2015). MAFR serves as a regulatory tool to safeguard the independence of the auditor and thereby the quality of the audit outcome, reducing the agency costs inherent within the management of public-interest companies (Casterella & Johnston, 2013). However, the literature provides evidence that a trade-off exists within MAFR, whereby the benefits of increased independence may not outweigh or offset the ‘switching costs’ of such rotation (Stefaniak et al., 2009). The theoretical models presented in Figures 7.3 and 7.4 diagramatically illustrate these potential trade-offs and provide a framework from which to test MAFR on a cost-benefit basis.

Furthermore, considering the importance of ‘independence in appearance’ from the perspective of capital market participants, especially investors, MAFR is being tested in this study on a perception basis (refer section 2.4.1). The investing public often blame auditors for financial misconduct in companies (Hay, 2015) and this is partly understood in terms of the expectations gap theory, which describes an ‘expectations gap’ between the level of performance expected by auditors and that expected by the users of financial statements (Monroe & Woodliff, 1994; Porter et al., 2012). The testing of the theoretical models using four key stakeholder groups (refer section 7.5), allows this study to better understand the nature and extent of the expectations gap in South Africa. This will be shown in the comparison between auditor perceptions of MAFR trade-offs and those of other stakeholders. Annexure 1 provides a sample of quotes from academic literature establishing the need for further research to “achieve a better understanding of the different incentives” of stakeholders in the MAFR debate (Tepalagul & Lin, 2015:113), as well as contribute to better understanding “the consequences” of MAFR (Lennox et al., 2014:1780).
7.4.2 Hypotheses and critical links to the literature

According to the theoretical models proposed in Figures 7.3 and 7.4 above, the direct and indirect effects of MAFR on audit quality are hypothesised:

<table>
<thead>
<tr>
<th>Hypothesis 1:</th>
<th>Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hypothesis 2:</td>
<td>Stakeholders perceive MAFR not to have a significant impact on auditors’ independence and professional scepticism.</td>
</tr>
<tr>
<td>Hypothesis 3:</td>
<td>Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.</td>
</tr>
<tr>
<td>Hypothesis 4:</td>
<td>Stakeholders perceive MAFR to increase the degree of market concentration by the Big Four firms in the audit profession.</td>
</tr>
<tr>
<td>Hypothesis 5:</td>
<td>Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession.</td>
</tr>
<tr>
<td>Hypothesis 6:</td>
<td>Stakeholders perceive that MAFR will reduce audit partners’ quality of work life.</td>
</tr>
<tr>
<td>Hypothesis 7:</td>
<td>Stakeholders perceive that MAFR will require audit partners to undergo significant efforts to upskill and retrain themselves for new industries.</td>
</tr>
<tr>
<td>Hypothesis 8:</td>
<td>Stakeholders perceive that MAFR will reduce the appeal, in the minds of chartered accountants, of the auditing profession in comparison to other career options.</td>
</tr>
<tr>
<td>Hypothesis 9:</td>
<td>Stakeholders perceive that MAFR will significantly increase costs to audit firms.</td>
</tr>
<tr>
<td>Hypothesis 10:</td>
<td>Stakeholders perceive that MAFR will significantly increase costs to companies in the form of increased audit fees.</td>
</tr>
<tr>
<td>Hypothesis 11:</td>
<td>Stakeholders perceive that MAFR will reduce the ability and/or incentive of the audit committee to apply professional judgement to assess auditor independence and to find the audit firm best able to provide them with a high-quality audit.</td>
</tr>
<tr>
<td>Hypothesis 12:</td>
<td>Stakeholders perceive that, in addition to the current measures in place, there are better solutions than MAFR to address the concerns raised by the IRBA.</td>
</tr>
</tbody>
</table>
Throughout Chapters 2 to 6, sections titled ‘critical links to the empirical study’ have linked the literature to both the study objectives and these hypotheses.

Critical links to the empirical study, i.e. the literature to the theoretical models to the hypotheses to the questionnaires, are described in Annexure 4 and Annexure 5.

**Annexure 4:** A detailed linkage of the literature reviewed in Chapters 2 to 6, to the direct and indirect effects of MAFR per the theoretical models in Figures 7.3 and 7.4. This annexure also links the direct and indirect effects to the hypotheses formulated above.

**Annexure 5:** A linkage of the hypotheses to the questionnaires. The questionnaires for each of the four participant groups are contained in Annexures 10 to 13.

### 7.5 DESCRIPTION OF KEY STAKEHOLDER GROUPS

The study focuses on four stakeholder groups, as described above. In the selection of participants for the questionnaires and definition of the target populations, the scope of the MAFR ruling by the IRBA was considered, which is as follows:

“…for auditors of all public interest entities, as defined in section 290.25 to 290.26 of the amended IRBA Code of Professional Conduct for Registered Auditors” (IRBA, 2017b:1).

In terms of the definition of ‘public interest entities’ provided in section 290:25 of the IRBA Code of Professional Conduct for Registered Auditors, the primary target group is exchange-listed companies (IRBA, 2016e). Therefore, this study focuses on stakeholder groups with particular experience with, and reference to, JSE-listed companies.
In order to test the above set of hypotheses, qualitative and quantitative data was obtained through specifically tailored surveys (questionnaires) of the following four key stakeholders in the South African MAFR debate:

1. Audit partners
2. Chief financial officers (CFOs)
3. Audit committee (AC) chairs
4. Equity fund managers.

### 7.5.1 Registered auditors accredited with the JSE

An audit partner is the person responsible on an audit engagement for signing the audit report that contains the audit opinion, in terms of the requirements of the Auditing Profession Act, 2005 (Act No. 26 of 2005) and the ISAs. Currently, pre-implementation of the IRBA ruling on MAFR requires audit partners to rotate every five years, as per section 92 of the Companies Act, 2008 (Act No. 71 of 2008) (RSA, 2008).

Harber (2016) conducted interviews with senior audit partners, which represents the first phase of this mixed methods design study. The views documented were therefore of a select group of auditors. It was then necessary to extend the testing to a wider selection of auditors. The population for this study is considered to be all IRBA registered auditors who are additionally accredited with the JSE to audit JSE-listed companies. The reason for this is that MAFR rules are chiefly applicable to exchange-listed companies and are not applicable to organisations which, according to the IRBA, are not public interest entities. Hence, it is appropriate to limit the target population to those auditors who are accredited to audit JSE-listed companies. It should be noted that this includes auditors who are not currently appointed as engagement partners for a JSE-listed company audit engagement, but who are accredited to do so in the future.
In Chapter 5 a review was performed of letters submitted by the Big Four audit firms to the IRBA in response to the IRBA consultation paper on MAFR. This review informs the formulation of the model and hypotheses of the study, however, an inherent limitation is that these letters represent the official position of only the Big Four audit firms. Therefore, the views expressed in these letters do not necessarily represent those of other audit firms, nor individual audit partners. This study is intended to obtain the perceptions of individual practitioners, separate from audit firm official position.

The questionnaire was sent to audit partners accredited to audit JSE-listed companies, per the latest JSE Listing Requirements (IRBA, 2017e; JSE, 2017). This list was obtained directly from the JSE and contained 305 registered auditors, after excluding the auditors who had retired since the compilation of the list. The 305 audit partners represented 20 accredited audit firms, with 192 auditors from the Big Four firms (63%).

7.5.2 CFOs of JSE-listed companies

The CFO of an organisation is a director of the company responsible for all financial matters. In terms of the King IV Report on Corporate Governance (IoDSA, 2016) and the Companies Act, 2008 (Act No. 71 of 2008) (RSA, 2008), the CFO is excluded from the responsibilities of appointing the auditor and managing the audit-client relationship, which includes assessing the independence of the audit firm and audit partner. However, the CFO, being responsible for the preparation of all financial information in the organisation, particularly the annual financial statements, will lead the organisation’s finance and accounting function. As such, the CFO is responsible for paying the audit fee and managing all the organisation staff who interact with the auditors during the audit.

In all audits, as per the requirements of the ISAs, the manager and partner on the audit team meet with the CFO to discuss financial reporting and audit-related matters, which
includes an assessment of the potential for fraud and financial misconduct in the organisation. According to the IRBA (2016:16), the CFO “is usually in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the audit firm will express an opinion” and most CFOs are chartered accountants themselves.

In Chapter 5, a review was conducted of the letter submitted by the CFO Forum to the IRBA in response to the IRBA consultation paper on MAFR. This review informs the formulation of the model and hypotheses but has a limitation insofar as it does not adequately show individual CFO perceptions. This study intends to explore the perceptions of experienced CFOs of JSE-listed companies to whom the IRBA MAFR ruling applies.

The questionnaire was distributed to the group-level CFOs of the Top 100 companies listed on the JSE according to market capitalisation, excluding companies with a secondary listing on the JSE exchange (i.e. companies that have a primary listing on a foreign exchange, usually the London Stock Exchange). This list of companies and CFO contacts was obtained directly from the JSE. According to JSE market statistics in February 2018, the JSE has a total equity market capitalisation of R14.8 trillion, if one includes the JSE Main Board and Alt X Board (Alternative Exchange) listings (JSE, 2018). If the companies without a primary listing on the JSE are excluded, the total market capitalisation of the remaining Top 100 companies is approximately R8 trillion (JSE, 2018; Sharenet, 2018).
Therefore:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>JSE market cap. (all inclusive)</td>
<td>R 14.8 trillion</td>
</tr>
<tr>
<td>JSE market cap. (excluding secondary listings)</td>
<td>R 8.67 trillion</td>
</tr>
<tr>
<td>Top 100 market cap. (all inclusive)</td>
<td>R 14.2 trillion</td>
</tr>
<tr>
<td>Top 100 market cap. (excluding secondary listings)</td>
<td>R 8 trillion</td>
</tr>
</tbody>
</table>

**Source:** JSE (2018) and Sharenet (2018).

The proportion of listed companies with a primary listing on the JSE which were sent the questionnaire therefore represents approximately 92% of the JSE market capitalisation (excluding secondary listings). As such, this proportion of companies represents a wide spectrum of stakeholders' interests in South African capital markets.

It was deemed reasonable and necessary to exclude the companies without a primary listing on the JSE as these companies will not need to comply with the IRBA MAFR ruling at a group level, as the holding company and corporate headquarters are domiciled outside of South Africa. It was therefore not considered reasonable or consistent to send the questionnaire to the group CFO and AC chair when this ruling would not have effect on companies in the group operating outside of South Africa. This does not mean that the South African regulations for firm rotation will not apply to these groups of companies, however, it does mean that it will not apply at a group level, only at a local subsidiary level, for companies incorporated in South Africa.

### 7.5.3 Audit committee chairs of JSE-listed companies

The AC has a responsibility in terms of the King IV Report on Corporate Governance and the Companies Act, 2008 (Act No. 71 of 2008) of recommending the auditor to
shareholders for appointment at the organisation’s annual general meeting. In addition, the AC manages the audit-client relationship, which includes the following key activities and judgements:

- Assessing the independence of the audit firm and audit partner;
- Approving the audit plan as presented by the auditor;
- Recommending the annual financial statements, which have been prepared under the oversight of the CFO and audited by the auditors, for approval by the shareholders (usually at the annual general meeting of shareholders); and
- Discussing and resolving the matters identified by the auditor during the course of the audit, which can include control deficiencies, accounting errors and instances of suspected fraud.

Therefore, the role of the AC, as led by the chair of the committee, is important to the proper functioning of the audit process and the quality of the audit outcome. This study is intended to explore the perceptions of experienced AC chairs of JSE-listed companies to whom the IRBA MAFR ruling applies.

For the same reason as indicated above for CFOs, the questionnaire was distributed to the group-level AC chairs of the Top 100 companies listed on the JSE, according to market capitalisation (excluding companies with secondary listings). In order to obtain a response from the AC chair, the correspondence with the CFO included a request to forward the respective questionnaire to the AC chair.

According to a review of the latest company records and annual reports for each of the 100 companies, it was determined that 7 individuals act as chair on more than one company in the target group of 100. Considering that these individuals would only complete the questionnaire once (as the tool is not company-specific), the total population was reduced to 93 AC chairs.
As calculated above for CFOs, the proportion of listed companies with a primary listing on the JSE which were sent the questionnaire represents 92% of the JSE-listed companies by market capitalisation.

7.5.4 Equity fund managers

A survey performed in 2012 by the Organisation for Economic Co-operation and Development (OECD), across its 35 member states, illustrates the role that large institutional investors can play in providing a source of stable, long-term capital. With the goal of optimising returns for targeted levels of risk, as well as for prudential regulation, institutional investors diversify investments into large portfolios, many of them having investments in thousands of companies (OECD, 2011). As such, according to Harber (2017b), institutional investors are significant long-term shareholders of companies and represent a major force in many capital markets, including South Africa.

A substantial majority of the shareholding of most public companies in the US is owned by a concentrated group of mutual funds, pension plans and other institutional investors (Gilson & Gordon, 2013). This is also the case in South African capital markets (Campher, 2017; Harber, 2017b). Therefore, it is important to consider the MAFR debate from the perspective of shareholders and institutional investors who represent the majority of the investing public. The IRBA has stated that the primary goal of MAFR is to improve audit quality so as to protect the financial interests of the ‘investing public’, which includes significant investments held by pension funds and collective investment schemes, managed by institutions on behalf of the public (IRBA, 2016e).

In South Africa, the primary body that represents institutional asset managers is the ASISA. According to the ASISA, it represents the majority of the country’s asset managers, collective investment scheme management companies, linked investment service providers, multi-managers and life insurance companies. ASISA’s members are considered the
custodian of the bulk of the nation’s savings and investments and are among the country’s biggest contributors to the national GDP (ASISA, 2018:1).

In Chapter 5 a review was conducted of the letter submitted by the ASISA to the IRBA in response to the IRBA consultation paper on MAFR. This review informs the model and hypotheses development but has an inherent limitation insofar as it represents the views of the ASISA organisation and not individual fund manager perceptions. This study intends to explore the perceptions of experienced equity fund managers responsible for investing third-party monies in the shares (equity) of JSE-listed companies to whom the IRBA MAFR ruling applies. The perceptions of equity fund managers represent an important contribution to the MAFR debate from the perspective of investors and shareholders.

The questionnaire was distributed to equity fund managers from the ten largest equity asset/investment management companies in South Africa, responsible for investing third-party monies in equity investments. These companies represent the ten largest equity asset managers in South Africa by way of funds under management, as determined by the records of the ASISA. These asset management companies are all members of, and actively involved with, ASISA. Based on a consultation with the CEO of ASISA and the records of funds under management as at 30 June 2017, the top ten companies account for over 85% of the total equity third-party funds under management by South African asset managers. An exact determination of the percentage is not possible due to the diverse nature of the investment industries, consisting of pension funds, collective investment schemes, medical aid funds, life insurance assets, hedge funds and segregated portfolios. Therefore, an estimation of 85% was the best estimate provided by the CEO of the ASISA\textsuperscript{11}.

\textbf{10 asset management companies}

\textsuperscript{11} A limitation inherent in the distribution is that it was not possible to quantify the size of the assets managed by the equity fund managers who completed the questionnaire. This is partly due to the commitment throughout the data collection to anonymity, as well as the reluctance of the companies to provide such information.
Refer to Annexure 6 for the list of companies, auditors and equity fund managers surveyed.

7.6 QUESTIONNAIRE DISTRIBUTION

The second phase of the empirical study consisted of questionnaires that were sent to the four stakeholder groups described above. All four questionnaires were compiled and accessible online using Qualtrics online survey software, rather than physical mailed questionnaires or attachments to emails. Qualtrics software is an internationally recognised research tool used for survey data collection. This allowed the participants to simply click a hyperlink in the body of the email which provided online access to the questionnaire. The emails were distributed as follows:

- Each **registered auditor** accredited with the JSE (as described above) was sent an email by the JSE requesting participation in the study on MAFR. The email was sent by the JSE’s Executive Director of Issuer Regulation, John Burke. Each email contained a covering message from Mr Burke in which he expressed support for the empirical study and requested the auditors to complete the questionnaires. The hyperlink to the questionnaire tailored for the audit partners was contained in this email. A follow-up email was then sent to each auditor by the researcher.

- Each **CFO** of the 100 companies (as described above) was sent an email by the JSE requesting participation in the study on MAFR. The email was sent by the JSE’s Executive Director of Issuer Regulation, John Burke. Each email contained a covering message from Mr Burke in which he expressed support for the empirical study and requested the CFOs to complete the questionnaires. In addition, the email requested that the CFOs forward the email to the **chairperson of the group-level AC** to complete the questionnaire specifically designed for them. Two hyperlinks were included in the email – one clearly marked for the CFO and one for the AC chair. A follow-up email was then sent to each CFO by the researcher.

- Each representative of the ten asset management companies (as described above) was sent an email by the ASISA requesting participation in the study on
MAFR. The email was sent by the ASISA CEO, Leon Campher. Each email contained a covering message from Mr Campher in which he expressed support for the empirical study and requested the asset manager to provide the questionnaire to their equity fund managers for completion. The hyperlink to the questionnaire tailored for equity fund managers was contained in this email. A follow-up email was then sent to each company representative by the researcher.

The fact that the questionnaires were sent by high profile executives of the JSE regulator and the ASISA provided the expectation of a high response rate. Follow-up reminders were conducted by email after two weeks by the researcher. For each email distribution from the JSE and the ASISA (i.e. three emails considering that the CFO and AC chair were targeted in a combined email), a covering letter by Professor Ben Marx, as study leader, was also attached in which the importance of the research was stressed.

Refer to Annexures 7, 8 and 9 for the emails accompanying the Questionnaires, distributed by the JSE and ASISA, as well as the accompanying cover letters provided by the study leader.

Refer to Annexures 10, 11, 12 and 13 for the Questionnaires.

7.7 QUESTIONNAIRE DESIGN AND CONTROL

The statements and questions in the questionnaires were constructed based on the information obtained from the literature study (Chapters 2 to 6), discussions with academics, audit practitioners, corporate governance experts and AC chairs and resultant factors that the researcher considered to be of importance. The draft questionnaires were then tested for validity and reliability (as described below). Refer specifically to the theoretical model and set of hypotheses developed, as shown in section 7.4.
7.7.1 Design of each questionnaire

The questionnaires were designed in such a manner so as to simplify completion and to limit the time required for completion. In most instances the respondents were required to choose either a ‘yes’ or ‘no’ or to select from a Likert-type scaling of five options. For all sections of the questionnaire, provision was made for comments by the respondents where they considered this necessary. The questionnaires were all completed on the Qualtrics online survey platform, with the exception of two respondents who requested an emailed electronic copy to complete in a typed manner using Microsoft Word.

7.7.2 Testing the questionnaires for validity and reliability

To yield accurate information, survey instruments must be both reliable and valid. Instrument validity means that the survey or test measures what it says it is measuring, and not some other concept. Instrument reliability means that the survey or test yields the same results on repeated trials and therefore reproduction by subsequent independent studies will achieve the same result (Creswell, 2013; Miles, Huberman & Saldana, 2014).

According to Kleinbaum and Klein (2012:253):

```
Validity refers to the accuracy or truthfulness of a measurement. Are we measuring what we think we are? This is a simple concept, but in reality, it is extremely difficult to determine if a measure is valid. Generally, validity is based solely on the judgment of the researcher. When an instrument is developed, each question is scrutinized and modified until the researcher is satisfied that it is an accurate measure of the desired construct and that there is adequate coverage of each area to be investigated.
```

In order to provide assurance of the validity and reliability of the questionnaires, they were tested by a selected group of highly experienced people, consisting of one academic, one corporate governance expert, one audit partner, one CFO and one AC chair. The testing was done prior to completion of the questionnaires and each tester was requested to provide feedback on the design and content appropriateness of the questionnaire,
considering their significant awareness of the South African MAFR debate. The consensus from the testers was that the questionnaires would take on average of 30-40 minutes to complete.

Refer to Annexures 7, 8 and 9 for the emails accompanying the Questionnaires, distributed by the JSE and ASISA, as well as the accompanying cover letters provided by the study leader.

Refer to Annexures 10, 11, 12 and 13 for the Questionnaires.

7.8 RESPONSE RATES

<table>
<thead>
<tr>
<th>Participant group</th>
<th>Population</th>
<th># Complete and usable responses received</th>
<th>Percentage response rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit partners</td>
<td>305</td>
<td>112</td>
<td>36.7% (Note 1)</td>
</tr>
<tr>
<td>CFOs</td>
<td>100</td>
<td>53</td>
<td>53.0%</td>
</tr>
<tr>
<td>AC chairs</td>
<td>93</td>
<td>41</td>
<td>44.1%</td>
</tr>
<tr>
<td>Equity fund managers</td>
<td>(Note 2)</td>
<td>21</td>
<td>(Note 2)</td>
</tr>
</tbody>
</table>

Note 1: 66 responses were from Big Four firms (59%) and 46 (41%) from non-Big Four firms.

Note 2: Of the ten equity asset management companies sent the questionnaire, at least one response was received from each company. Twenty-one complete and useable responses were received in total, which results in an average of 2.1 responses per company. The questionnaire was only sent to one senior executive at each company, being the representative of the company on the ASISA investment committee. This person was either the CEO of the company or a member of the company’s senior executive management. A request was made by the researcher and the CEO of the ASISA to forward the questionnaire to the ‘equity fund managers’ at the
company. Since there is no official definition of an ‘equity fund manager’,
the distribution of the questionnaire was left at their discretion. Therefore,
there is no means of calculating a survey response rate beyond noting that
all companies provided at least one response.

Baruch and Holtom (2008) examine organisational survey research response rates
across 490 studies published between 2000 and 2005 in 17 refereed academic journals.
The scope covered more than 100,000 organisations and 400,000 individual
respondents. The average response rate for studies that utilised data collected from
individuals was 52.7% with a standard deviation of 20.4, while the average response rate
for studies that utilised data collected from organisations was 35.7% with a standard
deviation of 18.8. In light of this, the responses rates received in this study across all four
participant groups are deemed comparable.

Daugherty et al. (2012) performed a survey of audit partners with regard to audit partner
rotation regulations in the US. The survey was distributed to 370 practicing partners from
14 audit firms nationally. This target group and distribution was similar to the 305 audit
partners targeted in this study. Of the surveys distributed, 170 (46%) were returned,
comprising 37 Big Four partners (21.8%), 86 mid-size firm partners (50.6%), and 47
partners from other firms (27.6%). In justifying the response rate of 46%, Daugherty et al.
(2012) stated that this response rate compared favourably with those of other survey-
based auditing research, namely Bamber and Iyer (2007), 23% and Brazel et al. (2010)
48.8%. Bamber and Iyer (2007) explain their 23% response rate by reference to survey-
based auditing research by Nelson, Elliott, Tarpley and Gibbins (2002) and Dowling
(2009) who achieved 16% and 29.7% respectively. Hatfield et al. (2011), in a study of
perceptions regarding proposed audit adjustments, justified a 12.4% response rate for
mailed surveys. Porter et al. (2012), performing a large scope survey of 1,610 participants
in the UK and 1,555 in New Zealand on the audit expectations gap, achieved response
rates of 14% and 29% respectively.
Based on the above comparisons, especially in relation to survey-based auditing research, it is submitted that the response rates achieved in this study are acceptable.
CHAPTER 8: RESEARCH FINDINGS AND ANALYSIS

8.1 INTRODUCTION

In this chapter the findings of the empirical study are summarised and analysed. The previous chapters, which comprise the introduction (Chapter 1), the review of the literature (Chapters 2 to 6) and the research methodology (Chapter 7), established the research objectives and linked them to the literature so as to provide a basis for the theoretical models and the resultant hypotheses.

The findings of the questionnaires that were distributed to the four participant groups are thus analysed in this chapter, with reference to the research objectives and hypotheses. The analysis is presented thematically, reflecting the logical ordering of the questionnaires and the hypotheses tested.

8.2 DEMOGRAPHIC DATA OF PARTICIPANT GROUPS

Table 8.1 below represents the demographic data for each of the participant groups. The age and number of years in their respective roles is an indication of the respondents’ experience of dealing with matters relevant to the audit industry and financial reporting, including auditor appointment, auditor independence and general involvement with audit teams. Gender and race categorisations are relevant to this study as transformation is an important aspect of the MAFR debate in South Africa (refer to Chapter 5, section 5.7). Finally, the categorisation of audit firm by size is relevant to the market concentration aspect of the MAFR debate in South Africa (refer to Chapter 5, section 5.7).
Table 8.1: Demographic data of respondents

<table>
<thead>
<tr>
<th>Participant group: Audit partners</th>
<th>Experience</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>32</td>
<td>71</td>
<td>46.68</td>
<td>7.86</td>
<td>130</td>
<td></td>
</tr>
<tr>
<td>Number of years acting as a registered auditor</td>
<td>4</td>
<td>45</td>
<td>15.88</td>
<td>7.77</td>
<td>130</td>
<td></td>
</tr>
<tr>
<td>Gender</td>
<td>Male</td>
<td>63.1%</td>
<td>Female</td>
<td>14.6%</td>
<td>2.3%</td>
<td>130</td>
</tr>
<tr>
<td>Race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013</td>
<td>African Black</td>
<td>3.9%</td>
<td>Coloured</td>
<td>3.1%</td>
<td>Indian/ Asian</td>
<td>11.6%</td>
</tr>
<tr>
<td>Audit firm type/size</td>
<td>Big 4 Audit Firm</td>
<td>97.7%</td>
<td>Non-Big 4 Audit Firm</td>
<td>2.3%</td>
<td>Count</td>
<td>130</td>
</tr>
<tr>
<td>Estimation of ranking of audit firm network rationally in terms of audit fee revenue, with 1st being the largest in estimated rational audit fee revenue</td>
<td>1st - 4th</td>
<td>57.7%</td>
<td>23.1%</td>
<td>After 8th</td>
<td>19.2%</td>
<td>130</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Participant group: Audit committee chairs</th>
<th>Experience</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>36</td>
<td>75</td>
<td>62.49</td>
<td>9.19</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>Number of years acting as an audit committee member</td>
<td>1</td>
<td>32</td>
<td>10.47</td>
<td>6.70</td>
<td>45</td>
<td></td>
</tr>
<tr>
<td>Gender</td>
<td>Male</td>
<td>84.4%</td>
<td>Female</td>
<td>13.3%</td>
<td>2.2%</td>
<td>45</td>
</tr>
<tr>
<td>Race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013</td>
<td>African Black</td>
<td>4.4%</td>
<td>Coloured</td>
<td>8.9%</td>
<td>Indian/ Asian</td>
<td>6.7%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Participant group: Chief financial officers (CFOs)</th>
<th>Experience</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>35</td>
<td>64</td>
<td>46.47</td>
<td>6.10</td>
<td>64</td>
<td></td>
</tr>
<tr>
<td>Number of years acting as a CFO of a listed company</td>
<td>0</td>
<td>31</td>
<td>5.5</td>
<td>5.37</td>
<td>64</td>
<td></td>
</tr>
<tr>
<td>Gender</td>
<td>Male</td>
<td>87.3%</td>
<td>Female</td>
<td>11.1%</td>
<td>1.6%</td>
<td>63</td>
</tr>
<tr>
<td>Race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013</td>
<td>African Black</td>
<td>3.1%</td>
<td>Coloured</td>
<td>3.1%</td>
<td>Indian/ Asian</td>
<td>7.8%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Participant group: Equity fund managers</th>
<th>Experience</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Dev</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>29</td>
<td>60</td>
<td>39.73</td>
<td>7.25</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Number of years acting as an equity fund manager</td>
<td>1</td>
<td>30</td>
<td>11.54</td>
<td>7.02</td>
<td>26</td>
<td></td>
</tr>
<tr>
<td>Gender</td>
<td>Male</td>
<td>88.5%</td>
<td>Female</td>
<td>3.8%</td>
<td>7.7%</td>
<td>26</td>
</tr>
<tr>
<td>Race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013</td>
<td>African Black</td>
<td>7.7%</td>
<td>Coloured</td>
<td>0.0%</td>
<td>Indian/ Asian</td>
<td>15.4%</td>
</tr>
</tbody>
</table>

Source: All questionnaires (own calculation)

---

12 The number of respondents (‘Count’) in this table represents those who completed the respective sections, and not the number who completed the questionnaire. Hence the difference from the numbers used to calculate response rates in the previous chapter.
8.3 RESEARCH FINDINGS ON DIRECT EFFECTS OF MAFR

As shown in the theoretical model presented in Chapter 7 (Figure 7.3), the direct effects anticipated by MAFR comprise four critical factors (or considerations), which are relevant to the IRBA’s intentions for MAFR in South Africa. MAFR regulations are intended to (i) increase the independence of the auditor from the client, so as to maintain and improve audit quality. Internationally, this is the primary objective of MAFR. However, the primary concern is that (ii) valuable client-specific knowledge and expertise will be lost upon rotation of the audit firm. In addition to these two direct considerations, the IRBA seeks to (iii) increase black economic participation in the audit industry, which is referred to as ‘transformation’, and (iv) to provide more opportunities for the smaller, non-Big Four audit firms to secure appointments of the exchange-listed companies, which would promote competition and lower market concentration. The findings with respect to these four direct effects are analysed in this section.

The hypotheses linked to these effects are as follows:

**H1**: Stakeholders perceive MAFR to have a negative impact on auditors’ client-specific knowledge.

**H2**: Stakeholders perceive MAFR to not have a significant impact on auditors’ independence and professional scepticism.

**H3**: Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.

**H4**: Stakeholders perceive MAFR to increase the degree of market concentration by the Big 4 firms in the audit profession.

**H5**: Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession.
8.3.1 Perceived impact of MAFR on auditor independence and professional scepticism

i. Objective of section

The objective of this section of the questionnaires was to elicit participants’ views on the state of auditor independence in South Africa and the resultant effect, and indeed necessity, of MAFR to improve independence. With reference to hypotheses H2 and H3, the findings from all four participant groups are discussed concerning the perceived impact of MAFR on auditor independence and professional scepticism.

As described in the literature review chapters, the primary argument of MAFR proponents is that long-tenure relationships between audit firms and clients can lead to audit failures due to high levels of familiarity that may impair auditors’ independence and professional scepticism. MAFR allows the new incumbent to bring a ‘fresh look’ to the auditing task, which is considered an effective way of ensuring auditor independence and preventing ‘opinion shopping’ (Lu & Sivaramakrishnan, 2009). According to Lennox et al. (2014:1783), “this fresh-eyes argument has been a key factor influencing the decision to introduce mandatory partner rotation in many countries”. However, opponents of MAFR argue that long-tenure auditor-client relationships lead to the development of valuable client- and industry-specific knowledge and expertise over time, resulting in enhanced audit quality (Casterella & Johnston, 2013; Fontaine et al. 2016). These contrasting views have resulted in the formulation of hypotheses H1 (analysed in the following section), H2 and H3 (analysed here).
ii. Findings regarding the current state of auditor independence in South Africa

At the outset of each questionnaire, respondents provided their assessment of auditor independence for JSE-listed companies, as well as the adequacy of existing regulatory frameworks to preserve such independence. An analysis of participant views concerning the current state of affairs of auditor independence and professional scepticism provides a suitable starting point for the analysis. The findings are shown for each participant group in Table 8.2.

Table 8.2: Perceptions on the current state of independence and professional scepticism

<table>
<thead>
<tr>
<th>Source</th>
<th>Audit Partners</th>
<th>Audit Committee Chairs</th>
<th>CFOs</th>
<th>Equity Fund Managers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2. South African auditors of listed companies lack the required degree of independence and professional scepticism.</td>
<td>2. South African auditors of listed companies lack the required degree of independence and professional scepticism.</td>
<td>2. South African auditors of listed companies lack the required degree of independence and professional scepticism.</td>
<td>2. South African auditors of listed companies lack the required degree of independence and professional scepticism.</td>
</tr>
<tr>
<td></td>
<td>3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.</td>
<td>3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.</td>
<td>3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.</td>
<td>3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.</td>
</tr>
<tr>
<td>Endpoints, Midpoint</td>
<td>1 = Strongly agree</td>
<td>3 = Neutral</td>
<td>5 = Strongly disagree</td>
<td>3 = Neutral</td>
</tr>
<tr>
<td>Mean</td>
<td>4.23</td>
<td>0.95</td>
<td>1.23 ***</td>
<td>4.35</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>1.62</td>
<td>0.82</td>
<td>[1.38] ***</td>
<td>1.84</td>
</tr>
<tr>
<td>Diff from neutral</td>
<td>4.23</td>
<td>0.95</td>
<td>1.23 ***</td>
<td>4.35</td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)
Concerning the current state of auditor independence, professional scepticism and the current regulatory framework, the views of the fund managers stand somewhat in contrast to those of the auditors, AC chairs and CFOs. The fund managers expressed a neutral view, i.e. not significantly different than neutral, with regards to independence, professional scepticism and the sufficiency of regulations. However, the auditors, AC chairs and CFOs strongly believe that there is a high degree of auditor independence and professional scepticism in South Africa (means = 4.23; 4.35; and 4.21 respectively; p < 0.001), as well as an appropriate regulatory framework to safeguard this independence (means = 1.62; 1.84; and 1.61 respectively; p < 0.001).

Regarding the auditors, it is important to separate the views of the Big Four firm respondents and the non-Big Four firm respondents. Doing so reveals that both groups are in agreement concerning independence, professional scepticism and the sufficiency of regulations. However, the Big Four firm partners expressed more conviction with respect to the standard of auditor independence (Statement 2; mean = 4.52) as opposed to non-Big Four partners (mean = 3.83). This was again the case with respect to the regulatory and professional framework governing independence (Statement 3; means = 1.42 and 1.89 respectively).

The agreement between Big Four and non-Big Four firm partners is perhaps surprising considering that Big Four firms have been accused of bias against MAFR on the grounds that they stand to lose clients to non-Big Four firms from the increased competition and tendering that will result to secure appointments. It appears that neither group believes auditor independence, nor the current regulatory framework safeguarding independence, is a concern. These findings are consistent with the final question in the questionnaire (Statement 86 – refer to section 8.5) that shows that on an overall cost-benefit analysis, both groups i.e. Big Four partners and non-Big Four partners, are strongly opposed to the adoption of MAFR in South Africa – as are CFOs and AC chairs.
These findings do not support MAFR in South Africa, which is designed to improve what the IRBA believes is the impaired independence of auditors of exchange-listed companies resulting from long audit firm tenures. The perceptions of audit partners, CFOs and AC chairs indicate that auditor independence is not compromised and the current regulatory framework is sufficient to maintain this acceptable level of independence. These findings imply that the participants, excluding the equity fund managers, believe that the IRBA is attempting to correct a problem which does not, in their opinion, actually exist.

iii. Findings regarding the impact of MAFR on auditor independence

Table 8.3: Perceptions on the impact of MAFR on auditor independence

<table>
<thead>
<tr>
<th>Audit Partners</th>
<th>Statement</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.</td>
<td>In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>4.15</td>
<td>0.77</td>
</tr>
<tr>
<td>15.</td>
<td>Longer audit firm tenures result in less auditor independence.</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>3.82</td>
<td>1.00</td>
</tr>
<tr>
<td>16.</td>
<td>MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>3.70</td>
<td>1.07</td>
</tr>
<tr>
<td>17.</td>
<td>MAFR will increase the independence of audit firms (and audit partners).</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>3.84</td>
<td>1.03</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Committee Chairs</th>
<th>Statement</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.</td>
<td>In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>4.02</td>
<td>0.83</td>
</tr>
<tr>
<td>15.</td>
<td>Longer audit firm tenures result in less auditor independence.</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>3.69</td>
<td>1.06</td>
</tr>
<tr>
<td>16.</td>
<td>MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>3.45</td>
<td>1.07</td>
</tr>
<tr>
<td>17.</td>
<td>MAFR will increase the independence of audit firms (and audit partners).</td>
<td>1 = Strongly agree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td>3.69</td>
<td>1.03</td>
</tr>
</tbody>
</table>

(Table continued on next page)
Considering that MAFR is specifically designed to improve auditor independence by reducing audit firm tenures, the findings shown in Table 8.3 are now analysed. Consistent with the results above regarding the current state of auditor independence and independence regulations (Table 8.2), these findings again show considerable disagreement with the IRBA position on MAFR.

Central to the pro-MAFR argument is that long firm tenures result in familiarity threats to independence, which impairs auditor independence and professional scepticism. This is argued by the IRBA (2016:10) to be a contributing factor to the rise of “high-profile corporate failures”. However, neither the responding auditors (Statement 15; mean = 3.82; p < 0.001), AC chairs (mean = 3.69; p < 0.001) or CFOs (mean = 3.77; p < 0.001) believe that longer audit firm tenures result in reduced auditor independence. An AC chair commented that “even with a new firm, there is no guarantee that their independence
“might not be compromised”, implying that it is not length of tenure that compromises independence. Another AC chair stated that “the auditor and the audit firm is either independent or not”, and as such, in their opinion, there are no degrees of independence which can wane as tenure increases. Other respondents expressed this binary, rather than continuous-scale view of independence, stating that an auditor is either independent in mind or not, and they therefore believed that the concept of being “sufficiently independent” or “decreased independence” was incorrect. Related to this was the feeling of some respondents, which was aptly expressed by a CFO, that “independence is not determined by rotation, but rather by the moral and ethical values of individuals”.

The following comments from two CFOs regarding their experiences illustrate the general views of the CFOs in this regard:

“In the two decades I have been dealing with our current firm I have never had the impression that they ever lacked independence. It depends on individual people and some will always remain independent while others may lose their independence on day 1. I have developed very strong professional relationships with our auditors, but they will always remain independent.”

“In my 23 years of experience in financial reporting, I have never had any reason to even come close to questioning the independence of any of the audit firms that I have dealt with.”

An AC chair explained a common theme in the comments, namely that, in their view, “independence has more to do with the relationship between individuals rather than entities” and as such, audit partner rotation was key, not firm rotation. “While a company retains an audit firm the people within that firm are rotated on a very regular basis at all levels. The bigger the firm the better the ability to rotate people. The audit IP is not lost in this rotation process, but independence is ensured.” The ability for a firm to retain the “institutional knowledge and experience” of the client, while preserving independence due
to partner rotation, is a common argument against MAFR as opposed to partner rotation. This argument is analysed in section 8.3.2.

Furthermore, contrary to the IRBA reasoning that longer tenure impairs independence, respondents argued that independence may actually be a concern early in the tenure, not after years of appointment, because “the new auditors will try hard to build and establish good relationships at the new audit client which will also have an unintended consequence of staying clear of certain contentious accounting, auditing, taxation, etc. points”. This is the opposite reasoning to that of the IRBA in favour of MAFR. As expressed by one auditor, the “[newly appointed] auditors will be on the back foot and will have to concede on a lot of important judgmental points because challenging well-established professional management of these complex clients will make them look less astute that the previous auditor”. This lack of experience in comparison to the outgoing audit firm may impair the independence of the auditor, resulting in them acquiescing to the judgement of management with respect to complex company- or industry-specific accounting matters. Given the size and complexity of large, exchange-listed multinational companies, MAFR may have the unintended consequence of incentivising new auditors to “stay… clear of certain contentious accounting, auditing, taxation, etc. points”.

This reasoning by some respondents is contrary to the pro-MAFR position and is consistent with the opinions expressed by senior managing partners in the interview-based study conducted by Harber (2016). Considered together with the possibility of the incoming auditor being unfamiliar with the client’s business and financial reporting risks, this potential for reduced independence could further impair audit quality.

a. Compromised independence vs. lack of competency?

Further to the above, in the experience of the responding auditors, AC chairs and CFOs, failures by auditors to detect misstatements (due to fraud or error) is not due to a lack of auditor independence (Statement 14; means = 4.15, 4.02 and 4.00 respectively; p <
0.001). The comments reveal that auditors consider that audit failure can arise from either compromised independence or simply careless and negligent compliance with professional standards, i.e. poor quality audit work. Some claimed that the IRBA incorrectly assumes that an audit failure must mean a case of lost independence, when in reality it was simply a case of poor decisions by an appropriately independent auditor. As one respondent articulated, a “lack of knowledge/skills and experience is a bigger risk for failure to detect misstatements because of fraud and error”.

According to the literature, audit quality can deteriorate due to either a lack of independence or a lack of capability/competency (Tepalagul & Lin, 2015). Comments by auditors, such as the one above, argue that failure to detect misstatements and fraud is more often the product of “shoddy work” and negligence, rather than compromised independence. Some respondents explained that audit work and financial statements were reviewed “by IRBA, [the audit firm’s] own rigorous internal review procedures and the JSE” thereby ensuring a high degree of quality. In the words of one CFO, “audit working papers are already subject to IRBA, JSE and internal firm reviews − surely that’s adequate?” Another CFO stated that “auditors do not need MAFR to worry about the quality of their work. The JSE, IRBA, other regulators and public are enough pressure”. These comments show that respondents are satisfied that current frameworks are sufficient to regulate both independence and audit quality, which is consistent with the findings for Statement 3 (Table 8.2). In addition, a common theme which emerged was the feeling that “auditors will not have their independence impaired for a client as they risk their livelihoods”. The risk of lost reputation and litigation against the auditor was seen as a deterrent to compromising audit quality.

These findings clearly show that these three participant groups strongly disagree with the key reason for implementation of MAFR in South Africa, namely, that long audit firm tenures have compromised auditor independence. As shown in the findings for Statement 17, neither group believes that MAFR will improve independence. This is most likely because the findings from Statement 2 show that neither group believes auditor
independence and professional scepticism are a problem in the audits of South African listed companies. It stands to reason that it is consistent and logical for respondents to believe that MAFR will not improve independence (Statement 17) if, firstly, they do not believe that independence is compromised (Statement 2) and secondly, they believe that long firm tenures do not impair independence (Statement 15).

b. Separating Big Four firm partners from non-Big Four

It is important to analyse the findings for Big Four firm partners separately from non-Big Four partners. The analysis indicates that non-Big Four firm auditors are less convinced than their counterparts that longer firm tenure does not impair independence (Statement 15; mean = 3.33; p < 0.05). Nonetheless, this result does imply a consensus that is similar to that of Big Four firm auditors, albeit not as strongly felt. In addition, concerning whether MAFR will increase the independence of audit firms (Statement 17), the two groups are in agreement that MAFR will not do so, with Big Four and non-Big Four partners showing means of 4.10 (p < 0.001) and 3.48 (p < 0.01) respectively. It can therefore be concluded from this that even the non-Big Four firm partners, who the IRBA believes will stand to gain clients from MAFR, do not agree that long firm tenures reduce independence, nor that MAFR will improve independence. This provides further evidence against the IRBA position.

c. Mixed views from fund managers

The findings from the equity fund managers again yield neutral views, although not contrary to the other groups. The fund managers express neutral perceptions (p > 0.05) regarding Statements 15 to 17. However, the means for these statements are less than the mid-point which indicates a slight skew to agree that long firm tenures could impair independence and MAFR may improve this. Analysing these findings in more detail, 47.8% of respondents ‘agree’ or ‘strongly agree’ that longer audit firm tenures result in less auditor independence and 43.5% ‘agree’ that MAFR will increase independence. Yet, despite this slight favouring of the pro-MAFR position, in their experience, failure by
auditors to detect material financial reporting misstatements is not due to a lack of auditor independence (Statement 14; mean = 3.52; p < 0.01). This finding is important because MAFR is principally designed to improve auditor independence. As representatives of the ‘investing public’, this again illustrates the differences of opinion between those parties ‘inside’ the audit engagement (auditors, CFOs and AC members) and those perceiving it from the ‘outside’ (shareholders and other stakeholders). Those ‘inside’ the audit engagement appear to be strongly against MAFR being necessary or effective to improve auditor independence, while those from ‘outside’ the audit process, and indeed outside the financial processes of the company, have differing and often conflicting sentiments concerning MAFR and independence. The findings from the fund managers are therefore mixed and not sufficient to conclude in favour of MAFR, especially considering the results for Statement 14.

d. Effects on quality as the rotation point approaches

In the South African MAFR debate, there have been contrasting claims regarding the impact on audit quality as the audit firm approaches the rotation point. On the one hand, as the appointment period draws to an end, MAFR may provide auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs, thereby increasing audit quality. Others believe that, as the years progress and the rotation point approaches, audit partners can get “lazy” on the audit or can start prioritising turning the audit client into an advisory client, so as to replace lost revenues resulting from rotation (Fontaine et al., 2016; Harber, 2016; IRBA, 2016e). This view was expressed by some responding auditors:

“MAFR will discourage audit firms to ‘invest’ in gaining a deep understanding of the business since the pay-off period has an absolute limit. In fact, the current ‘model’ of migrating an audit client to an advisory client towards the end of the audit tenure may negatively impact independence and quality of the audit.”

“In an environment where auditors are constantly required to build new relationships to win new audits, the focus will quickly shift from audit excellence towards finding the next
audit client. Auditors will focus more on winning new audits rather than serving audit clients (stakeholders, shareholders, audit committees) to the best of their abilities.”

The findings from Statement 16 indicate that auditors (mean = 3.70; p < 0.001), AC chairs (mean = 3.45; p < 0.01) and CFOs (mean = 3.32; p < 0.05) do not believe that MAFR will incentivise auditors to be more alert or pay closer attention to detail as the rotation approaches. This result may be due to the high regard these respondents have for the committed professionalism of the auditor and the mitigating quality controls in place over the audit process, which includes the oversight of the AC. Equity fund managers show a neutral view (mean = 2.83; not significantly different than neutral). The comments indicate that respondents do not believe that audit quality will be compromised or improved as the rotation point approaches, contrary to the belief of certain partners interviewed by Harber (2016) who believed that audit quality would decline as partners were distracted by the need to secure additional work to replace the fees lost through rotation.

It is important to note that this aspect of the debate relates to the capability/competency characteristic of the auditor, not independence. If an auditor “takes their eyes off the ball”, becomes “lazy” or “prioritises other objectives” near the end of a rotation period, these are not matters of independence, but rather matters of competency and professionalism. Therefore, it is submitted that whether or not these negative attributes develop near the end of the rotation period, it does not strengthen the argument of those who believe that longer tenure impairs auditor independence. The findings here imply that respondents believe audit quality will not change as the rotation point approaches.
iv. Findings regarding the IRBA argument from public inspections and corporate failures

As described in Chapter 5, the IRBA puts forward the findings of IRBA public inspections as well as instances of recent corporate failures, as evidence in support of MAFR. The IRBA argues that inspections of auditors and audit work reveal increasing instances of non-compliance with ethical and independence regulations and this is evidence that independence is compromised. The IRBA makes a case for MAFR based on the continuing occurrence of corporate failures that result from management fraud and misconduct, again claiming that this is evidence of impaired auditor independence (IRBA, 2016e).

Question (for Figure 8.1): The Public Inspections Report 2015/2016 recently released by the IRBA shows an overall regression in the inspection results, with an increase in unsatisfactory inspection results. The IRBA believes that this is a worrying trend. According to the IRBA the root cause identified for a number of these findings was the failure to strengthen and maintain independence as an underlying principle for high audit quality. Based on this, please provide your response to the following statement: Are you
of the opinion that the IRBA inspection findings strengthen the argument of the IRBA in favour of MAFR?

Figure 8.1: Opinions regarding IRBA inspection findings

Source: All questionnaires (own calculation)

Question (for Figure 8.2): The IRBA makes the argument that high-profile corporate failures have caused the investing public to question the role and the independence of auditors. According to the IRBA, investors are demanding more information and transparency and have become more aware of their rights, which need to be protected. Based on this, please provide your response to the following statement: Are you of the opinion that the above line of reasoning by the IRBA strengthens their case in favour of MAFR?
When presented with this reasoning, as shown in Figures 8.1 and 8.2, the auditors, CFOs and AC chairs did not believe that this provided sufficient evidence to support MAFR in South Africa. However, with respect to the poor public inspection findings, the fund managers generally did accept that this strengthened the IRBA case for IRBA. The opinions of fund managers with respect to ‘high-profile corporate failures’ was mixed.

It is submitted that the auditors are most affected by, as well as most informed, on the public inspections of audits performed by the IRBA, as it is their engagement audit files and their firm’s policies and procedures which the IRBA is ‘auditing’. The responding partners would have all had experience in the inspectorate’s reviews of their audit firms, as well as individual audit engagements to which they acted as the engagement partner. The IRBA public inspection findings highlight non-compliance with ethical and independence requirements, the root cause of which is described by the IRBA as being a “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” (IRBA, 2015:13). The inspection reports subsequent to the 2015
report highlight similar concerns over auditor independence and professional scepticism (IRBA, 2018a). From a review of responding auditor comments regarding these inspection findings, partners expressed that these findings most likely reflect instances of poor documentation of ethical consideration and should not be confused with actual compromised independence. This is an important distinction the respondents make concerning the IRBA findings. The following are a selection of representative comments:

“We have not seen evidence that the IRBA findings are independence-related.”

“The issues raised in the IRBA findings relate more to the formal documentation of thought processes applied by the independent auditor than a state of mind issue regarding the need to remain independent.”

“Signing ethics confirmations are considered to be independence findings by the IRBA and hence the outcome of its inspections stating that there are a large number of independence findings, is misleading.”

Comments from CFOs:
“I would question whether the ‘unsatisfactory inspection results’ and auditor independence is fully correlated and potentially question whether there are not several other, less severe reasons behind the perceived deterioration.”

“To my knowledge, IRBA has not published any report on audit failures where there was a failure in auditor independence. Their communication has not been transparent on this matter. I think that the market has a right to know the results of their findings.”
Responding auditors appear to believe that the inspection results show evidence of poor documentation of ethical and independence considerations and procedures, but that this is not indicative of poor independence in fact and mind. Respondents also raised serious concerns regarding the quality and intention of the IRBA practice reviews, indicating that they believed the system and processes of the IRBA regarding these reviews were flawed and needed improvement.

“The regression in inspection results is due to the poor quality of reviews by the regulator and their unpractical approach to reviews.”

“Inspectorate currently lacks knowledge, level of inspections are very shallow, with not enough balance being given to risk and judgement. To a large extent this is as a result of the calibre of individuals performing the inspections. Tends to be a tick box exercise.”

“I believe that the additional findings on inspections comes from an approach by the IRBA to try and justify MAFR. It is no secret that the IRBA will stop at nothing to find issues on an audit file.”

Regarding the argument of corporate failures, the comments raised by responding auditors, AC chairs and CFOs reflect a clear rejection of the IRBA position. Respondents stated that there were multiple reasons for corporate failures and that most of them related to factors other than audit failures and independence concerns. Even the current, highly topical and controversial alleged KPMG Inc. failures in South Africa were argued by some to yet be proven as a lack of independence as opposed to 'shoddy work', i.e. lack of competency. Respondents raised management fraud and/or mismanagement as the primary cause of financial scandals in companies as well as the need to look at each collapse on a case by case basis, rather than make blanket conclusions about audit failures. These results highlight the important distinction between impaired independence
and lack of competency when determining the cause of audit failures (Tepalagul & Lin, 2015). The following comments provide illustration:

“There is no direct correlation between corporate failures and the issue of auditor independence. Most corporate failures are as a direct result of lack of honesty and integrity by management. You cannot legislate against dishonesty!”

“There isn’t a causal link between audit failures, the needs of investors and independence in my mind.”

“Many high-profile corporate failures had little to do with independence. This cannot be put forward as the reason for MAFR.”

“Corporate failures are not as a result of the auditors, businesses fail because of poor decisions by the Board and management, not the auditors.”

“Corporate failures happen because management is dishonest, or business models fail. Audits don’t always find concerted efforts to defraud a company, and there is a misunderstanding often of the limitations of an audit. I am sure there are those instances where familiarity with management potentially clouded judgment, but I think the focus in corporate failures is over emphasised. I think the risk of changing auditors raises the risk of not finding errors / fraud, especially in the early stages of having rotated onto a new / large listed company.”

“I am not aware of any case where corporate failures have been attributed to lack of auditor independence.”
“Not one corporate failure in South Africa has been linked to independence issues.”

“I believe that this is a sweeping statement and not based on the underlying facts which relate to corporate failures. I am not aware of any corporate failures in South Africa which can be directly attributed to the role and independence of auditors. There is a tendency to attack the last man standing when a corporate failure occurs i.e. The Auditors. There are many reasons for corporate failures.”

“The findings of IRBA need to be further analysed and understood. To infer non-independence without understanding the root causes and merely a proposed conclusion leaves one with a significant difficulty in supporting such conclusion.”

Critical summary:

Regarding the IRBA argument from public inspection findings and corporate failures, it is clear from these findings that the responding auditors, AC chairs and CFOs reject the IRBA’s reasoning. Concerning inspection findings, among other counter-arguments provided, there is a belief that the adverse findings reflect documentation issues in the audit work and not actual compromised independence. Concerning corporate failures, the respondents do not believe that independence of the auditor has been proven to be a contributing factor.

However, the fund managers share mixed feelings with regards to the argument of corporate failures, and generally agree with the IRBA on this argument point. This is noteworthy as the equity fund managers are perhaps more reflective of the views of the ‘investing public’ and this may reinforce the view that there is a perceived problem with auditor independence.

v. Findings regarding ‘independence in appearance’ and the impact of MAFR on investor perceptions

As described in Chapter 2, section 2.4, the IFAC Code of Ethics for Professional Accountants defines independence in two parts, namely, “Independence in Mind” and
“Independence in Appearance” – which refers to the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm’s or a member of the audit team’s, integrity, objectivity or professional scepticism have been compromised (IFAC Code, 2016). Independence in mind is therefore a question of reality (fact), whereas independence in appearance relates to perception. The audit is an activity of public practice, instilling trust in, and credibility over, audited financial information, to allow investors to make decisions in capital markets. Since trust and credibility are subjective judgements made by transacting parties, it is necessary to consider investor perceptions of independence and audit quality in the MAFR debate. In addition, the literature on auditor independence highlights the importance of making this distinction between perceived and actual independence (Ewelt-Knauer et al. 2013; Fontaine et al., 2016; Knechel et al. 2013).

This section of the questionnaire emphasised perception in the minds of the ‘investing public’, since they represent the stakeholders invested in the company’s equity or debt, usually in the form of shareholding, corporate bonds or loans advanced. As stated by the IRBA, its “ultimate responsibility is to protect the investing public, and to contribute to ensuring a reliable financial market which will generate confidence and promote investment and growth” (IRBA, 2016f:28). The IRBA also provides this as the first and primary reason for introducing MAFR to improve audit quality in South Africa, as discussed in Chapter 5. In light of this emphasis on the investing public, the perspectives of the equity fund manager group are considered as particularly important as they represent an important subset of the investing public. Institutional asset managers represent the largest category of shareholders and corporate bondholders in South African capital markets (Harber, 2017b).
Concerning Statement 18 in Table 8.4, auditors (mean = 3.30; p < 0.01), AC chairs (mean = 3.48; p < 0.01) and CFOs (mean = 3.67; p < 0.001) do not agree that the investing public believes there is bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistle-blower.

Findings from Tables 8.2 and 8.3 show that these three participant groups do not believe that actual auditor independence is compromised (i.e. independence in mind), in the audits of South African exchange-listed companies. Here we have findings showing that they also do not believe that independence in appearance is compromised. These groups feel that the investing public has not lost trust in the audit function and the quality of the audit opinion. Some respondents’ comments did explain that it is often the general public
that has the view that audit firms lack integrity and/or independence, but this was not true of the more informed investing public. The general public was believed to have “a perception driven by financial journalism” which, in the view of some, distorted the real state of affairs in the profession and misinterpreted the role and function of the auditor. This is consistent with the expectation gap theory (Hay, 2015; Monroe & Woodliff, 1994; B. Porter et al., 2012).

The equity fund managers are generally neutral (neither agree nor disagree), indicating mixed feelings in this regard. Considering that equity fund managers, as professional institutional investors, are themselves an important category of investors, the findings from Statement 2 (Table 8.2) are relevant here. Findings show that fund managers’ themselves neither significantly agree nor disagree that South African auditors of listed companies lack the required degree of independence and professional scepticism (mean = 3.3). This provides evidence that the South African investing public, represented by the views of these equity fund managers, does not believe that excessive familiarity threats have compromised auditor independence and professional scepticism.

Respondents were then asked whether, in their experience or opinion, any concerns that investors may have regarding auditor independence were primarily due to that investors’ concern over familiarity threats that develop over long firm tenures (Statement 19). It is important in the MAFR debate to distinguish concerns regarding audit quality resulting from independence considerations and those arising from capability/competency considerations (Tepalagul & Lin, 2015). In addition, any independence-related concerns need to be based on long audit firm tenures (as opposed to other causes) for MAFR to be considered an appropriate regulatory response, as forced rotation of the firm is designed to limit firm tenures. Accordingly, the findings from Statement 19 show that auditors disagree that long firm tenure is the root cause of investor concerns over independence (mean = 3.45; p < 0.001). AC chairs and CFOs also express similar disagreement (mean = 3.40 and 3.31 respectively; p < 0.05), as does a separate analysis of the Big Four and non-Big Four partner responses. Again, equity fund managers are
generally neutral (neither agree nor disagree). It is important to understand the nature of any concerns raised regarding auditor independence. If the reason for independence concerns relates to factors such as significant non-assurance fee incomes, the size of the client relative to other audit firm clients or a pervasive belief in the ethical compromise of auditors, then it is less likely that MAFR regulations will improve this state of affairs. For example, it is possible that a newly appointed mid-tier firm lacks the required degree of independence because the client represents an unduly large portion of its total firm revenues and hence presents a threat to independence. As stated above, MAFR is primarily designed to limit the threats to independence that develop from long audit firm tenures. It is submitted that this distinction is often lost in the MAFR debate – namely that there can be multiple root causes for compromised independence but MAFR is a tool designed to primarily address one of them i.e. familiarity developed between auditor and client over long audit firm tenures. MAFR is not a regulatory tool designed to address other possible causes of compromised independence.

Considering the findings concerning investor perceptions of auditor independence and audit firm tenures (Statements 18 and 19), it is unsurprising that the findings from Statements 20 and 21 (Table 8.5) reveal that the shareholders in South African exchange-listed companies do not tend to question the independence of the auditors nor vote against the resolution of the AC to reappoint the auditors on grounds of long firm tenure. All four participant groups share similar sentiments in this regard, which is also not surprising considering all four groups are reflecting on the same events at the AGMs which they attend. These findings provide further evidence that investors do not feel that the long firm tenures of appointment over JSE-listed companies compromise auditor independence, as proposed by the IRBA.
Table 8.5: The perceived impact of MAFR on the investing public’s opinion of auditor independence

<table>
<thead>
<tr>
<th>Audit Partners</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.41</td>
<td>1.05</td>
<td>0.41 ***</td>
</tr>
<tr>
<td>21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.72</td>
<td>0.93</td>
<td>0.72 ***</td>
</tr>
<tr>
<td>22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.81</td>
<td>0.97</td>
<td>0.81 ***</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Committee Chairs</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.88</td>
<td>0.70</td>
<td>0.88 ***</td>
</tr>
<tr>
<td>21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>4.00</td>
<td>0.69</td>
<td>1.00 ***</td>
</tr>
<tr>
<td>22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.67</td>
<td>0.92</td>
<td>0.67 ***</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CFOs</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.72</td>
<td>1.1</td>
<td>0.72 ***</td>
</tr>
<tr>
<td>21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>4.12</td>
<td>0.79</td>
<td>1.12 ***</td>
</tr>
<tr>
<td>22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.57</td>
<td>0.89</td>
<td>0.57 ***</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity Fund Managers</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.68</td>
<td>0.82</td>
<td>0.68 ***</td>
</tr>
<tr>
<td>21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.82</td>
<td>0.72</td>
<td>0.82 ***</td>
</tr>
<tr>
<td>22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>2.91</td>
<td>0.79</td>
<td>0.09</td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)
One partner raised the concern that:

“…it is only a recent phenomenon where shareholders vote against re-appointment of auditors on long tenure. And sure, the requirement to disclose the tenure have probably caused it to some extent. But in the absence of the full picture, as auditors would explain to the audit committee annually how they manage their independence, to leave it to the public/investment community to decide on independence using one factor is downright silly and misleading.”

This highlights the argument by opponents of MAFR that ACs are best informed, skilled and experienced, as those charged with governance, to properly assess – on shareholders’ behalf – the independence of auditors. This could be well understood by investors and be a reason why these findings suggest that investors do not question the AC’s choice of auditor. After all, it is this AC, which comprises only non-executive directors, which the shareholders have appointed.

In the above comment, the audit partner referred to the IRBA auditor tenure rule, which requires the length of audit firm tenure to be disclosed in the auditors’ report as being the possible reason for perceived increases of instances whereby shareholders vote against auditor reappointment. Other comments also reveal a perception of an increasing trend of voting against resolutions to reappoint auditors, albeit not often. Some suggested that this was possibly due to shareholders wanting to early adopt the firm rotation rules voluntarily, and not necessarily because of concerns with auditor independence. An example of this provided was “the trend of the PIC {Public Investment Corporation} voting against auditors with long tenure”. The PIC, as South Africa’s largest institutional investor, managing the Government Employees Pension Fund, is often one of the largest shareholders in a JSE-listed company. This was a repeated theme in the comments, i.e. that “shareholders from the investing public rarely show up at AGMs” and that “it is common knowledge that the PIC will vote against the reappointment of the auditor if the tenure is longer than ten years, however, this is the only entity that I am aware of that will vote against the reappointment of the audit re tenure”.

257
Considering the above, the findings from Statement 22 are not unexpected. Equity fund managers express a neutral opinion (mean = 2.91), but the auditors, AC chairs and CFOs do not believe that MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public (means = 3.81; 3.67; and 3.57 respectively; p < 0.001).

Overall, these findings regarding investor perceptions provide evidence supporting the view that there are no considerable concerns in the minds of investors regarding auditor independence or long audit firm tenures over JSE-listed companies. Perhaps a distinction needs to be made between investors (investing public) and the general public. Comments were made by respondents to the effect that the IRBA is confusing the perceptions of informed investors with those of the relatively uninformed general public, with respect to auditor independence and long firm tenures, thereby concluding that the public has lost trust in the external audit function. These respondents believe this has resulted in a policy response by the IRBA that is not based on informed opinions of audit industry stakeholders.

**Critical summary:**

The findings indicate that, in the respondents’ experience, investors do not distrust the auditors based on feelings of bias or undue familiarity between management and auditor. It is not common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.

Responding auditors, AC chairs and CFOs do not believe that MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public. Equity fund managers expressed neutral views in this regard.
vi. Summary analysis: Auditor independence and professional scepticism

The findings from the equity fund managers show mixed opinions. In many of the statements, the equity fund managers express views that do not significantly differ from neutral, neither agreeing nor disagreeing. A review of the spread and standard deviation of the responses to these statements shows these neutral results are not because most fund managers selected the neutral ‘3’ option on the Likert scale, but rather because there is genuinely widespread disagreement on these issues. Therefore, on the following key issues regarding the MAFR debate, it appears that equity fund managers do not show consensus on the following:

- South African auditors of listed companies lack the required degree of independence and professional scepticism (Statement 2)
- Current regulations and professional standards in South Africa are sufficient to regulate auditor independence (Statement 3)
- Longer audit firm tenures result in less auditor independence (Statement 16)
- MAFR will increase the independence of audit firms (and audit partners) (Statement 17).

Unlike the other three groups, the equity fund managers did agree that ‘overall regression in the inspection results’ of the IRBA public inspections was evidence in favour of MAFR. Interestingly, however, there was consensus (mean = 3.52; p < 0.01) that auditor failures to detect material financial reporting misstatements (due to fraud or error) were not due to a lack of auditor independence. Therefore, it is concluded that, despite mixed opinions from these fund managers on matters of independence, the findings are not in favour of MAFR in South Africa.

Auditors, AC chairs and CFOs show consensus of opinion and express significant disagreement with the IRBA reasoning that MAFR is appropriate for JSE-listed companies. These groups do not consider that MAFR will be effective in improving audit
quality, partly because they believe that South African auditors of listed companies already possess the required degree of independence and professional scepticism and that current regulations and professional standards are sufficient to regulate auditor independence. In addition, they do not believe that the IRBA’s reasoning regarding the public inspection findings or corporate failures supports the IRBA position. Considering the views of the non-Big Four firms separately, there is a similar sentiment that MAFR is not necessary.

MAFR is a regulation designed to address independence concerns, more specifically, independence concerns that arise due to familiarity between auditor and client that occur as a result of long audit firm tenures (Casterella & Johnston, 2013; Hakwoon et al., 2015). The IRBA has stated clearly that this is their primary concern and reason for the MAFR ruling (IRBA, 2016e). With respect to the findings from Statements 2, 3, 16 and 17 in particular, it can be concluded that the responding auditors, AC chairs and CFOs believe MAFR is neither necessary nor will it be effective in achieving its primary objective. The comments have provided insightful perspectives into the debate and have added to the understanding of the perspectives of these three participant groups.

Finally, the important aspect of investor perceptions was considered. Neither responding auditors, AC chairs nor CFOs are of the view that there is a concern with investor perceptions of bias, familiarity or long audit firm tenures in the South African audit industry. Neither do they experience much disagreement from investors concerning audit firm tenures or auditor reappointment in shareholder meetings. However, there were comments expressed that this may be changing, owing to the recent allegations in South Africa against KPMG Inc., the implementation of the IRBA firm tenure rule and the activism of the PIC, questioning audit firm tenures.

The findings provide evidence in support of the perception-based research of Ewelt-Knauer et al. (2013), Fontaine et al. (2016) and Harber (2016), as well as research
measuring changes in audit quality over rotation periods (Cameran, Francis, Marra & Pettinicchio, 2015; Jackson, Moldrich & Roebuck, 2008; Kwon, Lim & Simnett, 2014; Ruiz-Barbadillo, Gómez-Aguilar & Carrera, 2009). These studies are not in favour of MAFR regulations improving independence or audit quality.

8.3.2 Perceived impact of MAFR on auditor client-specific knowledge

i. Objective of section

The objective of this section of the questionnaires was to elicit all four participant groups’ views concerning the impact of MAFR on audit quality considering the claim that the incoming auditor lacks the client-specific knowledge, experience and expertise of the outgoing auditor. This has been established as a primary argument against adoption of MAFR regulations and is linked to hypothesis H1.

Proponents of MAFR argue that the new incumbent audit firm brings a ‘fresh look’, or a ‘fresh set of eyes’ to the engagement, which is considered an effective way of ensuring auditor independence and audit quality. In the words of one audit partner, the thinking is that ‘a new broom sweeps clean’ and the incoming audit firm will have increased incentive, capability and opportunity to apply independent thought and professional scepticism to the client’s financial affairs. However, opponents of MAFR argue that longer firm tenure leads to an increase in valuable client- and industry-specific knowledge and experience over time, resulting in enhanced audit quality. According to this view, MAFR would cause a loss in the quality of audits as the incoming auditor lacks the deep understanding of the client’s business that the outgoing firm possesses (Casterella & Johnston, 2013; Fontaine et al. 2016).
ii. Findings concerning the existence and development of client-specific knowledge, experience and expertise

Referring to Table 8.6, it can be seen from the findings on Statements 6, 7 and 8 that all four participant groups, including the Big Four and non-Big Four partners analysed separately (findings not presented), express considerable agreement (means equal to and below 2; \( p < 0.001 \)) with the following statements:

- Audit firms develop institutional, client-specific knowledge of the company as the years progress in the auditor-client relationship. (Statement 6)

- In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment. (Statement 7)

- A steep learning curve exists for the incoming, newly-appointed audit firm. (Statement 8)
### Table 8. 6: Client-specific knowledge, experience and expertise

<table>
<thead>
<tr>
<th>Audit Partners</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.</td>
<td>1 = Strongly agree</td>
<td>1.39</td>
<td>0.63</td>
<td>[1.61] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.</td>
<td>1 = Strongly agree</td>
<td>1.54</td>
<td>0.75</td>
<td>[1.46] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. A steep learning curve exists for the incoming, newly-appointed audit firm.</td>
<td>1 = Strongly agree</td>
<td>1.42</td>
<td>0.69</td>
<td>[1.58] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.</td>
<td>1 = Strongly agree</td>
<td>2.34</td>
<td>1.13</td>
<td>[0.66] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Committee Chairs</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.</td>
<td>1 = Strongly agree</td>
<td>1.50</td>
<td>0.76</td>
<td>[1.50] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.</td>
<td>1 = Strongly agree</td>
<td>1.55</td>
<td>0.54</td>
<td>[1.45] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. A steep learning curve exists for the incoming, newly-appointed audit firm.</td>
<td>1 = Strongly agree</td>
<td>1.57</td>
<td>0.54</td>
<td>[1.43] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.</td>
<td>1 = Strongly agree</td>
<td>2.31</td>
<td>1.03</td>
<td>[0.69] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CFOs</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.</td>
<td>1 = Strongly agree</td>
<td>1.47</td>
<td>0.67</td>
<td>[1.53] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.</td>
<td>1 = Strongly agree</td>
<td>1.58</td>
<td>0.56</td>
<td>[1.42] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. A steep learning curve exists for the incoming, newly-appointed audit firm.</td>
<td>1 = Strongly agree</td>
<td>1.47</td>
<td>0.50</td>
<td>[1.53] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.</td>
<td>1 = Strongly agree</td>
<td>2.38</td>
<td>1.05</td>
<td>[0.62] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity Fund Managers</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.</td>
<td>1 = Strongly agree</td>
<td>1.61</td>
<td>0.49</td>
<td>[1.39] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.</td>
<td>1 = Strongly agree</td>
<td>2.00</td>
<td>0.59</td>
<td>[1.00] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. A steep learning curve exists for the incoming, newly-appointed audit firm.</td>
<td>1 = Strongly agree</td>
<td>1.78</td>
<td>0.51</td>
<td>[1.22] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.</td>
<td>1 = Strongly agree</td>
<td>3.26</td>
<td>0.74</td>
<td>0.26</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)
Considering the consistency of these findings across all participant groups, including the fund managers, with means of 2 or lower, this provides considerable evidence in support of the argument that audit quality may decline in the first years of the newly appointed audit firm. It is submitted, however, that this does depend on the ability and speed with which the new audit firm upskills and informs itself regarding the client’s operations and financial reporting risks. If there is a significant loss of knowledge and experience of the client’s business, then audit quality is at risk, especially in the first year of the engagement, unless the new auditor addresses the problem before or during the first year’s audit. This need to quickly upskill in the first year of appointment will likely come at considerable investment of time and resources, which is reflected in the high costs believed to be incurred by the incoming auditors (refer to section 8.4.2).

“The change of an audit firm in terms of MAFR should not be underestimated in terms of the requirement to audit opening balances and to upskill themselves for the audit of the entity - the complexity of which increases in a multi-national.”

It seems reasonable to conclude that if the incoming firm is not able to sufficiently upskill and inform itself in the first year of appointment, the quality of the audit will be impaired. Audit quality is a function of both auditor independence and auditor competency/capability (Tepalagul & Lin, 2015), and an auditor who is “less familiar with the financial reporting processes, financial reporting risks and industry risks” will surely impact the capability of the auditor, not matter how independent they may be.

“The ability to detect misstatements is linked to the ability of the auditor and not the number of years they have been appointed. I would expect newly appointed auditors to familiarise themselves sufficiently with the business to pick up misstatements.”
iii. Findings concerning the effect of MAFR on client-specific knowledge

Auditors, AC chairs and CFOs strongly feel that this potential loss of knowledge and experience of the client’s business is a significant problem with MAFR (Statement 12; means = 1.78; 1.88; and 1.83; p < 0.001). To a lesser extent, equity fund managers agree (mean = 2.35; p < 0.05). Interestingly, unlike the other three participant groups, fund managers are neutral with respect to Statement 9 (mean = 3.26; p > 0.05), that the newly-appointed audit firm is less likely to detect financial irregularities. Similarly, non-Big Four firm partners are also statistically neutral in this regard (mean = 2.81; p > 0.05). The reasons for this (considering the findings for Statements, 6, 7 and 8) is presumably that fund managers and non-Big Four partners believe that the incoming firm, despite having a steep learning curve and less knowledge of the client, could commit the time and resources to upskill itself during the first year’s audit before providing the first year’s audit opinion – and indeed has a professional obligation to do so to preserve audit quality.
Table 8.7: The impact of changes in client-specific knowledge on the MAFR debate

<table>
<thead>
<tr>
<th>Audit Partners</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Audiol unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.</td>
<td>1 = Strongly agree</td>
<td>1.81</td>
<td>0.93</td>
<td>[1.19] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.</td>
<td>1 = Strongly agree</td>
<td>2.87</td>
<td>1.13</td>
<td>[0.13]</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 The potential loss of client-specific knowledge is a significant problem with MAFR.</td>
<td>1 = Strongly agree</td>
<td>1.78</td>
<td>0.92</td>
<td>[1.22] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.</td>
<td>1 = Strongly agree</td>
<td>3.38</td>
<td>1.21</td>
<td>0.38 ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Committee Chairs</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.</td>
<td>1 = Strongly agree</td>
<td>1.76</td>
<td>0.75</td>
<td>[1.24] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.</td>
<td>1 = Strongly agree</td>
<td>2.64</td>
<td>0.97</td>
<td>[0.36] *</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 The potential loss of client-specific knowledge is a significant problem with MAFR.</td>
<td>1 = Strongly agree</td>
<td>1.88</td>
<td>0.79</td>
<td>[1.12] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.</td>
<td>1 = Strongly agree</td>
<td>3.67</td>
<td>0.99</td>
<td>0.67 ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CFOs</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.</td>
<td>1 = Strongly agree</td>
<td>1.95</td>
<td>0.74</td>
<td>[1.05] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.</td>
<td>1 = Strongly agree</td>
<td>2.77</td>
<td>0.99</td>
<td>[0.23]</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 The potential loss of client-specific knowledge is a significant problem with MAFR.</td>
<td>1 = Strongly agree</td>
<td>1.83</td>
<td>0.84</td>
<td>[1.17] ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.</td>
<td>1 = Strongly agree</td>
<td>3.77</td>
<td>1.05</td>
<td>0.77 ***</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Equity Fund Managers</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.</td>
<td>1 = Strongly agree</td>
<td>2.78</td>
<td>1.02</td>
<td>[0.22]</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.</td>
<td>1 = Strongly agree</td>
<td>2.48</td>
<td>1.06</td>
<td>[0.52] *</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12 The potential loss of client-specific knowledge is a significant problem with MAFR.</td>
<td>1 = Strongly agree</td>
<td>2.35</td>
<td>1.20</td>
<td>[0.65] *</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13 Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.</td>
<td>1 = Strongly agree</td>
<td>3.43</td>
<td>0.77</td>
<td>0.43 *</td>
</tr>
<tr>
<td></td>
<td>3 = Neutral</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>5 = Strongly disagree</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)
The findings for Statement 9 are particularly important. If the newly-appointed audit firm is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company, then this means that audit quality will be compromised. The potential loss of client-specific knowledge resulting from the rotation of an audit firm that is relatively unfamiliar with the client’s business (Statements 9 and 12) provides considerable argument against the IRBA view that small- and mid-tier firms will not necessarily compromise audit quality.

Auditors, AC chairs and CFOs believe that the incoming auditor’s unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with partner rotation (Statement 10; means all < 2; p < 0.001). Fund managers again reflect a neutral view. It is submitted that the auditors and AC chairs are the two parties most experienced with audit partner rotations and their impact on the audit engagement. It is therefore perhaps significant that they feel that partner rotation allows the knowledge and experience of the client to be preserved, as they have experienced this transfer of knowledge in practice over the years under the current system of five-year partner rotation. This is a common argument against MAFR in favour of partner rotation.

One reason why respondents feel that knowledge and experience of the client’s business is preserved within a system of partner rotation, is because the incoming partner is able to shadow the outgoing partner before rotation, which is one of the internal controls within audit firms to ensure that audit quality is preserved upon rotation.

“Certain countries who opted for MAFR are returning to partner rotation. As AC chairman, I discuss the review process with our auditors. In the case of {audit firm name} there is a second partner overseeing the audit process who is completely independent i.e. has no dealings whatsoever with client management or the directors.”
Another reason identified in interviews by Harber (2016) is that the audit managers and other members of the team do not change under partner rotation, thereby preserving some knowledge and experience. The feeling is that these benefits are lost under MAFR. The auditors and CFOs expressed a neutral view regarding the possibility that enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.

“Institutional knowledge is vital - the risk of error is always higher in the first year or two of engagement (unless there is a deliberate shadowing or hierarchical system at partner level). Why should outgoing firms be forced to pass on information to incoming auditors - this will add to cost for the outgoing auditor - the incoming auditor already needs to invest significant time and effort into learning the business.”

AC chairs and fund managers seem more hopeful that this is a possibility (Statement 11; means = 2.64 and 2.48 respectively; p < 0.05), however, all four groups show means below 3, indicating some degree of agreement that this type of enhanced communication could be a potential solution to the perceived problem. As this type of communication and formal hand-over procedures would fall outside of internal firm policies, the IRBA could consider formalising such processes and policies to mitigate what seems to be a widespread concern around the adoption of MAFR.

“The communication will only help if this communication is regulated. The client should not have to pay for this and furthermore, the outgoing auditor must be obliged to provide all the necessary information to incoming auditors and this must be regulated by IRBA. There should also be fines and penalties in the event of outgoing auditors not complying with this request.”

With regards to Statement 13 which addresses whether non-Big Four firms possess the requisite resources (money, time, staff, etc.) to audit larger JSE-listed companies, this is
addressed more fully under market concentration considerations in section 8.3.4. The findings from Statement 13 show that all four participant groups have significant reservations regarding the ability of medium-sized audit firms (non-Big Four) to appropriately perform the audits of the larger JSE-listed companies from a resource perspective.

“Non-Big 4 firms lack the requisite investment spend, requisite time, requisite staff, requisite technical knowledge and global reach which will result in an increase in audit failures.”

As described by a CFO:

“The requirement to fund the technical accounting and auditing divisions of the large firms cannot be matched by the smaller / medium sized firms. There are significant judgement calls that one needs to make as the CFO of a listed company and the large audit firms’ technical specialists are often relied upon to assist with these technical issues. Smaller firms may not have the same resources available to them to fund persons with the required skills and experience. In addition, the smaller firms do not have access to international resources / technical departments to refer to in the case of disputed local matters or international matters.”

Considering the findings for Statements 6, 7 and 8 across the four groups, it stands to reason that the incoming audit firm will need to commit significant staff and time in the first year of appointment to upskill and inform itself on the financial processes, controls and risks related to the large and complex multinational companies that are listed on the JSE. Without doing so, a considerable risk to audit quality is unavoidable. The question is whether the non-Big Four firms, especially the mid-tier, medium-sized firms, have the resources to audit large companies without a compromise in audit quality, especially in the early years of the appointment. When the findings for the non-Big Four firm partners are separated, it shows that these respondents believe that their firms do have the
resources required (mean = 2.65; p < 0.05). With a mean of 2.65, this is close to the neutral value of 3, albeit statistically different from neutral at the 5% level. Upon closer inspection of these responses, a few of the respondents disagreed that their firms had the resources to conduct such audits appropriately (neutral = 11.5%; disagree = 26.9%; strongly disagree = 3.9%). The comments from audit partners reveal that the greatest concern relates to the largest of the JSE-listed companies as well as those in specialist industries such as banking, insurance, telecommunications, mining or other financial services – it “depends on complexity of {the} audit and nature of {the} industry”. In the retail or manufacturing sectors, it was believed that non-Big Four firms would have the skills to perform the audit but perhaps not the resources.

“Significant reliance is placed on global networks to provide support on the audit of many complex industries such as financial services.”

“Maybe some medium-sized audit firms will have some resources to audit certain companies, but in specific areas they {are} lacking (e.g. insurance, mining, retail & banking industry, IFRS, actuaries, international tax, ERP support, SAP support).”

“I believe there are very few, and merely a handful of non-Big Four firms who have the resources and even then, not {with respect to} the complex multinational groups in the JSE top 40 listed entities.”

“Many of the large listed companies are global companies with operations around the world (with different languages in some instances). The smaller audit firms in SA are not necessarily represented in these offshore territories. I struggle to understand how a smaller firm will resolve this issue without adding significant cost to the client and risk to the quality of the audit.”
“We require sign off of the audited results within 2 weeks of year end and a medium sized firm may not be able to meet the deadline as they may not have sufficient staff they could allocate to a single client. This would require changing to another Big 4 firm which would not meet the transformation objectives. During the year we went through a change in auditors in a smaller listed subsidiary which resulted in significant inefficiency and overruns despite significant effort during the year in the planning process.”

The IRBA has been clear that small and mid-tier audit firms must only be appointed “provided they are competent to audit in those markets” (IRBA, 2015a:2). It would surely be detrimental to audit quality to appoint an audit firm that does not have the resources to adequately do the work. Some have argued that these firms will acquire the resources after appointment. However, this raises the question of whether the AC will be willing to appoint a firm that does not have the resources before appointment.

Critical summary:

The responding auditors, AC chairs and CFOs believe that the newly-appointed audit firm is less likely than the outgoing audit firm to detect financial misstatements due to the loss of client-specific knowledge, experience and expertise. In their views, this is a significant problem with MAFR.

The only way to prevent audit quality decline is a considerable investment in upskilling the audit team in the first year of the engagement. All four groups express concerns as to whether the medium-sized audit firms possess the resources (money, time, staff etc.) to bridge this experience gap with regards to the larger JSE-listed companies.

Auditors, AC chairs and CFOs believe that the existing system of partner rotation every five years, whereby the firm retains the appointment, results in significantly less loss of knowledge and experience.
iv. Summary analysis: Auditor client-specific knowledge

Section 8.3.1 analysed the findings concerning auditor independence and professional scepticism in the MAFR debate. This section focuses on the knowledge and experience of the client gained by the auditor over time which improves the capability of the firm to detect error and fraud in the financial reporting of the client. These represent two of the most important aspects of the debate, as increased independence and professional scepticism is framed as the main benefit of, indeed the reason for, MAFR regulations, whereas the consequences of the loss of knowledge and experience of the complexities of the client’s business are framed as the main problem (Casterella & Johnston, 2013; Fontaine et al., 2016). Both arguments make an appeal to audit quality, the first claiming audit quality will be improved, the second that it will be detrimental.

The findings of this section show that all four groups agree strongly that knowledge and experience is developed through the years that the audit firm is appointed and that the incoming audit firm will therefore be less knowledgeable and experienced with respect to the financial processes and risks of the client. There was agreement that this is unavoidable and that a steep learning curve exists. If the incoming auditor does not spend considerable time and resources to bridge this knowledge gap, then it stands to reason that audit quality will inevitably suffer. Formalising a system of knowledge transfer between audit firms upon rotation may be a part-solution to these concerns, but that will likely need to be driven by the IRBA.

The findings for Statements 9 and 12 provide considerable argument against the IRBA view that small- and mid-tier firms will not necessarily compromise audit quality. Fund managers express a neutral view, but the other participant groups agree that the incoming, newly-appointed audit firm is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company and this is a significant problem with MAFR. In addition, responding auditors, AC chairs and CFOs believe that the existing system of partner rotation every five years, whereby the firm retains the appointment, results in significantly less loss of knowledge and experience. These findings are
consistent with the partner interviews and the AC member interviews performed by Harber (2016) and Fontaine et al. (2016) respectively, as well as the responses by Big Four firm partners to the IRBA consultation paper (Harber & West, 2017).

A recurring theme in the comments was that non-Big Four firms are unlikely to have the technical skills, geographic presence across jurisdiction or the staffing resources to adequately audit the larger of the JSE-listed companies and groups of companies. This was especially felt with respect to the more niche industries such as banking, mining or insurance. There is also the question of whether the non-Big Four firms, let alone the Big Four firms, have the resources needed to bridge the knowledge gap in the first year of appointment so as not to prejudice the audit quality in those early years. It was seen as unacceptable that a new firm take a few years to “learn the ropes”. These considerations have implications for the IRBA’s intention to have more representation by the non-Big Four firms.

The findings provide evidence supporting the perception-based research of Ewelt-Knauer et al. (2013), Fontaine et al. (2016) and Harber (2016), as well as the research that measures changes in audit quality over rotation periods (Cameran, Francis, et al., 2015; Jackson et al., 2008; Kwon et al., 2014; Ruiz-Barbadillo et al., 2009). These studies are not in favour of MAFR regulations improving audit quality.

8.3.3 Perceived impact of MAFR on transformation in the audit profession

i. Objective of section

The objective of this section of the questionnaires was to understand the views of auditors and AC chairs (not CFOs and equity fund managers) concerning the impact of MAFR on transformation in the audit industry as it is understood in a South African context. The IRBA has stated that, while MAFR remains an attempt to improve audit quality, it will likely have the added benefit of promoting 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. This is linked to hypothesis H5.

Black economic participation in the economy is a South African national economic priority and the public discourse on MAFR in South Africa has been continuously linked to the topic of black economic empowerment, including the debate before Parliament’s Standing Committee on Finance in 2017. As described by the CEO of the IRBA (2017b:2),

...transformation of the profession has also been brought into the spotlight in recent months and has been further elevated by the parliamentary hearings into MAFR that took place in February and March. The IRBA as an organ of state and a regulator is compelled to drive transformation and ensure that the auditing profession is transformed in a fair, equitable and competitive manner.

Only the perspectives of the auditors and AC chairs were collected regarding the ability of MAFR to promote black economic participation in the audit industry. It is considered that these two stakeholder groups are most closely involved in auditor appointment and therefore they are best suited to provide insights on the transformation side of the MAFR debate. The audit partners best understand the issues facing audit firms with respect to transformation objectives and the ACs consider transformation as a criterion in the appointment of auditors (IRBA, 2016e; Shango, 2017). For the purposes of this section of the study, CFOs and fund managers are considered to be too far removed from the current state and progression of transformation within the staffing of audit firms.
ii. Findings with respect to views on current statistics

Table 8.8: Perspectives on transformation statistics

<table>
<thead>
<tr>
<th>Statement:</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>According to the IRBA, of the 4,283 registered auditors in South Africa, 74.8% are white and only 10.5% are black Africans. Of the 353 audit partners signing off on listed company audits, only 9 are black African. Based on this, please provide your response to the following statement: The rate of transformation in the audit profession is acceptable.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.53</td>
<td>1.06</td>
<td>0.53 ***</td>
</tr>
<tr>
<td>50. Audit partners’ response</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50. Audit committee chairs’ response</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.34</td>
<td>1.00</td>
<td>0.34 *</td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: Auditor and AC chair questionnaires (own calculation)

Black economic participation in the audit industry is a South African national economic priority, acknowledged by both business and government as an ethical and urgent national objective to correct the inequality in society which has resulted from South Africa’s history of Apartheid (Marais, 2010; Ponte et al., 2007). The IRBA believes that “the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity” (IRBA, 2016b:29). However, there has been considerable push-back in the public discourse regarding considering MAFR as a tool to improve transformation. Opponents have argued that while MAFR can be used as a tool to improve independence, it is inappropriate to further other objectives such as transformation or market concentration. In addition, they claim that MAFR will actually have the opposite effect in the audit industry, i.e. it will inhibit the progress being made by the firms to transform (Harber, 2016; Harber & West, 2017).

There has also been push-back against the idea that MAFR will boost the ability of non-Big Four firms to compete for JSE-listed company audits. According to SAICA, many of its members (chartered accountants) have argued that it is
...not appropriate to suggest that transformation should specifically be driven by creating and advancing smaller firms as opposed to transformation throughout the profession, including transforming the larger firms. The focus should be on firms of all sizes doing their part for transformation - this commitment already exists and in a lot of instances the results are positive (Nombembe, 2017:7).

Table 8.8 shows that auditors agree that the rate of transformation, especially in the context of the senior role of audit partners, is unacceptable (mean = 3.53; p < 0.001). Big Four partners expressed this sentiment with slightly more conviction than did the non-Big Four partners, with means of 3.62 and 3.40 respectively. AC chairs share a similar sentiment, although the results are closer to the neutral (mean = 3.34; p < 0.05). From these findings, it is fair to conclude that auditors and AC chairs feel that further efforts and interventions are necessary to speed up the rate of black economic participation in the audit industry.

iii. Findings concerning the impact of MAFR on transformation

The IRBA believes that MAFR will promote transformation in the audit industry by creating opportunities for non-Big Four firms to compete for appointment as auditor of the exchange-listed companies. As was also clear from the public hearings before the Standing Committee on Finance, some industry stakeholders, in agreement with the IRBA, believe that MAFR will be successful in this regard. Considering this, it is clear that transformation and market concentration objectives are linked objectives. Black economic participation in the audits of JSE-listed companies, according to the IRBA’s reasoning, will come via increased participation of the non-Big Four firms, especially the majority ‘black-owned’ audit firms such as SizweNtsalubaGobodo Inc. and Nkonki Inc., to name some of the larger such audit firms in the country. Therefore, in order to appropriately analyse the findings from the audit partner questionnaires, the findings from the Big Four firm partners need to be separated from those from the non-Big Four, as there could be differing incentives and perhaps bias with respect to the MAFR debate on the topic of transformation. Non-Big Four firm partners, according to the IRBA reasoning, stand to
benefit from MAFR by securing appointments of JSE-listed companies as these engagements are placed out to the market for tender.

a. *Big Four vs. non-Big Four audit partner perspectives concerning transformation*

**Table 8.9: Audit partners’ perspectives on transformation (Big Four vs. non-Big Four)**

<table>
<thead>
<tr>
<th>Big 4 Firm auditors</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>51. MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.45</td>
<td>1.23</td>
<td>[0.55] ***</td>
</tr>
<tr>
<td>52. MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>1.94</td>
<td>0.92</td>
<td>[1.06] ***</td>
</tr>
<tr>
<td>53. The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.48</td>
<td>1.09</td>
<td>[0.52] ***</td>
</tr>
<tr>
<td>54. MAFR will improve the transformation statistics in the South African audit profession.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>4.21</td>
<td>0.75</td>
<td>1.21 ***</td>
</tr>
<tr>
<td>55. Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>4.73</td>
<td>0.54</td>
<td>1.73 ***</td>
</tr>
<tr>
<td>56. The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.47</td>
<td>1.26</td>
<td>[0.53] **</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Non-Big 4 Firm auditors</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>51. MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.53</td>
<td>1.16</td>
<td>[0.47] **</td>
</tr>
<tr>
<td>52. MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.19</td>
<td>1.16</td>
<td>[0.81] ***</td>
</tr>
<tr>
<td>53. The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.45</td>
<td>1.14</td>
<td>[0.55] **</td>
</tr>
<tr>
<td>54. MAFR will improve the transformation statistics in the South African audit profession.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>3.79</td>
<td>0.79</td>
<td>0.79 ***</td>
</tr>
<tr>
<td>55. Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>4.13</td>
<td>1.12</td>
<td>1.13 ***</td>
</tr>
<tr>
<td>56. The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.77</td>
<td>1.28</td>
<td>[0.23]</td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

**Source:** Auditor questionnaire (own calculation)
As could be expected, the Big Four partners (Statement 51; mean = 2.45), in comparison to non-Big Four partners (mean = 2.53), feel more strongly that MAFR will inhibit their current progression towards transformation targets. Overall, however, the findings show that both groups do not share the IRBA’s opinion that MAFR will be beneficial for the transformation of the audit profession. The findings for Statement 54 challenge the IRBA position that MAFR will be a positive contribution to the goal of growing black participation in the profession. Even the non-Big Four firms, which the IRBA believes will stand to benefit from additional clients and therefore fee revenue and growth, do not feel that MAFR will achieve the result of a more transformed profession (Statement 54; mean = 3.79; p < 0.001). These findings provide evidence in support of the opinions of the Big Four partners in their responses to the IRBA consultation paper, as discussed in Chapter 5 (Bam, 2017; Bourne, 2017; Oddy, 2017; Shango, 2017). The CEO of PwC South Africa, Dion Shango (2017), has made the argument, echoed in the comments of the responding auditors, that the most transformed firms are the Big Four firms in terms of the number of black staff employed at all levels in the profession. This is consistent with the comments made by partners in this study that “transformation has been greatest in the Big 4 firms as compared to mid-tier and small firms”.

As explained by a senior EY South Africa director:

EY and many firms in the South African auditing profession understand the need for, and have unreservedly fully embraced, the need to transform. Accordingly, they have been transforming at all levels over the last three decades. Furthermore, EY and many other firms have contributed to the development of many black chartered accountants who are now in commerce and industry and making an outstanding contribution to our country’s economy (Bourne, 2017:13).

The CEO of Deloitte Africa, in a letter to the IRBA, expressed sentiments similar to the other Big Four firms:

Deloitte is firmly committed to accelerated transformation, not only within our own Firm, but also of the profession as a whole and we agree with the IRBA submission that MAFR is not the appropriate vehicle to achieve these
objectives. We have a number of programmes and processes in place to continuously increase our transformation results (Bam, 2017:14).

b. Reduced capacity to pursue transformation objectives

There was strong sentiment that MAFR would impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent (Statement 52; Big Four partner mean = 1.94; non-Big Four partner mean = 2.19; p < 0.001). From the results, the strongest convictions (Statement 55; means over 4) relate to disagreement over the idea that transformation of the audit profession will best be progressed via MAFR rather than through existing and/or improved efforts within the audit firms themselves. This is to be expected, as even the IRBA does not advocate MAFR as the best means to achieve transformation – it is likely that all parties agree that internal firm commitments and policies are the best means to improve black participation in the industry. It is unlikely that the IRBA would disagree with this as they continually encourage audit firms to persevere in efforts in this regard.

c. Audit committee chair perspectives concerning transformation

Table 8.10: Audit committee chairs’ perspectives on transformation

<table>
<thead>
<tr>
<th>Statement:</th>
<th>Endpoints, Midpoint</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>51. MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>3.05</td>
<td>1.06</td>
<td>0.05</td>
</tr>
<tr>
<td>52. MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.78</td>
<td>1.05</td>
<td>[0.22]</td>
</tr>
<tr>
<td>53. The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>3.1</td>
<td>1.05</td>
<td>0.10</td>
</tr>
<tr>
<td>54. MAFR will improve the transformation statistics in the South African audit profession.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>3.61</td>
<td>1.03</td>
<td>0.61***</td>
</tr>
<tr>
<td>55. Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>4.15</td>
<td>0.9</td>
<td>1.15***</td>
</tr>
<tr>
<td>56. The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.</td>
<td>1 = Strongly agree, 3 = Neutral, 5 = Strongly disagree</td>
<td>2.49</td>
<td>1.21</td>
<td>[0.51]</td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: AC chair questionnaire (own calculation)
As per Table 8.10, the AC chairs express a neutral view, neither significantly agreeing nor disagreeing with the idea that MAFR will reduce the ability of the audit firms to pursue transformation objectives. Perhaps this is because AC chairs, not being privy to internal audit firm activities, do not feel like they are in a position to make a judgement on this. However, as with the audit partners, they do not feel that MAFR will improve transformation in the profession (Statement 54; mean = 3.61; \( p < 0.001 \)).

As is discussed in section 8.4.2, there is widespread agreement from the participant groups that MAFR will impose significant costs on the audit profession (Statements 23a to 23f). Based on the findings from Statements 52 and 53, the responding auditors feel that these additional costs will inhibit the ability of firms to invest in transformation initiatives and will likely require a redirection of spending away from areas such as training and bursaries. The opinions of the Big Four firm leadership in their response letters to the IRBA consultation letter made it clear that they believed that the audit profession would become less profitable as a result of MAFR and this would consequently hamper their ability to invest in transformation-related initiatives (Harber & West, 2017).

Critical summary:
Both the responding Big Four firm partners and the non-Big Four firm partners disagree with the IRBA’s opinion that MAFR will promote transformation of the audit profession. This is consistent with the views of the AC chairs as well.

The auditors strongly feel that MAFR will impose additional costs that will inhibit the ability of firms to invest in transformation initiatives and attract talent.

Auditors and AC chairs do not believe that MAFR will improve transformation statistics in South Africa. This will best be achieved not by regulations but via existing and/or improved efforts within the audit firms themselves.
d. The risk-reward trade-off facing black chartered accountants

It has been suggested in the South African debate that the lack of transformation of audit partners is due to the disproportionately small pool of black chartered accountants and the disproportionate racial demographic of qualifying chartered accountants. This has been acknowledged by SAICA which has responded with various transformation initiatives to promote the qualification of greater numbers of black chartered accountants (Nombembe, 2017). The findings from Statement 56 indicate that the Big Four partners (mean = 2.47; p < 0.01) and the AC chairs (mean = 2.49; p < 0.05) tend to agree that the lack of numbers of chartered accountant graduates is partly to blame for the low numbers of black audit partners.

“The pool of black Chartered Accountants in the profession is too small to enable all firms to be able to attract this talent and due to this, the Big 4 traditionally attract them due to ability to pay competitive remuneration to what they can earn in commerce.”

“Firms do not have the ability to influence the efficacy of state education at primary, secondary and tertiary level. It is from those student ranks that the profession seeks recruits. If our maths education is poor, then how will we produce more CAs?”

The findings discussed in section 8.4.1, which show a decline in the appeal of the audit profession for chartered accountants, provides another potential reason why audit firms (especially the Big Four) are struggling to increase the number and proportion of black audit partners. Related to this, a very common theme invariably dominating the responses of the auditors, was the argument that newly qualified black chartered accountants leave either immediately, or soon after qualifying, to pursue higher paying and/or lower risk opportunities in commerce and industry, outside of public practice. Here are a sample of representative comments from auditors:
“Being a registered auditor in a listed environment is a high risk position. There are so many other opportunities for African CA’s with much less risk and higher reward, they are not interested in taking this high risk, high stress route for themselves.”

“The audit profession is a hard way of life. and it takes years to get ready to have the acumen and skills to sign a listed set of accounts. Many many potential black partners have been lured into commerce and industry for much more money than the firms can offer, at much reduced stress, and no regulatory (IRBA) review risk. Many examples of ex partners now as CFO’s. MAFR impact on profitability of the firms will accelerate this trend. Bright, talented black Registered Auditors have significant career optionality, and a world of MAFR and regulatory review is a significant disincentive to a career as a partner signing listed accounts.”

“A Black CA(SA) will earn more in commerce with less risk.”

“Banks and other large corporates have been head-hunting the black African talent in our firms. Then when we don’t have enough black African partners we and not the corporates and banks are criticized.”

“Why would a young African CA go into auditing which is a highly stressful and low paying profession with lots of overtime, when there are thousands of jobs adverts out there for non-white CA’s where they will work less and are being paid a significant premium?”

These sentiments were repeated by the AC chairs:

“The lack of black registered auditors is mainly due to the attractive financial packages available to black accountants from commerce, industry and the public sector which audit firms cannot compete with. Transformation and the training of black accountants has been very successful by the big firms.”
“In terms of black Registered Accountants (with IRBA), the problem is mainly due to the career opportunities afforded to black CA’s in the commercial, industrial & financial sector.”

“Talented black CA’s are reasonably plentiful, but they do not choose to work in audit firms as they have so many opportunities in the corporate world. Firms big and small find it very hard to retain these people. MAFR will not change this issue.”

There is clearly a problem in the audit profession which the IRBA needs to acknowledge and address. One audit partner explained that their firm invests considerable amounts of time and resources in developing black chartered accountants, only to have them qualify and leave the profession for better opportunities in corporate environments. The result, explained the partner, was that the audit firm is not recognised for the investment made but is rather criticised for poor transformation statistics. There was a considerable degree of unhappiness with this perceived state of affairs.

Another partner explained that they believed “...that in the broader context of {economic empowerment} one has the ‘audit firms’ competing with BIG-Business for a scarce resource. However, where a large listed company might only need, say 1 or 2, African Black CA(SA)’s in their business, audit firms HAVE to HAVE all of their audit partners as CA(SA)’s and are therefore NOT able to match the salaries being offered by BIG-Business.”

A caution made by some respondents was for the IRBA to understand that “developing a firm that is capable of carrying out a satisfactory audit of a listed entity does not happen in a short period of time” and therefore the industry and ACs should not rush to appoint firms that do not yet have the experience or skills to audit the business, as may be the
temptation considering the pressure to promote transformation. Another important impact on audit quality, as discussed in section 8.4.1, is the negative impact on audit quality over the longer term if talented accountants, whether black or not, cannot be retained in the profession. This inability to retain key staff is likely to cause a deterioration in the quality of the work in the entire industry over time, to the detriment of all stakeholders.

e. Responses from black respondents regarding transformation

During the parliamentary hearings before the Standing Committee on Finance in February and March 2017, the Chairman of the Committee, Yunus Carrim, instructed the audit profession that transformation in the profession was too slow and it needed to speed it up. The rate at which black accountants and black-owned auditing firms were being empowered was considered by the committee to be too slow.

“It cannot be that 23 years after our democracy, we still have a sector that is not transformed... But also, the government must ensure that through the Mandatory Audit Firm Rotation’s framework it has initiated, there is an increase in the use of black firms for auditing both in the public and private sectors” (Yunus Carrim, as quoted by Mputing, 2017:1).

At these parliamentary hearings, the President of the Association for the Advancement of Black Accountants of Southern Africa (ABASA), Gugu Ncube, expressed support for MAFR and its ability to promote transformation in the audit profession. In addition, the interim chairman of the interest group the Black Chartered Accountants Practitioners (BCAP), Victor Sekese, who is also the CEO of one of South Africa’s largest ‘black-owned’ audit firms, supported MAFR as a way for black-owned audit firms to get access to private sector audits, level the playing field and lessen the concentration of the market (Ensor, 2017).
From the above, it appears that some of the organisations which represent black chartered accountants, such as ABASA and BCAP, are in support of MAFR improving transformation in South Africa. It is therefore important to separately analyse the responses of black respondents to the questionnaire on this topic of transformation. The findings provide 28 responses to Statement 54 from auditors who selected ‘African black’, ‘Coloured’ or ‘Indian/Asian’, which are categories for race provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013. The results or Statement 54 are presented below in Figure 8.3. These are the race categories considered ‘black’ in the MAFR debate.

Statement 54: “MAFR will improve the transformation statistics in the South African audit profession.”

![Figure 8.3: Black audit partners' perspectives on transformation](image)

**Source:** Auditor questionnaire (own calculation)

As can be seen from Figure 8.3, 75% of the 28 respondents disagreed that MAFR would improve transformation in the audit profession (mean = 3.97). These findings are inconsistent with the opinions of the president of ABASA and the interim chair of BCAP,
as referenced above. It would not therefore be appropriate to conclude that black auditors are necessarily in favour of MAFR as a means of improving black participation in the audit industry.

The findings for the AC chairs provided only seven responses to Statement 54 from respondents who selected ‘African black’, ‘Coloured’ or ‘Indian/Asian’, with ‘2 agree’, ‘1 neutral’, ‘2 disagree’ and 2 ‘strongly disagree’. While the results favour disagreeing, the small number of responses allow for limited inference and interpretation.

Finally, with respect to the last statement in each questionnaire regarding each respondents’ overall position concerning MAFR, the following are the findings from respondents who selected ‘African black’, ‘Coloured’ or ‘Indian/Asian’ (Table 8.11). Although there are very few responses using this stratification of the data, the findings indicate that most black respondents are not in support of MAFR on an overall cost-benefit consideration basis.
Table 8.11: Black respondents’ overall position on MAFR

Statement: “Finally, on an overall cost-benefit analysis, considering the possible benefits and consequences of MAFR, financial and non-financial, do you believe MAFR, as ruled by the IRBA, is appropriate for South Africa?”

<table>
<thead>
<tr>
<th>Source</th>
<th>Yes (in favour)</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit partners</td>
<td>6 22%</td>
<td>21 78%</td>
<td>27</td>
</tr>
<tr>
<td>Audit committee chairs</td>
<td>2 29%</td>
<td>5 71%</td>
<td>7</td>
</tr>
<tr>
<td>Chief financial officers</td>
<td>2 29%</td>
<td>5 71%</td>
<td>7</td>
</tr>
<tr>
<td>Equity fund managers</td>
<td>2 67%</td>
<td>1 33%</td>
<td>3</td>
</tr>
</tbody>
</table>

Critical summary:

Big Four audit partners and AC chairs tend to agree that the lack of numbers of black chartered accountant graduates is partly to blame for the low numbers of black audit partners. However, a dominating sentiment among all groups was that the decline in appeal of the auditing profession as a career of choice for chartered accountants was a primary causal factor for the perceived slow rate of transformation in the profession. The experience of respondents was that qualifying black accountants leave the audit profession to pursue less risky and more rewarding careers outside public practice. This decline in appeal is perceived as a considerable threat to audit quality in South Africa.

A review of the overall MAFR opinions of black respondents only, across all participant groups, does not provide evidence in favour of MAFR. Most black respondents are against MAFR adoption.
iv. Summary analysis: Transformation considerations

Responding auditors and AC chairs agree that the rate of transformation in the audit industry is not acceptable, however, they do not believe that MAFR will improve it. Perhaps surprisingly, considering the IRBA’s intention for MAFR to promote black economic participation in the audit industry, the respondents who identified themselves as black generally agree with this conclusion. The comments made by the auditors and AC chairs supported the opinion that audit firms are struggling to transform because the talented black chartered accountants who qualify through them in public practice choose to leave for higher paying and less risky corporate opportunities. In the words of one auditor, “the risk-reward trade-off” is skewed against the profession and in favour of commerce and industry.

A few partners, presumably from Big Four firms, stated that the Big Four firms were the most transformed in terms of numbers of black staff and were contributing most of South Africa’s newly qualified black chartered accountants into commerce and industry. Both auditors (Big Four and non-Big Four) and AC chairs strongly believe that transformation of the audit profession should rather be promoted through existing and/or improved efforts within the audit firms themselves. The results of this section therefore provide evidence against the intentions of the IRBA with respect to transforming the profession. Indeed, the results suggest that MAFR will counter-intentionally reduce the degree of black participation in the audit industry as it may reduce the ability of firms to invest in existing transformation initiatives, thereby inhibiting their ability to achieve internally set goals in this regard.

The findings provide evidence in support of the interview research by Harber (2016) as well as the key stakeholder responses to the IRBA consultation paper (Harber & West, 2017).
8.3.4 Perceived impact of MAFR on the degree of market concentration by the Big Four firms

i. Objective of section

The objective of this section of the questionnaires was to understand the views of all four participant groups concerning the impact of MAFR on the concentration of Big Four audit firms servicing exchange-listed companies in South Africa. As described in Section 8.3.3, a secondary objective of the IRBA with respect to adoption of MAFR is to allow opportunities for small- and mid-tier audit firms (non-Big Four) to compete for the audits of JSE-listed companies, “provided they are competent to audit in those markets” (IRBA, 2015a:2). In addition, the IRBA wishes to reduce the risk that the loss of one auditing firm will have on the economy. An audit failure could “possibly disrupt stability in the financial market and damage investor confidence” (IRBA, 2016b:12). Chapter 5 section 5.7 discusses the IRBA argument in this regard, which includes the fact that only 4% of the JSE-listed companies in terms of market capitalisation are currently audited by non-Big Four firms (IRBA, 2016e). The objective of this section is linked to hypothesis H4.

ii. Findings concerning the impact of MAFR on market concentration

In the previous section, only the auditors and AC chairs were surveyed specifically with respect to transformation in the audit industry. Here, with respect to market concentration and the possibility of MAFR reducing the highly concentrated market for audits of JSE-listed companies, all four participant groups were surveyed. Audit firm appointment is ultimately a decision of the shareholders at the company’s AGM, based on recommendation from the AC, and therefore the perspectives of the fund managers and CFOs are considered relevant.

a. A potential lack of resources

As seen in Statement 13, Table 8.7 in section 8.3.2, all four participant groups have significant reservations regarding the ability of medium-sized audit firms to appropriately
perform the audits of the larger JSE-listed companies from a resource perspective. Resources would, for example, include staff experience, money to cover costs and investment, time and staff numbers. With respect to Statement 25 in section 8.4.2 (Table 8.16), Big Four partners (findings not presented; mean = 3.49; p < 0.01) and AC chairs (mean = 3.56; p < 0.01) generally do not believe that non-Big Four firms have the resources to provide competitive tender proposals. As may be expected, non-Big Four partners do believe that the smaller firms have the resources to provide adequate tender proposals and the non-Big Four firm partners believe that they do (Statement 25; findings not presented; mean = 2.56).

The findings from AC chairs concerning resources required to adequately perform the audit (Statement 13) or provide a competitive tender (Statement 25) are particularly important. AC chairs do not believe that non-Big Four firms possess the resources to tender for, or adequately perform, the audit of large exchange-listed companies. Considering that the AC is responsible for overseeing the tendering process, performing the due diligence work and making the recommendation of the audit firm to the shareholders for approval, this result confirms the legitimacy of this argument against MAFR being effective in lowering market concentration.

The CEO of SAICA has recognised this concern, stating what many respondents in this study have expressed, namely that

...MAFR may detract from the real transformation initiatives that are so crucial within the South African context, as well as concerns that market concentration will not be addressed since rotation would tend to spiral upwards towards the bigger firms, rather than the other way around (Nombembe, 2017:7).

If both the AC and shareholders are reluctant to recommend non-Big Four firms for appointment, then MAFR will not be successful in this regard. Counter intentionally, since the outgoing audit firm will not be eligible for re-appointment, it may have the effect of even increasing concentration as there would be only three Big Four firms left to consider.
Some responding auditors argued further that, in some sectors, not all the Big Four firms are equally experienced, which may reduce the number of firms considered even further to one or two.

A representative selection of comments expresses these sentiments:

Audit partner: “The Big 4 firms will just swap their clients, just like what they did with section 90.”

Audit partner: “The preference for Big 4 firms in my view will take long to change.”

Audit partner: “MAFR will simply result in one ‘Big Four’ auditor being replaced with another.”

Audit chair: “A large listed group will generally always want a top 4 audit firm for their depth of experience, technical specialist advice and support and their consistent international presence.”

Audit chair: “The issue is what level of service and capability can be provided by smaller audit firms, particularly for firms with complex businesses or requiring global presence due to offshore operations. Will they have the necessary investment in technical resources, etc?”

CFO: “Audits will just be rotated between the Big Four firms.”

CFO: “With the level of risks being taken on by boards and audit committees, this additional one due to inexperienced firms is one that we cause an exodus of members and willingness to act on committees where non Big Four are the auditors.”

CFO: “The smaller audit firms are unlikely to have the services or expertise.”

Table 8.12 below presents the findings from all four participant groups for statements on a range of relevant market concentration considerations in the MAFR debate.
Table 8.12: Perspectives on market concentration considerations

<table>
<thead>
<tr>
<th></th>
<th>Audit partners</th>
<th>Audit committee chairs</th>
<th>CFOs</th>
<th>Equity fund managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>39.</td>
<td>MAFR will allow other smaller audit firms, such as the mid-tier firms, the opportunity to tender for these audit engagements.</td>
<td>2.86</td>
<td>2.68</td>
<td>3.04</td>
</tr>
<tr>
<td>40.</td>
<td>MAFR will reduce the concentration of &quot;big 4&quot; audit firms providing audit services for JSE listed companies.</td>
<td>3.97 ***</td>
<td>3.37 *</td>
<td>3.47 **</td>
</tr>
<tr>
<td>41.</td>
<td>The size of an audit firm's &quot;geographical footprint&quot; (international presence) is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.</td>
<td>1.54 ***</td>
<td>1.54 ***</td>
<td>1.53 ***</td>
</tr>
<tr>
<td>42.</td>
<td>Non-&quot;big 4&quot; audit firms (mid-tier firms) have a sufficient &quot;geographical footprint&quot; (international presence) to be appointed as auditors of large multinational companies on the JSE.</td>
<td>3.47 ***</td>
<td>3.71 ***</td>
<td>3.60 ***</td>
</tr>
<tr>
<td>43.</td>
<td>In order to maintain audit efficiency, effectiveness and reduce the overall cost, the audit committee seeks to appoint (or recommend for appointment) the same audit firm in each of the geographic areas and jurisdictions in which the group operates.</td>
<td>1.70 ***</td>
<td>1.59 ***</td>
<td>1.74 ***</td>
</tr>
<tr>
<td>44.</td>
<td>Industry-specific knowledge and experience within the audit firm is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.</td>
<td>1.51 ***</td>
<td>1.54 ***</td>
<td>1.51 ***</td>
</tr>
<tr>
<td>45.</td>
<td>Non-&quot;big 4&quot; audit firms (mid-tier firms) have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE.</td>
<td>3.25</td>
<td>3.66 ***</td>
<td>3.54 ***</td>
</tr>
<tr>
<td>46.</td>
<td>Audit committees of JSE listed companies are likely to recommend non-&quot;big 4&quot; audit firms for appointment as external auditors.</td>
<td>3.66 ***</td>
<td>3.56 ***</td>
<td>3.82 ***</td>
</tr>
<tr>
<td>47.</td>
<td>Shareholders of JSE listed companies, in the AGM, are likely to appoint non-&quot;big 4&quot; audit firms as external auditors.</td>
<td>3.74 ***</td>
<td>3.56 ***</td>
<td>3.63 ***</td>
</tr>
<tr>
<td>48.</td>
<td>Considering that the performance of advisory services (non-audit work) by an audit firm creates an independence threat that limits or prevents that firm from being appointed as auditor, MAFR will reduce the choice of audit firms available for appointment by the audit committee.</td>
<td>1.82 ***</td>
<td>2.24 ***</td>
<td>2.19 ***</td>
</tr>
<tr>
<td>49.</td>
<td>Non-&quot;big 4&quot; audit firms will be able to obtain more non-audit work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors.</td>
<td>2.92</td>
<td>2.59 **</td>
<td>2.75 *</td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)

b. Reluctance from audit committees and shareholders

As discussed above, in terms of corporate governance principles and legislation, the AC recommends the audit firm to the shareholders for approval at the shareholder AGM. MAFR will not be effective in lowering market concentration of the Big Four firms over JSE-listed companies if both these stakeholder groups do not believe that non-Big Four firms are capable of providing the required standard of audit services.
Consistent with findings discussed above in part a., findings from Statements 39 and 46 indicate that although non-Big Four firms will have the opportunity to tender for appointment, it is unlikely that the AC will recommend them at the AGM for appointment. In addition, the findings indicate that shareholders would be unlikely to appointment non-Big Four firms even if the ACs were to recommend them (Statement 47). It is significant to note that these sentiments are also felt by the equity fund managers, although with a lower degree of certainty (as expressed by the mean values). Overall, with respect to market concentration, none of the participant groups believe that MAFR will lower concentration (Statement 40), although the sentiments of the fund managers, while above 3, are not statistically significant from neutral.

In addition to concerns regarding resources, the findings from Statements 41 to 45 provide further insight into why ACs and shareholders may be reluctant to appoint non-Big Four firms, especially with regards the larger groups of companies listed on the JSE. The size of an audit firm's 'geographical footprint' (international presence) is considered an important quality of the audit firm (Statement 41). Being present in a multinational company’s various geographic areas of business may be seen as helping to maintain audit efficiency and effectiveness and to reduce the overall cost of the audit. The smaller firms may not be seen as possessing the required degree of international presence (Statement 42).

“Global reach is non-negotiable as global entities want to work with one person, never mind one firm. Non-Big Four do not have advisory capability at any scale and will continue with their current scale which is very much based on individual skills of individuals in certain pockets i.e. tax or legal.”

Industry-specific knowledge and experience within the audit firm is another important consideration for the AC and shareholders in the appointment of a suitable audit firm (Statement 44). AC chairs and CFOs do not believe that the mid-tier firms have evident
industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE. Responding auditors and fund managers express a neutral view, neither significantly agreeing nor disagreeing (Statement 45). As shown above, the comments made by respondents express this concern, namely, that mid-tier firms are not perceived to be equal to the large-tier firms in possessing the resources, knowledge and experience for some of the more niche industries.

“For the ‘non Big Four’ companies to be in a position to audit large financial institutions (banks & insurance companies) will require significant investment.”

Critical summary:

In order for MAFR to boost the appointment of non-Big Four firms by JSE-listed companies, both the AC, and especially the shareholders, need to believe that these firms are capable of performing the audit work to an acceptable standard. However, findings indicate that these two groups do not believe that non-Big Four firms possess the resources or the ‘geographical footprint’ to convince the ACs and the shareholders to appoint them. All four participant groups are sceptical that ACs and shareholders of JSE-listed companies will promote the appointment of the non-Big Four firms.

c. Separating Big Four from non-Big Four perceptions

Considering that the Big Four firms potentially stand to lose JSE-listed clients, as is the intention of the IRBA, it is important to separately analyse the findings from Table 8.12 (Statements 39 to 49) with respect to Big Four and non-Big Four responding partners. Doing so reveals that, surprisingly, the two groups’ opinions are similar with respect to Statements 40, 46 and 47, namely that:

- MAFR will not reduce the concentration of ‘Big Four’ audit firms providing audit services for JSE-listed companies (Statement 40);
• ACs of JSE-listed companies are not likely to recommend ‘non-Big Four’ audit firms for appointment as external auditors (Statement 46); and

• Shareholders of JSE-listed companies, in the AGM, are not likely to appoint ‘non-Big Four’ audit firms as external auditors (Statement 47).

Therefore, even the non-Big Four firms are sceptical regarding the ability of MAFR to lower market concentration of JSE-listed company audits. The non-Big Four firms agree with the other participant groups that ACs are unlikely to recommend them to shareholders for appointment and even if they did so, the shareholders would be unlikely to appointment them. However, contrasting views were expressed with respect to non-Big Four firms’ sufficiency of ‘geographical footprint’ and industry-specific knowledge and experience (Statements 42 and 45). Unlike Big Four partners, non-Big Four respondents believe that mid-tier firms do indeed have a sufficient ‘geographical footprint’ to be appointed as auditors of large multinational companies on the JSE (mean = 2.62; p < 0.05) and that they do have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE (mean = 2.68; p < 0.05). Although these two means (2.62 and 2.68) do not convey strong convictions, it does illustrate a considerable difference of opinions from the other participant groups. However, unless the ACs and shareholders can be convinced regarding international presence as well as knowledge and experience, the mid-tier firms risk committing considerable resources towards tender proposals, only to be unsuccessful. This is the likely reason why non-Big Four partners do not believe that MAFR will lower market concentration (Statements 40, 46 and 47).

Concerning the resource capacity of non-Big Four firms (money, time, staff etc.) needed to perform the audit of a larger JSE-listed company as per Statement 13 in Table 8.3, when the findings for the non-Big Four firm partners are separately analysed, it shows that these respondents generally believe that their firms do have the resources required (mean = 2.65; p < 0.05), albeit with a mean relatively close to the neutral value of 3. Upon closer inspection of these responses, a few of the non-Big Four respondents disagreed
that their firms had the resources to appropriately audit the larger JSE-listed companies (neutral = 11.5%; disagree = 26.9%; strongly disagree = 3.9%). Therefore, there is a measure of disagreement and uncertainty in this regard.

Whereas the ACs of the smaller companies may consider the non-Big Four firms for appointment, it is unlikely that the larger company committees will do so. The findings indicate that many mid-tier firms will be unlikely to tender for the larger companies but may do so for the medium to smaller companies. It should be acknowledged that these findings are biased in favour of the larger companies considering that the top 100 JSE-listed company AC chairs and CFOs were surveyed, not the approximately 250 other companies listed on the JSE main board and AltX board. There may be a realistic opportunity for mid-tier firms to successfully tender for appointment over these smaller companies.

**Critical summary:**

Non-Big Four firms also believe that MAFR will not reduce market concentration on the JSE as they do not believe that ACs and shareholders of JSE-listed companies will agree to their appointment. Although Big Four firm partners, AC chairs and CFOs do not believe that the mid-tier firms have the experience, knowledge, resources or geographical presence to be appointed, non-Big Four firm partners believe that they do. In their view, the problem lies in the lack of such belief from the decision-making parties, namely the AC and the shareholders.
Considering the independence threat that non-assurance services can create for the audit firm, if a firm does not relinquish these services it is unlikely to be eligible for appointment as auditor. Auditors and ACs must assess the independence of the audit team, as required by section 94 of the Companies Act (applicable to the AC), internal firm policies and the codes of professional conduct (applicable to the auditors). In addition to this, section 90 of the Companies Act disallows the appointment as auditor any person or firm that has performed certain non-audit services to the company within the past five years, such as performing the duties of accountant/bookkeeper, maintenance of any of the company’s financial records or the preparation of any of its financial statements. The IRBA has issued specific guidance which takes a strict position on the application of section 9013. Herein lies the reason for the implementation date of MAFR as 1 April 2023, as it allows more than five years from the date of the MAFR ruling (June 2017) for audit firms to step away from non-audit services to companies to which they intend tendering for appointment as auditor. However, the findings from Statement 48 imply that audit firms will be unlikely resign from non-assurance services so as to be eligible for appointment as auditor from 2023.

The findings from Statement 48 in Table 8.12 show that responding auditors, AC chairs and CFOs strongly agree that MAFR will have the effect of reducing the choice of audit firms available for appointment by the AC (means = 1.82; 2.24; and 2.19 respectively; p < 0.001) because of non-assurance services already being performed by audit firms. Both Big Four partners and non-Big Four partners agree in this respect (means = 1.58 and 2.14 respectively; p < 0.001).

The comments from audit partners provide a possible reason for these findings:

“There is also the possibility that the Big Four will pick their battles and rather take on advisory / non-audit work which does not require the same level of independence scrutiny that audit requires.”

13 Refer to the IRBA document, “Guidance on the provision of non-audit services by the auditor of a company”.
“Big Four firms will not accept audit only assignments. The mark up on non-audit assignment are huge in comparison to audits. Remuneration from audits only is so low that no accountant will want to carry the audit risk in comparison to income received from audits only.”

There is the possibility that audit firms will not tender for appointment as auditors on companies that they either currently provide, or intend to secure, advisory services to. The findings from Statement 49 do not show strong agreement with the idea that non-Big Four firms will be able to obtain more non-audit work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors. This could be because Big Four firms may be unwilling to resign from advisory services or it could be because ACs may be reluctant to appoint non-Big Four firms for advisory work. According to one AC chair:

“Unfortunately, the non Big 4 firms have not demonstrated that they have built up specialist advisory skills to service large multinational companies.”

From the comments provided by responding auditors and AC chairs, advisory services are perceived as less risky and more lucrative than assurance, and as such may mean that Big Four firms will prioritise them over audit services. This trend may cause the industry to become more highly concentrated if ACs remain unwilling to appoint non-Big Four firms as auditor.

“MAFR will limit competition as instead of having 4 of the Big Four bidding, it will be limited to 3 and if another does the internal work then there will only be 2 firms in the tender process.”
On the other hand, if ACs are willing to consider non-Big Four firms for appointment as audit, then this seeming preference of Big Four firms for advisory work could result in an opportunity for mid-tier firms to secure appointments as auditor. Nonetheless, it stands to reason that from a long-term perspective, a prioritisation of advisory work over audit, resulting from a perception of higher risk and lower profitability in audit, can only be detrimental to the future of the profession and audit quality. These conclusions link with section 8.4.2 where results show that MAFR is likely to make the audit industry a poorer industry due to additional costs imposed. The IRBA needs to address these concerns and the possible threat they pose to audit quality.

Audit partner: “The current 5 year restrictions created by Section 90 reduces choice by companies to use the best service provider on non-audit services.”

Audit partner: “S90(2) of the Companies Act has a significant impact on audit committee’s available choices, especially in light of the 5 year cooling off period.”

AC chair: “Section 90 of Companies Act must be reviewed. Restriction must be reduced to one year.”

Based on the above comments, perhaps if section 90 of the Companies Act did not prescribe a five-prior-year restriction on certain advisory services, ACs would receive more tenders for audit appointment after implementation of MAFR in 2023. As it stands currently, in order for a firm (large- or mid-tier) to tender for auditor of a company after 2023, it would need to remove itself from all advisory services for the next five years in order to be eligible for appointment. In light of section 90, a scenario whereby audit firms prioritise advisory services over audit services is likely to limit the attraction of audit firms to compete for the audit, counter to the IRBA’s intentions. This would negatively impact audit quality and further concentrate the market.
iii. **Summary analysis: Market concentration considerations**

Overall, the findings provide considerable evidence that MAFR will not reduce the degree of concentration of the Big Four firms on the JSE – it may even contribute to its increase. All four participant groups have significant reservations regarding the ability of medium-sized audit firms (non-Big Four) to appropriately perform the audits of the larger JSE-listed companies from a resource perspective. The Big Four partners and AC chairs particularly do not believe that non-Big Four firms have the resources to provide competitive tender proposals. Again, all four participant groups, including non-Big Four audit partners, believe it is unlikely that the AC will recommend mid-tier firms at the AGM for appointment or that the shareholders will appoint them. Despite this, perhaps unsurprisingly, non-Big Four firm partners feel that, contrary to other participant groups, their firms do have the resources, skills and experience to provide adequate proposals and provide good quality assurance services to JSE-listed companies.

The size of an audit firm’s ‘geographical footprint’ as well as its industry-specific knowledge and experience is an important consideration for the AC and shareholders. It is these qualities that the AC chairs and CFOs feel the mid-tier firms do not possess sufficiently for the purpose of appointment over larger companies. This will remain a barrier to mid-tier firm appointment. Although the ACs of smaller JSE-listed companies
may consider non-Big Four firms for appointment, it is unlikely that the larger company committees will do so.

A problem was identified with respect to section 90 of the Companies Act and its five prior-year restriction on certain advisory services. Respondents claim that audit firms prefer advisory services over audit and that this may make the firms reluctant to give up such services to pursue audit appointments or to not tender for auditor appointments but rather focus on securing advisory work. The result could be a limited number of tenders received and therefore less choice for the AC under MAFR. Some responding auditors claim that MAFR will further enhance the perception that advisory work is preferable to audit. If true, this could pose a significant threat to audit quality in the longer term.

The findings provide evidence in support of the interview research by Harber (2016) as well as the key stakeholder responses to the IRBA consultation paper (Harber & West, 2017). The evidence in the UK (Agnew, 2016a) and in China (Russell, 2013) also suggests that audit firm rotation does not reduce the concentration of the Big Four firms servicing the exchange-listed companies.

8.4 RESEARCH FINDINGS ON INDIRECT EFFECTS OF MAFR

This section analyses the results related to the hypothesised indirect effects of MAFR in South Africa. As shown in the theoretical model (Chapter 7, Figure 7.4), the indirect effects anticipated include audit partner quality of life, the appeal of the audit profession in the mind of professional accountants, cost implications to firms and clients and the role of professional judgement by key participants in the audit appointment process.
The hypotheses linked to these effects are as follows:

**H6**: Stakeholders perceive that MAFR will reduce audit partners’ quality of work life.

**H7**: Stakeholders perceive that MAFR will require audit partners to undergo significant efforts to upskill and retrain themselves for new industries.

**H8**: Stakeholders perceive that MAFR will reduce the appeal, in the minds of chartered accountants, of the auditing profession in comparison to other career options.

**H9**: Stakeholders perceive that MAFR will significantly increase costs to audit firms.

**H10**: Stakeholders perceive that MAFR will significantly increase costs to companies in the form of increased audit fees.

**H11**: Stakeholders perceive that MAFR will reduce the ability and/or incentive of the audit committee to apply professional judgement to assess auditor independence and to find the audit firm best able to provide them with a high-quality audit.

---

**Note**: The critical links to the empirical study, which comprise the linkage of the literature to the theoretical models, hypotheses and questionnaires, are described in Chapter 7 Section 7.4, as well as Annexure 4 and Annexure 5. The questionnaires can be found in Annexures 10, 11, 12 and 13.

---

8.4.1 Perceived impact of MAFR on audit partners’ quality of work life and the appeal of the audit profession

---

**i. Objective of section**

The first objective of this section of the questionnaires was to understand the views of audit partners and AC chairs with respect to the anticipated work-life implications for auditors from the implementation of MAFR. This is linked to hypotheses **H6** and **H7**. The second objective is to elicit views from all four participant groups concerning the current state of appeal of the audit profession for professional accounts and the impact that MAFR
may have in this regard. This aspect of the MAFR debate is relevant to hypothesis $H_8$. Interview and survey-based studies on auditor rotation have produced findings that show that rotation regulations specifically, as well as audit industry regulations in general, can impact auditor work-life balance, job satisfaction and appeal to remain in the profession (Daugherty, Dickins, Hatfield & Higgs, 2012; Harber, 2016; Harber & West, 2017). Respondents in these studies also claim that these consequences could impact the quality of audit work performed.

ii. Findings concerning the impact of MAFR on quality of work life

With reference to perceived work-life implications from the implementation of MAFR, only the perspectives of audit partners’ and AC chairs were collected. It is submitted that only these two participant groups can provide an informed perspective on current issues relating to job satisfaction in the audit profession. However, emphasis should still be placed on the views of the auditors themselves. CFOs and equity fund managers would perhaps be less informed in this regard, being in less frequent contact with auditors and less involved in the audit profession, due to their specific roles. These two groups are also not involved in the detailed discussions between AC and auditor over the details of auditor appointment. In the section which follows (appeal of the audit profession), the findings with respect to all four participant groups’ views are analysed.

As described in Chapter 3 section 3.4.1.2, interviews with senior South African audit partners by Harber (2016) reveal that MAFR may increase the workloads of audit partners and introduce “unmanageable costs”, resulting from a variety of activities (as discussed in section 8.4.2), including the need for partners to retrain and up-skill themselves to audit new industries outside of their current expertise and experience. These views were again expressed by the senior leadership of the Big Four firms in their responses to the IRBA consultation paper (Harber & West, 2017), as discussed in Chapter 5 section 5.5.6.2. The findings of these studies show that these stakeholders are also in agreement that the South African audit profession is deteriorating in appeal to professional accountants and that MAFR would further exacerbate this trend. Fontaine et al. (2016:496), in interviews
with Canadian AC members, found that all participants emphasised “the tremendous time and effort involved with changing audit firms”. The study of partner perceptions in the US by Daugherty et al. (2012), in the context of partner rotation, showed that auditors believe rotation can increase partners’ workloads and the likelihood of relocation, which would have a negative impact on partner satisfaction at work. In addition, it was perceived by partners that when they retrain to gain new industry expertise, audit quality decreases.

Trivellas, Akrivouli, Tsifora and Tsoutsa (2015), in a study of accounting firms specifically, find that competent and satisfied employees are one of the most important resources in the pursuit of a sustainable competitive advantage and that accounting firms need to make changes to their company culture to promote job satisfaction as a matter of priority. It stands to reason then that a deterioration in the appeal of the audit profession is likely to impair audit quality.
Table 8.13: Perspectives on quality of auditors’ work life

<table>
<thead>
<tr>
<th>Audit Partners</th>
<th>Endpoints, Midpoint Mean</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>57. MAFR will require audit partners to devote more time to preparing and participating in tenders for audit appointments.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.59 0.75 [1.41] ***</td>
</tr>
<tr>
<td>58. MAFR will put pressure on outgoing audit firm partners and audit firm leadership to replace audit clients and lost revenue streams resulting from firm rotation.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.47 0.64 [1.53] ***</td>
</tr>
<tr>
<td>59. The pressure on outgoing audit firm partners to replace audit clients and lost revenue streams, resulting from MAFR, will cause audit partners to lose focus on the actual audit work, thereby decreasing audit quality in the final years of the rotation period.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>2.33 1.16 [0.67] ***</td>
</tr>
<tr>
<td>60. The rotation of audit clients, which will result from MAFR, places additional risk on engagement partners, especially during the initial years of the audit, when the risk of audit failure is greater due to lack of familiarity with the client and industry.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.75 0.92 [1.25] ***</td>
</tr>
<tr>
<td>61. MAFR will increase the need for registered auditors to retrain and upskill themselves to audit new companies, within industries with which they previously had little (or less) experience.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.81 0.70 [1.19] ***</td>
</tr>
<tr>
<td>62. The need for registered auditors to retrain and upskill themselves to audit new companies will negatively impact audit quality.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>2.89 1.11 [0.11]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Committee Chairs</th>
<th>Endpoints, Midpoint Mean</th>
<th>Diff from neutral</th>
</tr>
</thead>
<tbody>
<tr>
<td>57. MAFR will require audit partners to devote more time to preparing and participating in tenders for audit appointments.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>2.07 0.84 [0.93] ***</td>
</tr>
<tr>
<td>58. MAFR will put pressure on outgoing audit firm partners and audit firm leadership to replace audit clients and lost revenue streams resulting from firm rotation.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.85 0.61 [1.15] ***</td>
</tr>
<tr>
<td>59. The pressure on outgoing audit firm partners to replace audit clients and lost revenue streams, resulting from MAFR, will cause audit partners to lose focus on the actual audit work, thereby decreasing audit quality in the final years of the rotation period.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.05 1.19 0.05</td>
</tr>
<tr>
<td>60. The rotation of audit clients, which will result from MAFR, places additional risk on engagement partners, especially during the initial years of the audit, when the risk of audit failure is greater due to lack of familiarity with the client and industry.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.90 0.73 [1.10] ***</td>
</tr>
<tr>
<td>61. MAFR will increase the need for registered auditors to retrain and upskill themselves to audit new companies, within industries with which they previously had little (or less) experience.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>1.78 0.52 [1.22] ***</td>
</tr>
<tr>
<td>62. The need for registered auditors to retrain and upskill themselves to audit new companies will negatively impact audit quality.</td>
<td>1 = Strongly agree 3 = Neutral 5 = Strongly disagree</td>
<td>3.22 1.02 0.22</td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: Auditor and AC chair questionnaires (own calculation)

a. The pressure of needing to replace existing revenue streams

As shown in Table 8.13, Statement 58 indicates that both responding audit partners and AC chairs strongly believe that MAFR will result in additional pressure on partners to
replace audit clients and lost revenue streams (means = 1.47; and 1.85 respectively; p < 0.001). This pressure implies that there may be a decline in job satisfaction. Responding auditors believe that there will consequently be a decline in audit quality as auditors begin to prioritise replacing the client near the end of the rotation period (Statement 59; mean = 2.33; p < 0.001), whereas AC chairs express a neutral view (mean = 3.05) in this regard. This auditor perspective is consistent with the partner interviews conducted by Harber (2016). As described by a responding AC chair,

“…rotation of audit partners is already unsettling a number of partners I have dealt with. If they don’t get good clients every five years their earnings are in many instances reduced materially. [MAFR] could result in emphasis being placed on getting new clients for the firm rather than concentrating on their present/new audits.”

In a separate part of the questionnaire given to CFOs, one CFO commented that “if an auditor knows they will be rotated off soon, I’m not sure if a company will get the same quality of service”. This is consistent with the findings here for audit partners.

One activity that will require time and resources under a system of MAFR is that of producing competitive tender proposals (Statement 57). Both the responding partners and AC chairs strongly feel that more time will need to be devoted to this activity (means = 1.59 and 2.07 respectively; p < 0.001). The comments of the auditors made it clear that the activity of preparing tenders is onerous and time-consuming and due to the competition, will often not result in a successful appointment. This reality will increase pressure on audit partners, especially as their clients approach the end of the rotation period. This is consistent with the perspectives of responding partners and AC chairs regarding proposal (tender) costs as per Statement 23.e in section 8.4.2 below.

b. The pressures of retraining and upskilling to audit new companies

Responding auditors strongly believe that MAFR will require them to spend considerable effort upskilling themselves to become familiar with the client’s business and this will
introduce audit risk i.e. the risk of not detecting material fraud or error misstatements during the audit (Statements 60 and 61; means = 1.75; and 1.81 respectively; \( p < 0.001 \)).

The findings from the AC chairs show similar strong sentiments in these regards, with means below 2. As described in the comments:

“The pressures on audit partners and managers is ever increasing and MAFR may add to the pressure.”

“Diligent audit partners and staff will upskill themselves in anticipation of their changing role. The risk will however be in the execution of the audit in the early years.”

It is reasonable to conclude that perceptions of additional personal and professional risk in providing audit opinions, as well as recognition of the need to work harder to upskill and retrain, presumably in the first year of appointment, will translate into a deterioration in job satisfaction.

Interestingly and importantly, neither responding auditors nor AC chairs believe that audit quality will deteriorate due to the need for auditors to retrain and upskill themselves. The findings show neither significant agreement nor disagreement concerning the possibility that retraining and upskilling to audit new companies will negatively impact audit quality (Statement 62). This view could be expected of auditors, who could be susceptible to the overconfidence effect, which is when a person’s subjective confidence in his or her judgements is greater than the objective accuracy of those judgements. In other words, the auditors may be biased in favour of their own abilities and professionalism. However, this would not account for a similar sentiment from the more objective AC chairs. The respondents are therefore of the opinion that despite the additional risk and work required to retrain and upskill, especially in the early years of the new engagement, the auditors would respond by appropriately mitigating the risks with additional work and diligence. As
shown in section 8.4.2, the additional work required is unlikely to be compensated by additional audit fee revenue.

“Audit firm margins will be reduced meaning less income for auditors and this will increase risk but also make the profession less attractive.”

iii. Findings concerning the impact of MAFR on the appeal of the audit profession

As described above, audit regulations that are perceived to be more onerous on audit practitioners and increase personal liability risk may have unintended consequences such as a decline in job satisfaction and audit quality (Daugherty et al., 2012; Fontaine et al., 2016; Harber & West, 2017). This section is concerned with the views of all four participant groups on the anticipated impact of MAFR on job satisfaction and the appeal of the profession as a career of choice for professional accountants. The findings from this section of the questionnaires are presented in Table 8.14.
Responding auditors believe that the profession is over-regulated (Statement 63; mean = 2.25; p < 0.001), whereas the other three responding groups express a neutral view, neither significantly agreeing nor disagreeing. One partner explained that “the more significant issue is the risk associated with the profession, especially as jointly and severally liable and the extent of audit effort required to demonstrate compliance with professional standards”. The CFOs and fund managers are unlikely to be well informed of the regulations governing the audit profession, hence the neutral view. However, it is reasonable to conclude that the AC chairs are reasonably well informed.

The responding partners also express strong sentiments that the audit profession is decreasing in appeal for professional accountants relative to other career paths (Statement 64; mean = 1.30; p < 0.001) and that MAFR will compound this problem (Statement 65 and 66; means = 1.85 and 1.70 respectively; p < 0.001). In their view, MAFR will result in less newly qualified chartered accountants desiring to become audit practitioners, as well as existing staff seeking employment outside of public practice.

### Table 8.14: Perspectives on the appeal of the audit profession

<table>
<thead>
<tr>
<th>Mean</th>
<th>Mean</th>
<th>Mean</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.25</td>
<td>***</td>
<td>2.93</td>
<td>3.11</td>
</tr>
<tr>
<td>1.30</td>
<td>***</td>
<td>2.56</td>
<td>*</td>
</tr>
<tr>
<td>1.85</td>
<td>***</td>
<td>2.88</td>
<td>2.71</td>
</tr>
<tr>
<td>1.70</td>
<td>***</td>
<td>2.78</td>
<td>2.68</td>
</tr>
</tbody>
</table>

1 = Strongly agree; 3 = Neutral (Midpoint); 5 = Strongly disagree

* *, ** *, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

**Source:** All questionnaires (own calculation)
As stated by a partner, in their view, “the over regulation and the obsession by the IRBA to be the no1 regulator in the world is certainly impacting the ability for firms to retain managers and partners and certainly reducing the appeal to become an auditor”. This was a common sentiment expressed in the partners’ comments:

“It has already started – in my business the migration away from assurance and out of the firm is sad to see – it’s the top talent that went first.”

“Absolutely no doubt that MAFR will just be another nail in the proverbial coffin for the TALENTED.”

It is submitted that these views, if true, present a significant risk to audit quality in South Africa and present an important unintended consequence of MAFR that the IRBA needs to address. As described in the literature, the capability and competency of the auditor is a key factor, in addition to independence, in the outcome of audit quality (Tepalagul & Lin, 2015). If the audit profession is considered undesirable as a profession in comparison to other accounting-related job opportunities in the market, then audit firms will not retain the talented and competent auditors required to maintain audit quality.

“IRBA need to play their role in attracting [auditors] – over a 10 year period, the number of [auditors] have dropped due to the profession being made very unattractive.”

These views are again consistent with those of partners interviewed by Harber (2016), as well as the leadership of the Big Four firms’ responses to the IRBA consultation paper (Harber & West, 2017). As stated by an AC chair: “MAFR will increase the probability that audit partners will leave the profession, further reducing audit quality.”
Responding CFOs and to a lesser degree, the AC chairs, are in agreement that as a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths (Statement 64). However, based on the mean values, their sentiment is not as strong as the auditors’ in this regard. The findings from Statements 65 and 66 for CFOs and AC chairs do not show strong deviations from the neutral value, indicating neutral feelings regarding the contribution of MAFR to the decreasing appeal for the profession. One CFO made an interesting point: “If IRBA ensures that the right people become auditors, they don’t have to further regulate their behavior.”

A few respondents indicated in their comments that since they were not auditors, it was difficult to comment – this may account for the findings being relatively close to neutral. However, a review of the qualifications of the JSE company CFOs and AC chairs indicates that the considerable majority of them are themselves chartered accountants and registered as such with SAICA. This implies that they may be aware of the state of appeal of various career alternatives for young professional accountants in South Africa.

A relatively strong view, contrary to that of the auditors, is expressed by the equity fund managers with respect to Statement 65. The fund managers disagree that MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants (mean = 3.67; p < 0.001). Similarly, they do not believe that MAFR will result in an increased exodus of managers and partners from the profession (Statement 66).

Critical summary:

Responding auditors, AC chairs (to a lesser degree) and CFOs believe that the audit profession is decreasing in appeal for professional accountants relative to alternative career paths. Auditors believe MAFR is exacerbating this worrying trend, but equity fund managers disagree. Concerns were raised by many respondents that this decline in appeal is a threat to audit quality.
iv. Summary analysis: Perceived impact on audit partner quality of work life and the appeal of the audit profession

Responding partners and AC chairs are concerned over the additional pressure on outgoing audit firm partners and audit firm leadership to replace audit clients and lost revenue streams resulting from firm rotation. Audit partners believe this will cause audit partners to lose focus on the actual audit work, thereby decreasing audit quality in the final years of the rotation period. This pressure is perceived as being exacerbated by the necessity of producing detailed and onerous tender proposals that are competitive, to place the firm in a position to secure appointments to replace clients lost due to rotation.

Strong sentiments were expressed by responding partners and AC chairs regarding the likelihood of additional risk being placed on newly-appointed partners, especially during the initial years after rotation. This risk is felt to be due to the relative lack of familiarity with the client and industry. Both groups also strongly believe that MAFR will increase the need for auditors to retrain and upskill themselves to audit new companies, within industries with which they previously had less experience. Perhaps surprisingly, neither group believes that the need to retrain and upskill will negatively impact audit quality. This implies that, despite additional risk on the newly appointed audit partner, the experience gap will be sufficiently bridged or overcome in the first year of the appointment, through significant additional work and effort.

It is clear from the findings that the responding auditors strongly believe that the profession is over-regulated and deteriorating in appeal as a career for both newly qualified professional accountants and existing audit managers and partners. MAFR is believed by responding auditors to be a move in the wrong direction in this regard. The other three participating groups mostly express neutral views on these issues. However, CFOs agree that the audit profession is decreasing in appeal relative to alternative career paths but are unconvinced that MAFR is exacerbating the problem. Equity fund managers
do not believe MAFR will reduce the appeal of the audit profession. Considering that the audit partners express such strong views, which were reinforced in their comments, the IRBA needs to urgently address this perceived problem. It seems clear that an inability to retain talent in the industry and the declining job satisfaction felt by auditors will result in staffing problems and declining audit quality over time.

The findings provide evidence in support of the interview and survey research by Daugherty et al. (2012), Fontaine et al. (2016) and Harber (2016) as well as the key stakeholder responses to the IRBA consultation paper (Harber & West, 2017).

8.4.2 Perceived impact of MAFR on costs to audit firms and companies

i. Objective of section

The objective of this section of the questionnaires was to understand the views of all four participant groups with respect to the perceived cost implications from the implementation of MAFR in South Africa. The imposition of unnecessary and unmanageable costs on both clients and audit firms has been posited as a reason not to adopt MAFR, on a cost-benefit analysis. The perceived benefits are considered by some to be insufficient to justify perceived costs. Opponents of MAFR claim that forcing firm rotation will introduce financial strains on the audit profession which will result in a lowering of audit quality over the long term. The management of exchange-listed companies has expressed similar concerns. Appointing new audit firms and dealing with auditors who are relatively unfamiliar with the company's operations may add additional costs and inconvenience to the company (Ewelt-Knauer et al., 2013; Fontaine et al., 2016; Harber & West, 2017; Ramon, 2016). Refer to the literature review chapters, Chapter 3, section 3.5; Chapter 5, sections 5.5, 5.6 and 5.8 for a description of the literature informing this section of the questionnaires.
It is necessary to better understand the views of audit stakeholders regarding the nature and extent of these costs in order to better evaluate MAFR on a cost-benefit basis. The potential impact of cost increases on audit quality also needs to be better understood. This section therefore refers to hypotheses H9 and H10.

ii. Findings concerning cost implications to the clients

The perceived cost implication to the client will be considered first, followed by the costs to the audit firm.

Table 8.15: Participants’ perspectives on cost to companies

<table>
<thead>
<tr>
<th></th>
<th>Audit partners</th>
<th>AC chairs</th>
<th>CFOs</th>
<th>Equity fund managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>MAFR will result in significantly increased audit fees, i.e. significant to the companies involved.</td>
<td>2.49 ***</td>
<td>2.29 ***</td>
<td>1.98 ***</td>
</tr>
<tr>
<td>31</td>
<td>Regarding potential increases in audit fees resulting from MAFR: Audit committees will agree to increased audit fees in the short-term (1-2 years of the new appointment), but not in the longer-term.</td>
<td>3.17</td>
<td>3.02</td>
<td>3.04</td>
</tr>
<tr>
<td>32</td>
<td>Regarding potential increases in audit fees resulting from MAFR: Audit committees will agree to permanently increased audit fees, i.e. for the duration of the rotation period that the audit firm may be appointed.</td>
<td>3.82 ***</td>
<td>3.73 ***</td>
<td>3.98 ***</td>
</tr>
<tr>
<td>33</td>
<td>MAFR will result in significant costs to the company in terms of time and resource investment by senior management and audit committees.</td>
<td>1.75 ***</td>
<td>1.76 ***</td>
<td>1.60 ***</td>
</tr>
<tr>
<td>34</td>
<td>MAFR will introduce a significant added cost to the audit committees of JSE listed companies as they will be required to receive and consider tenders (proposals) to appoint auditors more regularly.</td>
<td>2.01 ***</td>
<td>2.29 ***</td>
<td>2.05 ***</td>
</tr>
<tr>
<td>35</td>
<td>The additional cost to the company from MAFR will not add any incremental benefits, economic or otherwise, and thus negatively impact on shareholder value.</td>
<td>1.98 ***</td>
<td>2.05 ***</td>
<td>2.11 ***</td>
</tr>
<tr>
<td>36</td>
<td>The additional investment in time by boards, audit committees and executive management, resulting from MAFR, will be a significant distraction from running the business to those involved at the company.</td>
<td>2.30 ***</td>
<td>2.27 ***</td>
<td>2.18 ***</td>
</tr>
</tbody>
</table>

(Table continued on next page)
The views of the auditors are considered first. Concerning the audit fee implications of MAFR, as shown in Table 8.15, responding partners agreed with the statement that MAFR will result in increased audit fees that are considered significant to the company (Statement 30; mean = 2.49; p < 0.001), however, there was a degree of mixed opinions in the comments provided. Some partners believed MAFR would even lower fees, as stated by one partner: “…in a competitive bidding situation audit fees tend to go down and not up. The audit firms will therefore bear the costs of the bidding process as well as receive less fees than the incumbent in most cases”. Nonetheless, the consensus was that audit fees would increase.

Responding partners are generally neutral (Statement 31; mean = 3.17) towards the statement that ACs would be willing to accept these increased fees in the short term and do not believe they would over the longer term, i.e. after the first year or two (Statement 32; mean = 3.82; p < 0.001). The neutrality of opinion regarding fees in the early years may be because the responding partners believe the ACs will acquiesce to a higher fee to cover the extra work needed to upskill and bridge the knowledge gap, as discussed in section 8.3.2. However, after this period of upskilling to bridge the knowledge gap, the AC would require the fees to be normalised to prior levels.

### Table 8.15: The Impact of MAFR on Audit Fees

<table>
<thead>
<tr>
<th>Statement</th>
<th>Description</th>
<th>Mean</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>37</td>
<td>MAFR will require significant additional investment in time by the financial managers, supervisors and controllers, including other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team.</td>
<td>1.63</td>
<td>*** 1.68</td>
</tr>
<tr>
<td>38</td>
<td>MAFR will cause significant additional cost and time for the group to appoint the same auditor across all group companies as it will require various shareholder approvals and regulatory processes.</td>
<td>1.92</td>
<td>*** 2.17</td>
</tr>
<tr>
<td>74</td>
<td>MAFR will provide a significant additional cost and administrative burden in the wider South African economy.</td>
<td>1.85</td>
<td>*** 2.27</td>
</tr>
<tr>
<td>57</td>
<td>MAFR will require audit partners to devote more time to preparing and participating in tenders for audit appointments.</td>
<td>1.59</td>
<td>*** N/A</td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at ≤ 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

**Source:** All questionnaires (own calculation)
Separating the opinions of the Big Four firm auditors from those of non-Big Four, a disagreement of opinion emerges. Big Four firm partners do not believe that ACs will allow the increased fees in the first few years (Statement 31; mean = 3.43) whereas the non-Big Four partners are more hopeful (mean = 2.8). Both groups agree that fees would not remain permanently higher after this early period. Looking at the findings from the AC chairs, Table 8.15, Statement 30 shows that AC chairs believe fees will increase, but the committee would be unwilling to allow fees to remain higher after the new auditor has “learnt the ropes” in the early years of appointment (Statement 32; mean = 3.82; p < 0.001). Statement 24 in Table 8.17 below also indicates that costs incurred due to MAFR will be passed on to companies in the way of increased audit fees (Auditors mean = 2.49; AC chairs mean = 1.95; p < 0.001).

One partner explained that “the appetite for increased fees needs to be understood by these companies”. Another expressed that “the costs of new client acquisition will be expected to be borne by the firms (and) this will result in a significant decline in profitability for the [audit] firms”. This indicates that there may be increased fee disagreements between the two engaging parties (auditor and AC) in negotiating the terms of the engagement within a system of MAFR. In addition, many of the comments raised by the partners expressed the concern that even though fees should increase as a result of MAFR, the true cost will be borne by the audit firms, and not the companies, to which the fee is a relatively small component of the cost structure.

There is strong consensus among responding partners with the statement that they will have to devote more time to preparing and participating in tenders for audit appointments (Statement 57; mean = 1.59; p < 0.001). The comments raised made it clear that the tender process is onerous and expensive and will add a significant new cost layer to audit firms that will mostly not be recoverable from the client in fee revenue, especially not if the tender is unsuccessful.
“It has already been proven that global tender processes are significant, and the audit fees will not compensate for these investment costs. The time taken by partners involved in the tender process may have a negative impact on audit quality as the firms focus on tendering rather than the incumbent audit.”

Considering the perceptions of the responding AC chairs and CFOs (Table 8.15), both groups believed that audit fees would increase, with the stronger view of such likelihood being held by the CFOs (mean = 1.98; p < 0.001) in comparison to the AC chairs (mean = 2.29; p < 0.001). Again, however, there were mixed views regarding the likelihood that ACs would agree to raised fees, especially in the longer term, i.e. after the incoming audit firm has “learnt the ropes” and gained experience of the client. However, there may be higher fees allowed in the first one to two years of the engagement. Table 8.15 shows that responding fund managers do not believe that audit fees will be impacted by MAFR (Statement 30; mean = 2.71; not significantly different from neutral).

The above discussion clearly shows some mixed findings but it seems reasonable to conclude that there is consensus that audit fees will increase following the implementation of MAFR but that the fee discussions may be difficult as the committee will be reluctant to allow such increases to persist. There may be a willingness to allow the fee increases at first, but only to compensate the new auditor for the considerable additional investment needed to upskill in knowledge of the company’s business. These findings are consistent with the opinions of the leadership of the Big Four firms responding to the IRBA consultation paper (Harber & West, 2017) and the findings of Kwon et al. (2014) and Simnett et al. (2016). The findings do not provide evidence of the potential for low-balling fees, such as described by Cameran et al. (2015), who found evidence that the incoming auditors under MAFR charge less in the first year in order to secure appointment, even though they have abnormally higher engagement hours in the first year. Cameran et al. (2015) found that the audit fees after the first year were abnormally higher and exceed the initial fee discount. However, it is noted that the strategy of low-balling would be unlikely to be admitted by the respondents if that was their intention. Velte and Stiglbauer
(2012) also conclude that MAFR may have the unintended effect of price dumping strategies (low-balling), which in turn will endanger audit quality.

An interpretation of the effect of MAFR on audit fees probably requires an assumption on the competitive structure of the South African audit market for JSE-listed companies. It is clear from the findings of this section that audit firm costs will increase under a system of MAFR (refer below) and therefore if the market is competitively priced, it is reasonable to conclude that audit fees will consequently rise in compensation. ACs will have to accept such fee increases as the competitive pricing of audit tenders will factor in the cost pressures. However, if the audit market is not highly competitive, as suggested by the IRBA and the fact that it is an oligopoly dominated by the Big Four firms, then it is reasonable to conclude that an increase in audit costs will not necessitate an increase in audit fees. ACs will have the bargaining power due to the high profits in the highly concentrated market and audit fee prices will not increase, thereby reducing the profitability of the engagements. Based on the evidence provided in this study it appears that there are not excessive profits in the market. This is reinforced by findings from, and the comments provided by, the non-Big Four firms in particular. Hence, it is submitted that the first interpretation is reasonable, i.e. that the market is competitive, profitability is not excessive, and therefore fees will need to be increased to compensate for the cost pressures.
**Critical summary:**

Responding auditors, AC chairs and CFOs believe that MAFR will result in significantly increased audit fees in the industry. They believe that audit committees will only agree to temporarily increased fees. After the first year or two, the committees will likely demand a fee comparable to that of the previous auditors. This indicates that there may be increased fee disagreements between the two engaging parties.

The degree to which fees increase may depend on the competitiveness of the industry. Based on the evidence provided in this study, especially regarding auditor perceptions of costs analysed in this section, it appears that there are not excessive profits in the market.

*b. Additional costs to the company*

In clear contrast to the opinions of the equity fund managers, all three other groups believe that on a cost-benefit analysis, the additional cost to the company from MAFR will “negatively impact on shareholder value” (Statement 35). Of all statements in the questionnaire, this perhaps best illustrates the high degree of push-back from these stakeholders against firm rotation regulation. The primary reason for MAFR is to maintain audit quality, thereby protecting the investor and ensuring the smooth functioning of capitalist markets. However, responding auditors, AC chairs and CFOs believe it will impair shareholder value. Overall, considering all factors surrounding the MAFR debate in South Africa, 72% of auditor respondents were against its implementation, as were 80% of responding CFOs and 81% of AC chairs. As summarised by one CFO: “This is my single biggest issue in that [MAFR] will add significant cost and distraction for all involved, for no benefit.”

In contrast, representing the investors in South African capital markets, the equity fund managers did not significantly agree nor disagree with Statement 35 (mean = 3.05; not
significantly different from neutral). This indicates that they are unconvinced of the benefits to shareholders relative to the costs imposed on the company from MAFR.

All four participant groups agree that MAFR will result in significant costs to the company in terms of time and resource investment by executive management and ACs (Statement 33; p < 0.01) as well as lower level financial managers, supervisors and controllers (Statement 37; p < 0.001). The added costs to ACs to deal with tender proposals upon rotation of audit firms was agreed to be significant across all stakeholder groups, albeit this sentiment was felt less strongly by the fund managers (Statement 34 p < 0.01). Again, a similar agreement is expressed that the lower level staff in the company who interact with the audit teams more regularly will be impacted due to the less knowledge and experience of the newly appointed audit team. As could be expected, Big Four partners expressed these views more strongly than did the non-Big Four partners, probably due to the bias inherent in their different perceived outcomes of MAFR. Big Four firms are generally believed to lose business to non-Big Four firms from a system of firm rotation. This is certainly the expectation of the IRBA (IRBA, 2016e).

Interestingly, as per Statement 36, fund managers disagreed with the other three groups. Auditors, AC chairs and CFOs feel that MAFR will result in significant distraction to directors and executive management, distracting their ability to run the business. It is important to note that this was also the feeling of the CFOs (mean = 2.18; p < 0.001) who, of the three groups, represent executive management responsible for managing the business on a daily basis. Fund managers are unconvinced, expressing a neutral opinion in this regard.

Dealing with the tender/proposal process will be an important and necessary result of MAFR as forced firm rotation will result in significantly more engagements to be placed for tender to competing firms. Currently in South Africa, periodic audit tendering by the AC is not a legislative requirement nor a corporate governance recommendation, as it is
in some other jurisdictions. As stated above, responding auditors strongly feel that tendering requires significant time investment (Statement 57). Responding AC chairs also believe there will be a significant added cost to as they will be required to deal with tenders to appoint auditors more regularly (Statement 34; mean = 2.29; p < 0.001). This same view was expressed by auditors, CFOs and fund managers. These results are consistent with interviews with Canadian AC members who indicated “that the most significant cost associated with changing auditors is the time and effort involved in the tendering process and in bringing a new auditor up to speed with client- and industry-specific knowledge” (Fontaine et al., 2016:498).

A concern that has been raised by various stakeholders in the South African debate relates to the fact that the exchange-listed companies impacted by MAFR are multinational groups of companies and as such operate companies in various national jurisdictions. The concern is that this reality could complicate the application of MAFR (as discussed in section 8.3.4). Here again we note a difference between the fund managers and the other three groups (Statement 38). Responding auditors were particularly concerned that audit risk and administrative cost would result from having auditors from different firms auditing various group subsidiaries (Statement 38; mean = 1.92 p < 0.001). As per one partner’s comment, the “holding company now has Auditor A at group and Auditor B in South Africa. ISA 600 challenges now exist for Auditor A”. A similar comment was made by AC chairs: “…it does not make economic sense and it is likely to be costly to have different auditors at the Holding Company level accounting for significant associates who are not subject to MAFR” and “[multinational companies] will have tremendous difficulties with different auditing regulations in different countries”. AC chairs (mean = 2.17; p < 0.001), as the party responsible for handling auditor appointment, and especially the CFOs (mean = 1.96 p < 0.001), expressed a similar sentiment with respect to Statement 38. Considering the respective means on the scaling for Statement 38, these perceptions showed strong views in agreement from the three groups, yet equity fund managers are neutral on the issue (mean = 2.9).
Statement 74 required the respondents to consider the wider economic impact of MAFR. Responding auditors (mean = 1.85; p < 0.001) and CFOs (mean = 1.89; p < 0.001) especially, are of the opinion that MAFR will create a significant additional cost and administrative burden on the wider South African economy, again illustrating the overall disagreement with the need for MAFR on a cost-benefit analysis from responding auditors, CFOs and AC chairs.

### Critical summary:

A significant finding is that responding auditors, AC chairs and CFOs strongly believe that MAFR will provide a significant additional cost and administrative burden in the wider South African economy. These respondents also feel that the additional cost to the company from MAFR will not add any incremental benefits, economic or otherwise, and thus negatively impact on shareholder value.

Of the additional cost areas perceived to be incurred by companies, the most significant appears to be the time and resource investment by company staff, such as senior management and audit committees, financial managers, supervisors and other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team. In addition, there are the costs and time required for the group to appoint the same auditor across all group companies as it will require various shareholder approvals and regulatory processes.

### iii. Findings concerning cost implications to the audit firm

#### a. The nature of cost implications

To understand the nature of the potential cost areas that may affect audit firms from MAFR, Statement 23 in Table 8.16 requested audit partners and AC chairs to express their opinions regarding the various cost activities that were identified by the respondents to the IRBA consultations paper, as discussed in Chapter 5. Due to the detailed and
specific nature of the cost activities, it was deemed that only the auditors and AC chairs would be sufficiently informed and experienced to provide opinions. The CFOs and equity fund managers are too far removed from the internal processes of the audit firms.

Table 8.16: The nature of potential costs to the audit firm

<table>
<thead>
<tr>
<th>Activity Description</th>
<th>Audit partners</th>
<th>AC chairs</th>
</tr>
</thead>
<tbody>
<tr>
<td>MAFR will require audit firms to spend significant resources (money, time, staff etc.) around the following activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>23.a Activity: Senior leadership time investment in getting to know the new client.</td>
<td>1.44 ***</td>
<td>1.51 ***</td>
</tr>
<tr>
<td>23.b Activity: Additional meetings both locally and internationally with management.</td>
<td>1.43 ***</td>
<td>1.59 ***</td>
</tr>
<tr>
<td>23.c Activity: Additional time spent on understanding the business and industry.</td>
<td>1.44 ***</td>
<td>1.39 ***</td>
</tr>
<tr>
<td>23.d Activity: Additional industry specialist involvement including technical input.</td>
<td>1.52 ***</td>
<td>1.49 ***</td>
</tr>
<tr>
<td>23.e Activity: Marketing and proposal (tendering) presentation costs.</td>
<td>1.43 ***</td>
<td>1.56 ***</td>
</tr>
<tr>
<td>23.f Activity: National and international travel costs.</td>
<td>1.77 ***</td>
<td>2.05 ***</td>
</tr>
</tbody>
</table>

*, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: Auditor and AC chair questionnaires (own calculation)

Responding auditors and AC chairs strongly agreed (p < 0.001) with the likelihood of costs increasing within the six cost-incurring activities provided (Statements 23.a to 23.f). These findings corroborate the opinions of the CEOs of the Big Four firms in their letters to the IRBA describing the nature of the costs (Bam, 2017; Bourne, 2017; Oddy, 2017; Shango, 2017) and provide useful insight into the nature of cost areas.

Of these various activities, the auditors felt strongly about all identified cost areas, especially costs required to meet with the client and to prepare tenders for appointment:
"Global tender processes are significant, and the audit fees will not compensate for these investment costs. The time taken by partners involved in the tender process may have a negative impact on audit quality as the firms focus on tendering rather than the incumbent audit."

Again, the resources required to complete competitive tenders in terms of money, staff and time are reflected in the findings (Table 8.16 Statement 23.e and Table 8.15 Statement 57), as well as the comments provided by respondents. As expected, the Big Four firms expressed very strong sentiments of cost increases in these six cost-incurring activities, with means closer to 1. However, even non-Big Four firms expressed strong agreement with these statements, indicating broad agreement across audit firm type. The AC chairs expressed the strongest sentiment with respect to additional auditor time spent on understanding the business and industry. This emphasises the primary perceived negative of MAFR – the loss of institutional knowledge and experience gained by the auditor over years of appointment (specific findings discussed in section 8.3.2).

**Critical summary:**
Both responding auditors and AC chairs express strong agreement with the six cost-incurring activities listed (Statements 23.a to 23.f). These findings provide a useful understanding of the nature and extent of the perceived costs to the audit firms, corroborating the opinions of the Big Four firm leadership in their response letters to the IRBA consultation paper.

**b. Additional cost implications for audit firms**

In addition to the six cost-incurring activities outlined in Statements 23.a to 23.f, the following additional relevant aspects of cost implications were explored.
A highly controversial aspect of the MAFR debate revolves around the question of whether smaller, non-Big Four audit firms have the capacity, in terms of staff and other resources, to adequately provide assurance services to larger exchange-listed companies (Harber, 2017a; Harber & West, 2017). The findings here for Statement 25 were discussed in section 8.3.4.

The findings in Table 8.17 clearly indicate a perception by respondents that cost increases to the audit firms will be significant. Responding auditors do not believe that these increases in audit costs from MAFR or potential losses in audit revenues will be offset by opportunities to provide non-audit services, such as tax and advisory services to previous audit clients (Statement 26; mean = 3.35; p < 0.001). In addition, they do not believe that any financial losses incurred by the audit firm will be sufficiently offset by new client appointments (Statement 28; mean = 3.78; p < 0.001). These sentiments add evidence to the conclusion that partners, especially Big Four firm partners, believe that

Table 8.17: Additional cost implications for the audit firm

<table>
<thead>
<tr>
<th></th>
<th>Audit partners</th>
<th>AC chairs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>Mean</td>
</tr>
<tr>
<td>24. Increases in costs will be passed on to companies in the way of increased audit fees.</td>
<td>2.49 ***</td>
<td>1.95 ***</td>
</tr>
<tr>
<td>25. Medium-sized audit firms (non-&quot;big 4&quot;) have the resources (money, time, staff etc.) to provide competitive tender proposals to secure audit appointments.</td>
<td>3.09</td>
<td>3.56 **</td>
</tr>
<tr>
<td>26. Increases in audit costs, or losses in audit revenues to audit firms, caused by MAFR, will be offset by opportunities to provide non-audit services, such as tax and advisory services to previous audit clients.</td>
<td>3.35 ***</td>
<td>3.20</td>
</tr>
<tr>
<td>27. MAFR will result in employment instability and retrenchments (within audit firms) due to loss of clients through rotation.</td>
<td>2.11 ***</td>
<td>2.63 *</td>
</tr>
<tr>
<td>28. Any financial losses incurred by the audit firm due to MAFR will be sufficiently offset by new client appointments.</td>
<td>3.78 ***</td>
<td>3.10</td>
</tr>
<tr>
<td>29. MAFR will result in significant increases in the premiums of audit firm professional indemnity insurance.</td>
<td>2.40 ***</td>
<td>2.56 ***</td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: Auditor and AC chair questionnaires (own calculation)
MAFR will significantly reduce the profitability of the audit industry and make it “a poorer profession”. The auditors believe that MAFR will cause retrenchments and instability in the audit industry as a result (Statement 27; mean = 2.11; p < 0.001). These sentiments were echoed by the AC chairs, albeit to a lesser degree (mean = 2.63; p < 0.05). This may have implications for audit quality and talent retention as there is pressure on salaries and money available for investment in quality control.

“IRBA has put a very simplistic argument around costs by saying when auditors have changed fees have remained the same. The KPI that should be looked at is ‘gross margin’ not revenue. Changes in Europe have seen margins on new audit clients plunge between 80-90%, this will not bode well for the attractiveness of the profession.”

“Significant increases in costs due to marketing and proposal activity, time spent to learn the business and evaluate the financial reporting risks in new clients will not be recovered by from audit clients. They will simply use fee levels to decide on which firm to give the audit to.”

“The costs of new client acquisition will be expected to be borne by the firms. This will result in a significant decline in profitability for the firms… the unintended consequence of MAFR will be the destruction of the profession on commercial grounds.”

Both the responding AC chairs and the auditors believe that professional indemnity insurance will become more expensive due to the added risk to the audit from having newly appointed auditors (Statement 29; mean = 2.56 and 2.40 respectively; p < 0.001). Again, this shows that these stakeholders believe that the loss of client knowledge and experience as a result of MAFR adds to audit risk and may lower audit quality.
iv. Findings quantifying fee implications to auditor and company

As shown in Table 8.18, an attempt has been made to quantify the perceived cost implications of MAFR in the following categories:

- [Audit firm cost]: costs incurred to tender/propose for a listed company (Questions 76 to 78)
- [Audit firm cost]: set-up and transitional costs (Questions 79 and 80)
- [Client cost]: additional once-off 'on-boarding' cost (Question 81)
- [Client cost]: the average percentage (%) increase in ongoing costs to the company that will likely be introduced by the adoption of MAF (Question 83)

Question 75, which represents an attempt at quantifying the Rand value of the audit fee payable for exchange-listed companies, shows the average audit fee to be between 0.49% and 0.89% of company revenues. The CFOs and AC chairs disclosed it as 0.51% and 0.49% respectively. As a Rand value, the average was disclosed as R28.95 million and R35.28 million by the AC chairs and CFOs respectively. This information could be useful for further research considering that audit fee disclosure in the annual financial statements is no longer a legislative requirement in South Africa. If it is disclosed, it usually includes fees payable to the audit firm for both assurance and non-assurance services. For the purposes of this study, it serves to illustrate the quantitative significance of the audit fee payable by the largest companies on the JSE (top 100), and hence illustrates the cost to the company and the revenue to the firms. It is submitted that although the audit fee may be a small operating cost to the company relative to other operating costs such as employee costs or inventory procurement, it is nonetheless large. In addition, it is likely that these fees receivable are significant to the audit firms, even though they are mostly Big Four firms with a diversified client base, spread across assurance and non-assurance business divisions.
Table 8.18: Quantifying perceived effects of MAFR

<table>
<thead>
<tr>
<th>Question</th>
<th>Field</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>75.</td>
<td>Percentage (%)</td>
<td>0.00</td>
<td>3.51</td>
<td>0.89</td>
</tr>
<tr>
<td>76.</td>
<td>Percentage (%)</td>
<td>0.00</td>
<td>151.00</td>
<td>42.35</td>
</tr>
<tr>
<td>77.</td>
<td>Rand (R'000s)</td>
<td>0.00</td>
<td>5000.00</td>
<td>1736.13</td>
</tr>
<tr>
<td>78.</td>
<td>Rand (R'000s)</td>
<td>28.00</td>
<td>4059.00</td>
<td>838.47</td>
</tr>
<tr>
<td>79.</td>
<td>Percentage (%)</td>
<td>0.00</td>
<td>251.00</td>
<td>63.63</td>
</tr>
<tr>
<td>80.</td>
<td>Percentage (%)</td>
<td>9.00</td>
<td>201.00</td>
<td>51.76</td>
</tr>
<tr>
<td>81.</td>
<td>Percentage (%)</td>
<td>0.00</td>
<td>432.00</td>
<td>53.22</td>
</tr>
</tbody>
</table>

Source: Auditor, AC chair and CFO questionnaires (own calculation)
MAFR will naturally result in many more audits being placed for tender as firms are forced to rotate off the client and in turn need to replace these clients with new appointments. The cost of submitting a tender proposal has been argued to be high and an unmanageable concomitant of MAFR regulation – refer to discussion surrounding Statements 23e and 34 above. In particular, the unsuccessful firms will not have the resultant audit fee revenue to offset the cost of the tender process (Fontaine et al. 2016; Harber, 2017; Harber & West, 2017). According to the partners surveyed, the anticipated costs to be incurred in a tender proposal for an exchange-listed company were considered to amount to 42.35% (average) of the first year of appointment’s audit fee (Question 76). As per Chapter 5, South African CEOs and senior leadership of the Big Four audit firms, in their letters to the IRBA regarding MAFR, estimated the tender costs to amount to 30% of the audit fee (Bam, 2017) or in the region of 10% to 30% (Oddy, 2017). The results of this study surveying a broader base of auditors (Table 8.18) indicate that the costs may be higher than these estimates. It should be noted that South African audit partners should currently be experienced in producing audit tenders as this is a normal part of the business of obtaining (and retaining) clients when the audit is placed out for tender by the AC.

Considering set-up and transitional costs incurred for a listed company (Questions 79 and 80), the responding partners estimated that these costs amount to an average of 64% for a top 100 JSE-listed company and 52% for the remaining companies. In the literature Chapter 5, Shango (2017) estimated set-up and transitional costs to be more than the first year’s audit fee. Bam (2017) estimated it between 30-50% and Oddy (2017) 40-70%. Separating the estimates provided by Big Four and non-Big Four responding partners, it is clear that the smaller firm partners believe these costs to be considerably less that the larger firm partners. The non-Big Four partners estimate set-up and transitional costs of 50% for top 100 companies (Big Four estimate 74%) and 39% for others (Big Four estimate 60%). Considering that so few non-Big Four firms audit JSE-listed companies (4% according to the IRBA), this difference may be due to the lack of experience by smaller firm partners in producing competitive tenders for large company audit engagements.
Regarding the potential for a once-off ‘on-boarding’ fee payable by the company to the new audit firm in the first year of appointment (Question 81), the average fee was 53% of the annual audit fee. However, 30% of responding partners chose 0%, meaning they did not believe that the company would pay such a fee at all. Of these audit partners that selected 0%, the majority were from non-Big Four firms. This indicates that despite some mixed opinions, audit partners are of the opinion that such a cost exists and will be charged to the client.

Finally, the CFOs and the AC chairs were asked to estimate the average percentage (of the annual audit fee) increase in ongoing costs to the company that will likely be introduced by the adoption of MAFR. The average was 45% and 41% respectively. This refers to the estimated cost borne by the company, outside of the audit fee, from any cost-bearing implications of MAFR to the company. Based on the above evidence and the comments raised by the responding CFOs and AC chairs in the questionnaire, this mostly relates to perceived inefficiencies produced, additional investment in staff time and the additional need to place the audit for tender by the AC.

The following CFO comments reflect these sentiments:

“I am not too concerned about the audit costs but rather the investment in time by management required with a new audit firm.”

“We believe that MAFR will result in significant additional costs… This rotation would require companies to incur additional direct costs through higher audit fees as well as through extensive management time in assisting the new audit firms in gaining an understanding of the entity. These costs are compounded across a multinational and are also more complicated within a regulated group that operates (in) various jurisdictions...
(Our company)’s rotation of auditors in 2014 resulted in significantly higher costs and time taken by senior management to evaluate and appoint the new audit firm. The auditor transition plan was highly intense and again required time and effort from the global operations to explain the business, the drivers, risks and opportunities… The cost of learning and understanding the client's business was borne by the incoming audit firm.”

However, comments from the AC chairs expressed hesitation in trying to quantify the direct and indirect costs to the company from MAFR, owing to the perceived uncertainty in this regard. Some AC chairs expressed that “MAFR is unlikely to cost companies more” from fee increases, but the true additional cost comes in the “impact {that will be} more on time allocated by the Company and AC” and the likelihood of MAFR to “increase the risk of audit failure. The cost thereof is hard to quantify”.

Critical summary:

Responding auditors do not believe that the increases in audit costs from MAFR or potential losses in audit revenues will be offset by opportunities to provide non-audit services nor will they be sufficiently offset by new client appointments. Considering the findings of Statements 23.a to 23.f, together with those of Table 8.17, audit partners, especially Big Four firm partners, perceive that MAFR will significantly reduce the profitability of the audit industry and make it ‘a poorer profession’. This may have implications for audit quality and talent retention, as there is pressure on salaries and money available for investment in quality control.

Useful and insightful cost estimates have been provided by participants concerning audit fees payable, tendering costs, set-up and transitional costs, potential once-off ‘on-boarding’ costs and client ongoing costs from the adoption of MAFR. These findings provide a useful understanding of the nature and extent of the perceived costs, corroborating the opinions provided by the Big Four firm leadership in their response letters to the IRBA consultation paper, especially regarding the existence of set-up/transitional costs to the audit firms.
v. Summary analysis: Perceived cost implications

Contrary to the opinions of the equity fund managers, the other three groups believe strongly that on a cost-benefit analysis, the additional cost to the company from MAFR will “negatively impact on shareholder value”. As representatives of the investing public, fund managers appear undecided, expressing a statistically neutral view. Of all statements in the questionnaire, this perhaps best illustrates the high degree of pushback from these stakeholders against firm rotation regulation and provides evidence against the success of MAFR being to the benefit of the investing public. When asked to consider the wider economic impact of MAFR, auditors, AC chairs and CFOs are of the opinion that MAFR will result in a significant additional cost and administrative burden on the wider South African economy, again illustrating the overall disagreement with the need for MAFR on a cost-benefit analysis. These findings are consistent with interviews of Canadian AC members by Fontaine et al. (2016), Big Four firm leadership letters sent to the IRBA (Harber & West, 2017) and other stakeholders (Ewelt-Knauer et al., 2013).

Useful and insightful information has been provided by respondents on the potential nature and extent of cost activities impacted by MAFR. There is widespread concern regarding the imposition of significant layers of costs on audit firms and companies. The nature of these costs has been further explored in this study, providing greater insight into the debate. Auditors are particularly concerned with the time and resources required to prepare and participate in tenders for audit appointments. CFOs and AC chairs are particularly concerned with costs to the company in terms of time and resource investment by executive management and ACs, especially the lower level financial managers, supervisors and controllers who will need to spend time with the less experienced incoming audit team. An attempt was made to quantify the potential cost implications to the audit firm and the company, including tender costs, set-up and transitional costs as well as a potential once-off ‘on-boarding’ fee payable by the company.
An objective of the IRBA with respect to MAFR is to promote competition in the audit industry and allow the non-Big Four firms the opportunity to compete for the audits of larger companies. However, the findings show that AC chairs express significant reservations as to whether non-Big Four firms have the resources to provide competitive tender proposals for large exchange-listed multinational companies. As may have been expected, the Big Four firms do not believe that the smaller firms have the resources to provide adequate tender proposals whereas the non-Big Four firm partners believe that they do.

Considering that the IRBA believes non-Big Four firms stand to gain clients from the implementation of MAFR, it is interesting to note that non-Big Four firm partners expressed similar perceptions to those of Big Four firms regarding the cost implications of MAFR, albeit with less conviction. It is therefore appropriate to conclude that responding partners believe that MAFR will introduce multiple layers of additional costs to the firms and that these costs will not be fully recoverable from companies in terms of increased fees. There is a perception amongst auditors, CFOs and AC chairs that MAFR will produce a less profitable audit industry and it is unlikely that any increase in audit fees will be allowed to persist after the first year or two of the new engagement. There may be a willingness to allow the fee increases at first, but only to compensate the new auditor for the considerable additional investment needed to upskill in knowledge of the company’s business. These three participant groups clearly believe that the added costs to both the profession and the companies involved are unnecessary. It was clear from the comments that many of the responding auditors considered these cost implications to be detrimental to the sustainability of the profession and ultimately to audit quality.

The findings may have implications for audit quality and talent retention in the audit industry. A profitable industry is perceived as necessary to allow the audit firms to offer competitive salaries to retain talented accountants in public practice as well as to allow investment in transformation initiatives and quality control. If the audit industry is indeed
to become marginally profitable as a result of MAFR, as the evidence suggests, this poses a threat to audit quality and transformation and needs to be addressed.

8.4.3 Perceived impact of MAFR on exercising professional judgement

i. Objective of section
The objective of this section of the questionnaires was to understand the views of all four participant groups with respect to the impact of MAFR on the use of professional judgement by responsible parties within the audit function. As discussed in the literature review (particularly Chapter 4 and Chapter 5, Sections 5.5, 5.6 and 5.8), current corporate governance regulations and principles state that the shareholders are ultimately responsible for appointing the audit firm, under the judgement and guidance of the AC, which should comprise independent non-executive directors. In addition, a further control to ensure auditor independence is the self-assessment performed by the auditor, as a matter of professional and ethical judgement, guided by the IRBA and the IFAC codes of professional conduct. From the interviews with South African audit partners by Harber and McGregor (2017) and Canadian AC members by Fontaine et al. (2016), there is a concern by some that MAFR will inhibit (some believe even negate) the exercise of professional judgement by parties to assess auditor independence. This section therefore refers to hypothesis H11.

ii. Findings concerning the impact of MAFR on exercising professional judgement
MAFR has been perceived as a threat by various stakeholders to the shareholder-granted authority for ACs to assess the independence of the auditor and to make audit firm appointment decisions (Fontaine et al., 2016; Harber & McGregor, 2017; Ramon, 2016). Studies have shown some evidence that AC members, company management as well as auditors believe that the professional judgement of the auditor and the AC is the most effective means of ensuring auditor independence (Fontaine et al., 2016; Harber, 2016;
Harber & West, 2017). MAFR was viewed as an unnecessary intervention that infringed on their ability to apply their judgement on the independence and appropriateness of the auditor. Canadian AC members perceived MAFR as a threat to their shareholder-granted autonomy and authority, stating that their own judgment and observations were the most effective means of ensuring auditor independence and objectivity (Fontaine et al., 2016). Fontaine et al. (2016) explained these results as an application of self-determination theory.

Research in a South African context by Marx (2009a:i) found that

...audit committees are well established, properly constituted, have the authority and resources to effectively discharge their responsibilities and consist of members who act independently and who have the right mix of appropriate experience, financial literacy and financial expertise amongst their members. The audit committee’s role was found to be generally well understood and supported by the board and the Chief Financial Officers.

If this is the case, some argue, then MAFR regulation is unnecessary to ensure auditor independence. However, other research, not in a South African context, indicates that ACs are not always suitably independent and do sometimes acquiesce to management preferences regarding financial reporting issues raised by the auditors (Cohen et al. 2010; Owens-Jackson, Robinson & Shelton, 2009).

According to Shango from PWC Inc. (2017), “MAFR reduces the audit committee’s ability to fully discharge its oversight responsibilities and in turn disenfranchises shareholders’ ability to obtain the highest quality audit in the most efficient way” (Shango, 2017:4). According to the KPMG Inc. Head of Audit in South Africa, Oddy (2017), MAFR would undermine the AC’s ability to choose the best auditor for the job and determine whether a change in auditor, as well as the associated timing of this decision, is in the best interest of the company and its stakeholders. In addition, MAFR was believed by Oddy (2017) to remove an important mechanism, indicating issues at a company and therefore conceal problems between a company and its auditor.
Table 8.19: Perspectives on exercising professional judgement

An analysis of the results in Table 8.19 indicates that, as may be expected, all four participant groups strongly agree that the active assessment of auditor independence through exercising professional judgement is an important responsibility of the audit firm, the engagement partner and the AC (Statements 67 and 68; means < 2; p < 0.001). The findings show similar consensus with respect to the AC’s consideration of the best audit firm to provide the company with a high-quality audit (Statement 69). These findings would be expected considering the regulations, statutes, ethical codes and corporate governance principles applicable to these parties in the audit engagement. However, despite this strong agreement, it is important to note that all four participant groups strongly disagree that MAFR will reduce the need for auditors to apply their minds regarding auditor independence (Statement 70; means ≥ 3.71; p < 0.001). Similarly, there is consensus that MAFR will not reduce the need for ACs to apply their minds concerning the independence and suitability of the audit firm and the individual audit partner (Statement 71; means ≥ 3.81; p < 0.001). The comments provided by respondents reflect these findings:

Table 8.19: Perspectives on exercising professional judgement

<table>
<thead>
<tr>
<th>Statement</th>
<th>Audit partners Mean</th>
<th>Audit committee chairs Mean</th>
<th>Chief financial officers Mean</th>
<th>Equity fund managers Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit firm and individual audit partner.</td>
<td>1.23 ***</td>
<td>1.41 ***</td>
<td>1.38 ***</td>
<td>1.52 ***</td>
</tr>
<tr>
<td>The consideration as to which audit firm is best able to provide the company with a high-quality audit, is a fundamentally important responsibility of the audit committee.</td>
<td>1.36 ***</td>
<td>1.20 ***</td>
<td>1.32 ***</td>
<td>1.57 ***</td>
</tr>
<tr>
<td>MAFR will reduce the need for auditors to apply their minds in regard to the independence of the audit firm and the individual audit partner.</td>
<td>4.13 ***</td>
<td>4.05 ***</td>
<td>3.93 ***</td>
<td>3.71 ***</td>
</tr>
<tr>
<td>MAFR will reduce the need for audit committees to apply their minds in regard to the independence and suitability of the audit firm and the individual audit partner.</td>
<td>4.09 ***</td>
<td>4.37 ***</td>
<td>4.05 ***</td>
<td>3.81 ***</td>
</tr>
<tr>
<td>MAFR will interfere with, and/or restrict, the ability of the audit committee to decide the appropriate time to replace the auditor, or place the audit out for tender to the market, considering the company's specific context and circumstances.</td>
<td>2.08 ***</td>
<td>2.66 **</td>
<td>2.27 ***</td>
<td>2.95 ***</td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)
“I don’t believe MAFR will reduce the need for auditors or audit committees to apply their minds, which I see as a professional imperative. It will, however, reduce the scope of choice available, once minds have been applied.”

This provides evidence contrary to the AC and audit partner opinions expressed in the interviews conducted by Fontaine et al. (2016) and Harber and McGregor (2017) respectively. The respondents in this study believe that the auditors and ACs will continue to exercise the same degree of vigilance and judgement in assessing independence threats, despite the mandatory rotation of the firm every ten years. From the comments provided, it is clear that the reason for this view among all participant groups is the expectation that the auditor and the AC will commit themselves to their professional responsibility to assess independence and threats to independence, despite MAFR regulations or any impending rotation. As explained by one AC chair:

“If an audit committee is unable to assess the independence and capabilities of their auditors, they should resign as members. My experience is that audit committee members of JSE Listing Companies are qualified professional persons capable of asking the right questions and forming their own opinions with regard to their auditors. I cannot see how MAFR is going to change this decision-making process. To question the capabilities of the members of audit committees to make decisions in this regard is a slight on their integrity and questions to proper governance.”

The findings from Statement 72 do indicate that the responding auditors and responding CFOs are concerned that MAFR will interfere with the ability of the AC to decide the appropriate time to replace the auditor or place the audit out for tender to the market, considering the company's specific context and circumstances. AC chairs and fund managers express a neutral view in this regard. In the words of one audit partner, “the concept of MAFR is an insult to these individuals as it suggests that they are not in a position to determine when it is appropriate to consider a change in auditors”. 
A review of the comments from respondents indicates that this is where the greatest concern lies. As indicated by the findings from Statement 70, the concern is not about the application of professional judgement over auditor independence. The concern is with the suitability of the auditor and audit rotation, given the specific events and circumstances in which the company may find itself when rotation is required by MAFR regulation. The company may be undergoing a merger or acquisition, for example, and this is when the experience of the incumbent audit firm is most required – but this may be when rotation is forced on the AC. This reality of MAFR may place strain on the company management, the AC and even introduce additional audit risk for the incoming auditor as they need to deal with the unusual set of circumstances that may occur upon rotation, such as a merger or acquisition. This view was confirmed by respondents who commented:

“The audit committee is rendered useless in the face of major corporate action, acquisitions, key change of finance personnel. In a particular instance of a 5-year audit period by an audit partner on a major multinational listed audit client, the CFO position changed three times and CEO position changed once in that period. Forcing an audit firm change in that period as well would have been challenging.”

“If there are planned mergers and and/or acquisitions about to take place in a year where rotation is about to happen changing auditors could be detrimental to achieve the deadlines and the costs associated with the transaction due to the need to access information from 2 firms.”
iii. Summary analysis: Exercising professional judgement

The findings reflect consensus that the professional judgement roles of the audit firm, audit partner and AC are vital to safeguarding audit independence and that MAFR is not likely to negatively impact this application of judgement. This does imply that the respondents place a high regard on the level of professionalism and competence of the parties involved, especially that of the audit committee. This is consistent with the findings of Marx (2009a) and contrary to the views of the leadership of the Big Four audit firms in their responses to the IRBA consultation paper (Harber & McGregor, 2017; Harber & West, 2017).

Responding auditors and CFOs believe that there could be an adverse impact of MAFR in circumstances when the company is experiencing a significant transaction or set of events, during which the experience of the outgoing audit firm would be most needed. During times of important financial events such mergers or acquisitions, the audit risk due to the complexity of the transactions may best be audited by the more experienced audit firm which has a more intimate knowledge of the client’s business. This is important not only for the quality of the audit of these transactions, but also for the value-added services.

Critical summary:

Respondents do not believe that MAFR will reduce the need for auditors to apply their minds in regard to the independence of the audit firm and the individual audit partner. This is primarily due to the high regard for the professionalism of the parties involved, especially that of the audit committee.

However, responding auditors and responding CFOs are concerned that MAFR will interfere with the ability of the audit committee to decide the appropriate time to replace the auditor or place the audit out for tender to the market, considering the specific events and circumstances which the company may find itself in when rotation is required by MAFR regulation. This may place strain on the company management and audit committee as well as increase audit risk.
and non-assurance advisory services provided by the audit firm in such times. MAFR due to its prescribed timelines for rotation, would force the audit firm to rotate just when they are most needed from and advisory and audit risk perspective.

Fontaine et al. (2016) found that Canadian AC members perceived MAFR as a threat to their shareholder-granted autonomy and authority, stating that their own judgment and observations were the most effective means of ensuring auditor independence and objectivity. Fontaine et al. (2016) explained these results as the application of self-determination theory. The evidence from Table 8.19 above, analysed together with Table 8.20 below, supports the findings of Fontaine et al. (2016).

8.5 RESPONDENTS’ OVERALL POSITION ON MAFR

i. Objective of section

This section analyses the overall positions of each participant group on a cost-benefit, ‘all things considered’ basis, with respect to MAFR in South Africa. Firstly, an analysis of the findings for preferable alternatives to MAFR are presented and discussed. This is followed by an analysis of perspectives of MAFR in South Africa on an overall cost-benefit basis. Finally, respondents were asked to provide their views on the appropriate rotation and cooling-off periods for MAFR, on the understanding that the MAFR ruling has been enacted by the IRBA but could be amended before the implementation date in April 2023. This section thereby provides a macro-view of participant views on MAFR in South Africa. These views were elicited from respondents at the end of the questionnaires, as it was deemed to be the most appropriate position in the questionnaires to capture respondents’ overall positions, with each respondent having considered all the aspects of the MAFR debate.
ii. Perceived alternatives to MAFR in South Africa

Many of the audit industry stakeholders have provided what they believe are superior alternatives to MAFR in South Africa, claiming that these alternatives will result in less unintended negative consequences for the industry and provide a better cost-benefit trade-off (Harber & West, 2017). This section therefore elicits views on these possible alternatives to address concerns of impaired auditor independence and audit quality. As such, the following hypothesis is tested:

**H12**: Stakeholders perceive that, in addition to the current measures in place, there are better solutions than MAFR to address the concerns raised by the IRBA.

Table 8.20 presents the findings for each participant group when asked to show their degree of preference for select alternatives to MAFR. These alternatives were determined by reference to the professional debate as discussed in Chapter 5 and a review of the existing regulations and standards that govern auditor independence in South Africa, including international standards such as the IFAC auditing standards (ISAs and ISQC 1) and the IFAC Code of Ethics for Professional Accountants (IFAC code). All of these alternatives were recommended to the IRBA in some form by industry stakeholders in response to their consultation paper issued in October 2016 (Harber & West, 2017). Respondents were requested to indicate their opinion on the provided alternatives, considered in combination, not in isolation, as being preferable to MAFR. The opportunity to provide written comments provided the avenue for respondents to suggest further alternatives not explicitly mentioned in the questionnaire.

---

**Note**: The critical links to the empirical study, which comprise the linkage of the literature to the theoretical models, hypotheses and questionnaires are described in Chapter 7 Section 7.4 as well as Annexure 4 and Annexure 5.
As is clear from the findings above concerning alternatives to MAFR (Statements 73.a to 73.g), all respondents particularly favour the following alternatives (low mean values), considered in combination rather than in isolation:

- Continued development and enforcement of the auditors’ Code of Professional Conduct (Statement 73.c);
- Continued development of effective and independent Engagement Quality Control Review (EQCR) within the audit firms (Statement 73.e);
- Stronger AC oversight of auditors (Statement 73.f); and
- Improved disclosure of how the company has assessed the quality and independence of the audit firm, as well as how the auditors themselves have ensured that they are independent, and will remain independent, in the year ahead (Statement 73.g).

### Table 8.20: Perspectives on preferable alternatives

<table>
<thead>
<tr>
<th>Statement</th>
<th>Audit partners</th>
<th>Audit committee chairs</th>
<th>Chief financial officers</th>
<th>Equity fund managers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>Mean</td>
<td>Mean</td>
<td>Mean</td>
<td>Mean</td>
</tr>
<tr>
<td>73.a</td>
<td>2.66 **</td>
<td>2.78</td>
<td>2.72</td>
<td>2.67</td>
</tr>
<tr>
<td>73.b</td>
<td>3.43 **</td>
<td>4.05 ***</td>
<td>3.83 ***</td>
<td>2.90</td>
</tr>
<tr>
<td>73.c</td>
<td>1.79 ***</td>
<td>1.90 ***</td>
<td>1.78 ***</td>
<td>2.43 *</td>
</tr>
<tr>
<td>73.d</td>
<td>2.29 ***</td>
<td>2.15 ***</td>
<td>1.93 ***</td>
<td>2.62</td>
</tr>
<tr>
<td>73.e</td>
<td>1.75 ***</td>
<td>1.76 ***</td>
<td>1.76 ***</td>
<td>2.52 **</td>
</tr>
<tr>
<td>73.f</td>
<td>1.85 ***</td>
<td>2.02 ***</td>
<td>2.24 ***</td>
<td>2.38 **</td>
</tr>
<tr>
<td>73.g</td>
<td>1.90 ***</td>
<td>2.22 ***</td>
<td>1.94 ***</td>
<td>2.19 ***</td>
</tr>
</tbody>
</table>

* *, **, *** Denote significance at < or = 0.05, 0.01 and 0.001 levels, respectively (two-tailed).

Source: All questionnaires (own calculation)
Auditors, AC chairs and CFOs were also in favour of the further development of robust Independent Regulatory Oversight, such as continued investment in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms (Statement 73.d). The means for these three participant groups were low, often lower than 2, indicating very strong agreement with these alternatives to MAFR, considered in combination with each other. These findings are useful in informing the IRBA and the profession to strengthen and adapt existing measures, regardless of whether MAFR is adopted, as these measures and MAFR are not mutually exclusive.

The comments show that respondents felt that “these suggestions [of alternatives] will provide the investment community with greater assurance at less cost than the MAFR alternative”. Interestingly, none of the participant groups favour a system of joint audits as a solution to concerns over auditor independence (Statement 73.b). Auditors, AC chairs and CFOs express particular push-back against this option, most likely due to the perceived cost and inefficiencies believed to result from joint audits, including the likelihood of duplication of work and communication difficulties across firms (derived from a review of comments provided). Many South African audit firms have experience with conducting joint audits as this system is required in the audits of banks and has been employed in audits of state-owned entities, usually as a means of transitioning from the appointment of a large audit firm to a medium-sized audit firm. Responding auditors express some appreciation for mandatory tendering regulations, with neutral views expressed in this regard by other responding groups (Statement 73.a).

“My personal experience of joint audits is that they massively undermine audit quality. Accountability is diluted, audit committees are blindsided, costs increase and none of this increase is productive.”
“The costs of joint audits for a non-financial institution is expensive as well as the fact that this will reduce the number of the remaining audit firms available for certain non-audit services.”

Considering the overall positions of the participant groups in the next section, it is recommended that the IRBA consider these findings as possible alternatives to MAFR. Although the respondents were asked to indicate their preferences in Statements 73.a to 73.g “considered in combination, not in isolation, as being preferable to MAFR”, perhaps these findings could be considered by the IRBA for the purpose of improving controls over audit quality in addition to MAFR. The findings indicate that the four participant groups particularly favour efforts to further develop professional codes of conduct as well as continued development of effective and independent Engagement Quality Control Review (EQCR) within the audit firms (Statements 73.c and 73.e). These findings provide evidence that these additional controls over auditor independence are in constant need of monitoring and refinement. This perspective is reinforced by the understanding that most of these alternatives require key audit industry participants to apply professional judgement, integrity and due care in their respective roles, whether it be the AC, the engagement partner, the audit firm quality control partner, the standard-setting body or the IRBA inspectorate. MAFR is a ruling that requires compliance with little professional judgement in its execution, as opposed to these other suggested alternatives.

“The audit firms should develop robust policies to ensure the independence, these policies and their application should then be subject to independent regulatory oversight.”

iii. Overall position on MAFR in South Africa

The beginning of each questionnaire asked the respondent a simple question regarding their overall position with regards to the IRBA ruling, requiring a yes/no/maybe response (Figure 8.4). At the end of each questionnaire, having responded to the many aspects of the MAFR debate, each respondent was again asked their overall position, this time
considering all factors on a cost-benefit analysis basis, with only a yes/no response available (Figure 8.5). As the last question forced a ‘yes’ or ‘no’ answer, without allowing a ‘maybe’ response, it required each respondent to choose a final position on the matter, having considered all the aspects of the debate and their corresponding responses in the questionnaire.

Figure 8.4: Overall position at beginning of questionnaire

Source: All questionnaires (own calculation)
Important to note from Figures 8.4 and 8.5 is that the responding auditors, AC chairs and CFOs are considerably against the adoption of MAFR in South Africa. There are mixed findings from the equity fund managers, with an almost 50-50 split, in slight favour of the anti-MAFR position. This split from the fund managers is consistent with the detailed findings from the questionnaire, as analysed in this chapter, which often showed neutral sentiments, with results around the neutral 3 score, as opposed to statistically significant agreement or disagreement. This result from the fund managers could be interpreted as being due to the reality that this participant group is further removed from the audit engagement and represents the stakeholder group, namely, shareholders or the investing public, who are likely to have differing views from those closer to the audit engagement.

As discussed in section 8.3.1 the equity fund managers, as an important sub-set of the investing public, and outsiders to the auditor-client relationship, can be understood as providing a deeper insight into the ‘independence in appearance’ argument for MAFR.
Findings in Table 8.4 showed that the fund managers do not significantly agree nor disagree that the investing public tend to believe that there is a significant degree of bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistle-blower (Statement 18). Findings in Table 8.2 (Statement 2) and Table 8.3 (Statement 17) concerning fund managers also do not provide significant evidence in favour of MAFR. These results, taken together with the almost 50-50 split in Figure 8.5, allow the conclusion that the fund managers are undecided as a collective whether MAFR will achieve its primary goal of improving auditor independence and audit quality or whether it is needed as a tool to address concerns with perceived independence. This conclusion is significant considering that protection of the ‘investing public’ is the primary goal of the IRBA.

The number of responding AC chairs and audit partners in favour of MAFR remained relatively constant from the beginning of the questionnaire to the end. However, the proportion of CFOs and fund managers in favour increased after having completed the questionnaire and being forced to choose a ‘yes’ or ‘no’ response.

Figure 8.5 shows that 91.1% of responding auditors are against MAFR as proposed by the IRBA. When the findings for the non-Big Four firm partners are looked at independently, it shows that 87% are against MAFR. This is significant considering the IRBA believe that MAFR will benefit non-Big Four firms, allowing them to compete for, and secure, appointment by exchange-listed companies. The findings in this study have shown numerous reasons why non-Big Four firms do not believe that MAFR is necessary nor effective.

An analysis of the final, overall comments made by respondents at the end of the questionnaire illustrates the considerable push-back against MAFR. This is consistent with the findings in Figures 8.4 and 8.5. The audit partners especially criticised the poor reasoning and lack of evidence provided by the IRBA in favour of MAFR and highlighted
that they believed MAFR was being implemented for transformation grounds rather than to legitimately improve audit quality. Hence, many respondents believed that the IRBA’s intentions for MAFR were driven by political objectives surrounding transformation of the audit industry, rather than for purposes of improving audit quality. Comments also identified the recent trend of regulators internationally to either decide against MAFR or to repeal it once implemented (refer to Chapter 6), and as such South Africa should heed the reasons given for such decisions. The comments from the auditors, AC chairs and CFOs reflect their disagreement with the fundamental idea of the IRBA that MAFR is needed, or that it will be effective, in improving audit quality. The comments from the equity fund managers were more mixed, which is consistent with the collective findings of this study.

The following is a selection of representative concluding comments made by the respondents at the end of the questionnaire when requested for final comment:

From audit partners:

• “The important part of this question is whether it is ‘...appropriate for South Africa?’ It may be appropriate in some jurisdictions of the world but for South Africa it will not contribute to improved audit quality. In fact, it will have the opposite effect.”

• “I don’t believe it will achieve the transformation results they want to achieve albeit that MAFR is camouflaged as an attempt to increase auditor independence.”

• “MAFR is political.”

• “South Africa should not be the leader in the world for regulations on the auditing profession. The SA economy needs to grow and be encouraged to grow. The over regulation of the listed sector and the audit profession is hampering growth.”

• “There is no success in other jurisdictions to speak about to motivate why it must be implemented in SA on an urgent basis. There are many examples or reversals
of MAFR to speak of. Hence, the jury is out as to how MAFR achieves the desired outcomes of the regulator.”

- “The objective is to enhance transformation of the profession and the concentration of work to move away from the Big Four and I do not believe that this will be achieved.”

- “But MAFR will do untold damage to the registered auditing profession, retard transformation and make no contribution to improved audit quality.”

From AC chairs:

- “Are we really clear on what we aim to achieve on MFAR? Firms, especially the Big Four and medium size firms, have 10 years to build a significant relationship with management with the intention of performing consulting work with the company after MFAR. This indeed is the greater threat to independence.”

- “MAFR as conceived by IRBA will not improve independence (real or perceived) but will cause unwarranted and costly disruptions to companies and firms.”

- “Unfortunately, independence was used in an effort to push transformation. They should not be related. Even if firms don’t rotate every effort must be made to train more and more Black CAs.”

- “IRBA’s dishonesty in relation to MAFR has undermined its integrity, as well as the reputation of a profession build on honesty and transparency. Let’s scrap MAFR and focus on transformation of the profession, particularly of the big firms.”

- “I think MAFR was influenced to some extent by a desire to promote black audit firms.”

- “I believe the agenda for MAFR was not based on auditor independence but rather had its roots in transformation. This was suddenly taken off the table and the focus was on independence. However, as soon as the President mentioned ‘Radical Economic Transformation’, within 48 hours IRBA sought the opportunity to appear before the Presidential committee to pursue the Transformation agenda.”
From CFOs:

- “It’s a huge disruption that will cost more in many ways than just the measurable Rand cost with none of the said benefits really.”

- “There is no evidence that the introduction of MAFR will bring any significant positive change to auditor independence and auditor quality. This is supported by the lack of evidence to support the positive benefits of MAFR in other jurisdictions. However, it is likely to reduce audit quality, at least initially, and increase costs substantially.”

- “This mandatory rotation and the associated costs (both audit firm and client) destroys shareholder value without providing any discernible benefits. In SA, we have various safeguards around auditor independence and I believe that these, together with the recent changes for audit committees to disclosure additional information around auditor independence, to be adequate. Furthermore, in SA, shareholders that are not satisfied with the independence of auditors can vote against this. Lastly, this responsibility of ensuring auditor independence rests with the audit committee and introducing MAFR, removes this important responsibility to some extent from them and curtails their ability to do what is best for the company.”

- “Unfortunately, this debate should never have reached this point. It is common knowledge that the real reason for putting forward MAFR is transformation… Transformation has to take place, however, attempts to effect this by using MAFR as a foil, are, in my view completely misguided.”

- “As raised earlier address transformation as a separate issue. Do not confuse it with audit firm rotation.”

- “Rather spend time and effort on developing the profession than trying to regulate the industry. Spend more time on the review of audit files for potential misconduct and unacceptable behaviour. Trust the audit committee members to make the best decision on behalf of the shareholders.”
From equity fund managers:

- “There’s clearly a need to transform the audit profession (amongst others), however the MAFR seems a blunt tool in achieving this goal and has wider unintended costs and consequences. There is a need to address the oligopolistic nature of the bulk of auditing business as well however, the question that is still unanswered is whether MAFR will do enough address these.”

- “Shareholder representatives should ensure that Audit Committees are as independent and financially literate as possible. Such Committees are probably better able to assess Auditor independence and suitability as well as audit quality than are regulators. Has IRBA satisfactorily addressed reasons for abandoning MAFR in other jurisdictions?”

- “Auditors have brought this on themselves... poor audits conduced on numerous failed firms. Auditors are performing a function for the Company and by implications its shareholders. However, more often than not they seem to be performing a function for management. This needs to be rectified.”

- “Likely to see increased ‘whistle blowing’; more qualified accounts; and more significant items being brought to the attention of shareholders (as opposed to being ‘swept under the carpet’).”

The above comments reinforce the findings presented in Figures 8.4 and 8.5 above, namely that there is considerable push-back against the IRBA position on MAFR.

iv. Firm tenure and ‘cooling-off’ periods

On the assumption that MAFR is implemented in April 2023 as per the current IRBA ruling, respondents were asked to choose preferred firm tenure and ‘cooling-off’ periods for MAFR. The findings are presented below in Figures 8.6 and 8.7. For the appropriate tenure period, the mode response from responding AC chairs, CFOs and fund managers
was 10 years, consistent the IRBA ruling. As may be expected from the audit partners, likely influenced by their significant anti-MAFR position, the mode response was longer than 10 years, being 16-20 years. Interestingly, it appears that fund managers are more open to a shorter rotation period, whereas the other three groups express preference for a longer rather than shorter period. This may be because the auditors, AC chairs and CFOs are more influenced by the perceived costs of firm rotation and as such, prefer a longer rotation period.

**Figure 8.6:** Perspectives on appropriate tenure period

**Source:** All questionnaires (own calculation)
Regarding the ‘cooling-off’ period, the mode response from all participant groups was 5 years, again consistent with the IRBA ruling, with an equal number of fund managers preferring shorter periods of 3 to 4 years. A period greater than 5 years was not considered appropriate.

It can be concluded, based on these findings, that a 10-year rotation period and 5-year ‘cooling-off’ period is considered most appropriate if MAFR is to be implemented in South Africa.
8.6 CONCLUSION OF FINDINGS CHAPTER

In this chapter, the findings of the empirical study were discussed. The approach integrated the findings for each participant group in each section on a theme by theme basis that reflected the logical structure of the questionnaires. Considering the acceptable response rates received and the professionalism and expertise of the respondents, the information is considered to be representative of the four participant groups concerning large exchange-listed companies in South Africa.

The results of the empirical study provide considerable evidence against MAFR in South Africa being effective in achieving the objectives communicated by the IRBA, especially the primary objective, which is to enhance auditor independence and thereby improve the degree of audit quality. The evidence also indicates that MAFR will not be effective in addressing transformation and market concentration objectives and, of particular concern, may result in reduced audit quality, reduced capacity for audit firms to pursue transformation initiatives and increase the degree of market concentration. These effects would be counter to the intentions of the IRBA.

In Chapter 9 final conclusions on the study hypotheses are provided, including an overall conclusion on implications for audit quality. The findings from each participant group are separately summarised and following this, specific recommendations regarding MAFR in South Africa will be provided. Finally, limitations of the study are acknowledged and areas for further research suggested.
CHAPTER 9: CONCLUSIONS AND RECOMMENDATIONS

9.1 INTRODUCTION

In this chapter the findings from the literature and empirical studies are summarised. The approach taken in Chapter 8 was to integrate the analysis of the findings for each participant group on a theme by theme basis that reflected the logical structure of the MAFR debate and the questionnaires. This chapter provides the important final conclusions concerning the hypotheses formulated in the study, including overall concluding implications for audit quality. In addition, the findings from each participant group are separately summarised. Specific recommendations will then be provided, based on the findings and conclusions of the study. The recommendations are intended to contribute to the existing knowledge on MAFR, as well as to inform the various regulatory and professional bodies involved in the South African audit industry. This chapter, together with the previous chapter (Chapter 8), therefore meets the study objectives determined in Chapter 1. Finally, limitations of the study are acknowledged and areas for further research suggested.

9.2 CONCLUSIONS FROM THE LITERATURE STUDY

From the literature study it is evident that audit engagement partner rotation is not a new concept, practiced in many countries and formally adopted in the IFAC Code of Ethics for Professional Accountants. In contrast, MAFR is a regulatory tool that has come to the fore in the last 15 to 20 years, especially in the wake of high-profile accounting scandals such as Enron and WorldCom that resulted in the discussions in the US culminating in the 2002 SOX Act. National audit regulators have debated the merits of MAFR as a replacement for audit partner rotation, with many countries considering and rejecting it and others adopting it. Of those that have adopted MAFR in the past, many have since abolished it
to return to audit partner rotation, while others have maintained it, even if only on a limited industry-specific basis. Chapter 6 provides a description of international trends on auditor rotation, with Annexure 2 providing a list of countries showing application of MAFR. There is no international consensus on MAFR, but it is fair to conclude that the majority of regulatory bodies have chosen not to adopt it. The most recent decision by a sizeable jurisdiction to adopt MAFR has been the EU, as discussed in Chapter 6. According to all academic, regulatory and professional literature reviewed, the reason for adoption of any form of auditor rotation is to limit auditor tenures (firm or partner), so as to safeguard the independence and professional scepticism of the auditor. Limiting auditor tenure is believed to reduce the threats to independence that develop over time in the auditor-client relationship. In this way the goal of auditor rotation regulation is always to promote the highest degree of audit and financial reporting quality.

The IRBA position on MAFR is described in Chapter 1, section 1.6, and is consistent with that of other national audit regulators in favour of MAFR (most notably the EU). However, the secondary objectives of the IRBA for MAFR in South Africa add unique aspects to the South African professional debate. This refers to the IRBA’s intentions of promoting black economic participation in the audit industry (the transformation objective), as well as providing opportunities for the small- and medium-sized audit firms to tender for appointment on large and exchange-listed companies (the market concentration objective).

As discussed in Chapters 1 to 6, the most important findings of the literature study, as they relate to the MAFR debate, are stated below.

i. The concept of audit quality is difficult to define, let alone measure. However, audit quality may be considered the market-assessed, joint probability that a given auditor will detect and report upon financial reporting errors and fraud, which include the possibility of financial misconduct by management.
ii. Audit quality is necessary for the proper functioning of capital markets, allowing market participants to assess and manage risk in economic decision-making. As such, the audit function fulfils a vital role in classic agency theory, whereby the auditor acts as an independent monitor, appointed by shareholders to provide assurance with respect to management’s financial reporting and financial management of the organisation.

iii. Audit quality can only be assured if the auditor is independent and competent. Any impairment of independence or capabilities can result in inappropriate audit work being performed and inappropriate opinions expressed on the fair presentation of the financial statements issued by the company, with respect to both error and fraud.

iv. Professional scepticism is a concept related to independence, referring to the importance of a questioning mind that critically assesses of audit evidence and is alert to conditions which may indicate possible financial error or fraud.

v. There is an acknowledged deficit of trust between the investing public and the audit function, borne out of the perception that auditors should prevent corporate failures and financial misconduct perpetrated by management. Research indicates that the blame on auditors is often due to the ‘expectations gap’ which is the gap between the level of performance expected by auditors and that expected by the users of financial statements.

vi. Independence in mind is an important aspect of the auditor rotation debate. The auditor is expected to be independent in mind as well as in appearance to informed outside parties, often referred to as the ‘investing public’.

vii. Although there is substantial research on auditor rotation, there is little research on the effectiveness and consequences of MAFR. One identified reason for this is because there are so few practical situations where MAFR has been enforced. Another is the problems encountered in developing appropriate and robust proxies to measure changes in audit quality around the rotation period.
viii. Considering that MAFR has not yet been implemented in South Africa, it is not possible to determine, using audit quality measures, whether MAFR improves audit quality in South Africa. This study therefore performs an exploratory study of key stakeholder perceptions surrounding audit quality, independence and MAFR.

ix. There have been many calls from academia and the accounting profession to provide further research on MAFR.

x. The primary argument in favour of MAFR states that as firm tenure lengthens a familiarity develops between auditor and management of the client and this results in a loss of independence and professional scepticism. The counter view is that as firm tenure lengthens, the firm increases its understanding of their clients' complex business, thereby improving its expertise as auditor, resulting in higher audit quality.

xi. There are mixed results on the impact of auditor tenure on audit quality, however, the weight of evidence suggests that auditor tenure does not impair audit quality. A common mistake in the literature cited in the MAFR debate is the failure to distinguish between research on audit firm tenure and that on audit partner tenure.

xii. Research indicates that long audit firm tenure does not impair auditor independence and may even improve audit quality through the increasing skill and experience of the audit firm with respect to the financial reporting of the client. However, at an audit partner level, some studies have shown tenure to be negatively associated with audit quality. This provides some evidence in favour of mandatory partner rotation but not MAFR.

xiii. A review of the literature shows that caution is needed in distinguishing the findings from studies in jurisdictions where firm rotation is voluntary (as is currently the case in South Africa) from those where it is mandatory (as it will be in South Africa from 2023).

xiv. Studies examining whether audit firm rotation improves auditor independence, using proxies for audit quality, report mixed results. However, the evidence favours the conclusion that MAFR is not effective in improving audit quality.
xv. A qualitative methodology using interviews and questionnaires has been successfully employed in research on audit quality, corporate governance and auditor rotation. The perceptions and arguments of key stakeholder groups in the MAFR debate are an important contribution, especially in exploring the potential for unintended consequences.

xvi. Research on audit stakeholder perceptions of MAFR (such as auditors, AC members, senior company management, investors, etc.) in various jurisdictions indicate push-back against the necessity of MAFR. Arguments against MAFR focus on the perceived unintended consequences such as lost client-specific knowledge and unmanageable or unreasonable financial costs to the company and audit firms.

xvii. The South African public debate on MAFR in 2016 and 2017 included written responses by stakeholders of the IRBA consultation paper, as well as public hearings before the Standing Committee on Finance of the South African Parliament. This public debate illustrated the considerable push-back against MAFR as intended by the IRBA, as well as a degree of mixed views. The public debate has also highlighted the importance of transformation in the audit industry and the potential for MAFR to contribute in this regard.

xviii. The Big Four firms in South Africa are strongly opposed to MAFR. They believe that auditors in South Africa are suitably independent and that existing regulations, internal policies and professional codes are sufficient to safeguard independence. In addition, they argue that the IRBA consultation paper was poorly drafted, evidenced and reasoned.

xix. There appears to be no consensus internationally regarding which auditor rotation rules are best suited to safeguarding audit quality. However, there is a current preference, in terms of numbers of countries, to require audit partner rotation, similar to that recommended in the IFAC Code of Ethics for Professional Accountants. The countries that have decided against MAFR tend to emphasise the perceived negative consequences of such legislation as outweighing the benefits.
xx. Of the more significant economic jurisdictions, the US, Singapore, Canada and Australia have rejected MAFR regulations while China and the E.U. have adopted it. Many countries in Europe which had decided against it, such as Germany and France, will now be required to adopt it by virtue of being part of the E.U.

xxi. Due to the nature of its responsibilities, AC effectiveness impacts the independence of the auditor and audit quality. Hence, the role and effectiveness of ACs in South Africa must be considered in the MAFR debate.

From the above, it can be concluded that the academic literature does not favour MAFR as a tool to improve audit quality. However, the research around MAFR is sparse and shows a degree of mixed results. Evidently, there is a need for further research on the implications of MAFR.

9.3 CONCLUSIONS FROM THE EMPIRICAL STUDY

In Chapter 8 an integrated analysis was conducted, aggregating and contrasting in detail the findings from the questionnaires relevant to each participant group. In concluding on the study, it is necessary to summarise how the study results support or contradict the original hypotheses, especially concerning the link between MAFR and audit quality. Therefore, the purpose here is:

i. To provide final conclusions on the hypotheses formulated in the study, with overall concluding implications for audit quality; and

ii. To separately discuss and summarise the findings from each participant group, with a focus specifically on the primary arguments for and against MAFR.
9.3.1 Hypotheses conclusions

The critical links to the empirical study, meaning the development of the theoretical models from the academic literature and the professional debate, allowing the formulation of the hypotheses and instrument tools (questionnaires), are described in the following sections of the study:

- **Chapter 7 section 7.4**: Theoretical models and hypotheses development
- **Annexure 4**: Hypotheses and linkages from theoretical model (direct and indirect effects)
- **Annexure 5**: Linking the hypotheses to the questionnaire
- **Annexures 10 to 13**: Questionnaires for each participant group

Twelve separate hypotheses (H1 to H12) were formulated based on the literature reviewed and the theoretical models developed which illustrate the direct and indirect effects of adopting MAFR. These hypotheses have been incorporated into the analysis of findings throughout Chapter 8. The objective here is to provide conclusions on whether the results of the study support or contradict these hypotheses. Therefore, each hypothesis is either accepted, rejected or considered indeterminate based on the findings and analyses.

In each section of the questionnaire, a statistical, two-tailed $p$-value approach was employed to determine whether the findings could be considered ‘likely’ or ‘unlikely’ by determining the probability of deviation from the theoretical mid-point of the Likert scale, which was always 3 on the 5-point scaling (1 = Strongly agree; 3 = Neutral (Mid-point); 5 = Strongly disagree). The $p$-values were therefore calculated by comparing means to the scale mid-point, which is a meaningful mid-point separating general agreement from disagreement with the questionnaire statement. Statistical significance was then determined at 95%, 99% and 99.9% confidence levels.
a. Hypotheses relating to direct effects

**Hypothesis 1 (H1)** - Stakeholders perceive MAFR to have a negative impact on auditor client-specific knowledge.

| Overall conclusion: | The hypothesis is **ACCEPTED** at a 99.9% confidence level based on the perspectives of responding auditors, AC chairs and CFOs. |
| Specific exceptions: | The conclusion with respect to the equity fund managers is considered indeterminate. |
| Section reference: | Section 8.3.2 |

**Hypothesis 2 (H2)** - Stakeholders perceive MAFR to not have a significant impact on auditors’ independence and professional scepticism.

| Overall conclusion: | The hypothesis is **ACCEPTED** at a 99.9% confidence level based on the perspectives of responding auditors, AC chairs and CFOs. |
| Specific exceptions: | The conclusion with respect to the equity fund managers is considered indeterminate. |
| Section reference: | Section 8.3.1 |

**Hypothesis 3 (H3)** - Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public.

| Overall conclusion: | The hypothesis is **REJECTED** at 99.9% confidence level based on the perspectives of responding auditors, AC chairs and CFOs. |
| Specific exceptions: | The conclusion with respect to the equity fund managers is considered indeterminate. |
| Section reference: | Section 8.3.1 |

**Hypothesis 4 (H4)** - Stakeholders perceive MAFR to increase the degree of market concentration by the big 4 firms in the audit profession.

| Overall conclusion: | The hypothesis is **ACCEPTED** at a 95% confidence level based on the perspectives of responding auditors, AC chairs and CFOs. |
| Specific exceptions: | The conclusion with respect to the equity fund managers is considered indeterminate. However, the fund managers do not believe that audit committees of JSE listed companies are likely to recommend, nor shareholders likely to appoint, non-Big 4 audit firms as external auditors. This provides evidence in support of the hypothesis. |
| Section reference: | Section 8.3.4 |

**Hypothesis 5 (H5)** - Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession.

| Overall conclusion: | The hypothesis is **ACCEPTED** at a 99.9% confidence level based on the perspectives of responding auditors and AC chairs. |
| Specific exceptions: | None. CFOs and equity fund managers were not surveyed with respect to transformation considerations. |
| Section reference: | Section 8.3.3 |

**Source**: Researcher's own conclusions
b. Hypotheses relating to indirect effects

<table>
<thead>
<tr>
<th>Hypothesis</th>
<th>Overall conclusion</th>
<th>Specific exceptions</th>
<th>Section reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 (H6)</td>
<td>The hypothesis is ACCEPTED at a 99.9% confidence level based on the perspectives of responding auditors and AC chairs. This conclusion is based on the statistically significant perceptions of respondents that MAFR will require substantially more work from audit partners, add to their existing responsibilities and contribute additional professional and personal risk in the provision of the audit opinion.</td>
<td>None. CFOs and equity fund managers were not surveyed with respect to implications on audit partner work life.</td>
<td>Section 8.4.1</td>
</tr>
<tr>
<td>7 (H7)</td>
<td>The hypothesis is ACCEPTED at a 99.9% confidence level based on the perspectives of responding auditors and AC chairs.</td>
<td>None. CFOs and equity fund managers were not surveyed with respect to the need for auditors to upskill and retrain.</td>
<td>Section 8.4.1</td>
</tr>
<tr>
<td>8 (H8)</td>
<td>The hypothesis is neither accepted nor rejected. Responding auditors strongly agree that MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants. Equity fund managers strongly disagree. AC chairs and CFOs express agreement, but not at a 95% confidence level. Therefore, the conclusion is considered INDETERMINATE.</td>
<td>Refer above.</td>
<td>Section 8.4.1</td>
</tr>
<tr>
<td>9 (H9)</td>
<td>The hypothesis is ACCEPTED at a 99% confidence level based on the perspectives of responding auditors, AC chairs, CFOs and equity fund managers.</td>
<td>None.</td>
<td>Section 8.4.2</td>
</tr>
<tr>
<td>10 (H10)</td>
<td>The hypothesis is ACCEPTED at a 99% confidence level based on the perspectives of responding auditors, AC chairs, CFOs and equity fund managers.</td>
<td>None.</td>
<td>Section 8.4.2</td>
</tr>
<tr>
<td>11 (H11)</td>
<td>The hypothesis is REJECTED at a 99.9% confidence level based on the perspectives of responding auditors, AC chairs, CFOs and equity fund managers.</td>
<td>None.</td>
<td>Section 8.4.3</td>
</tr>
<tr>
<td>12 (H12)</td>
<td>The hypothesis is ACCEPTED at a 99.9% confidence level based on the perspectives of responding auditors, AC chairs and CFOs. The equity fund managers expressed agreement with a more limited choice of alternatives, at a 99% confidence level.</td>
<td>None.</td>
<td>Section 8.5.1</td>
</tr>
</tbody>
</table>

Source: Researcher's own conclusions
9.3.2 Conclusions concerning audit quality

The evidence provided in the academic literature established that MAFR is a tool specifically designed to improve the quality of audits by limiting the term of appointment of audit firms (Casterella & Johnston, 2013; Knechel et al., 2013). This is consistent with the intention of the IRBA (IRBA, 2016e). Therefore, it is appropriate to provide direct conclusions in this regard based on the findings of this study and the preceding conclusions on the hypotheses.

Acknowledging the limitations of the study, as described below, the following conclusions from this study concerning the impact of MAFR in South Africa on audit quality are provided:

**Conclusion 1:**
Based on the conclusion of hypothesis H1, taken together with the detailed analysis of findings in section 8.3.2, and the established Link 6 in the theoretical model of direct effects (Section 7.4, Figure 7.3), it is concluded that MAFR is likely to decrease audit quality in South Africa.

**Conclusion 2:**
Furthermore, based on the conclusion of hypotheses H6, H7 and H9, taken together with the detailed analysis of findings and the established Link 13 and Link 15 in the theoretical model of indirect effects (Section 7.4, Figure 7.4), it is concluded that MAFR is likely to decrease audit quality in South Africa.
Conclusion 3:
Based on the conclusion of hypotheses H2, taken together with the detailed analysis of findings in section 8.3.1, and the established Link 5 in the theoretical model of direct effects (Section 7.4, Figure 7.3), it is concluded that MAFR is unlikely to improve auditor independence and professional scepticism in South Africa and thereby will not contribute towards improving audit quality.

Conclusion 4:
Based on the conclusion of hypotheses H4 and H5, taken together with the detailed analysis of findings in section 8.3.3 and 8.3.4, it is concluded that MAFR is unlikely to improve transformation or decrease market concentration within the South African audit industry. There is considerable evidence to suggest that, counter to the IRBA intentions, MAFR may inhibit transformation and further concentrate the presence of large audit firms providing assurance services to the large exchange-listed companies. As per Link 7 and Link 8 in the theoretical model of direct effects (Section 7.4, Figure 7.3), reduced transformation and increased concentration in the audit industry is likely to decrease audit quality in South Africa.

The above conclusions provide findings consistent with the following key studies on MAFR:

- Using measurable audit quality proxies in jurisdictions that have applied MAFR, Ruiz-Barbadillo et al. (2009) in a Spanish context, Kwon et al. (2014) in the South Korean market and Cameran et al. (2015) in Italy, provide evidence against MAFR improving audit quality.
Regarding the critical relationship between audit firm tenure, auditor independence and audit quality, studies indicate that long audit firm tenure does not impair auditor independence and may even improve audit quality by increasing the skill and experience of the audit firm with respect to the financial reporting of the client (Ball, Tyler & Wells, 2015; Knechel et al., 2013; Stefaniak, Robertson & Houston, 2009; Tepalagul & Lin, 2015).

Fontaine et al. (2016) found that Canadian AC members strongly opposed MAFR, perceiving it as a threat to their shareholder-granted autonomy and authority, and indicating that their own judgment and observations were the most effective means of ensuring auditor independence and objectivity. In addition, the costs associated with changing auditors, relating to the time and effort involved in the tendering process and in bringing a new auditor up to speed with client- and industry-specific knowledge, were believed to outweigh the benefits of MAFR.

Ewelt-Knauer et al. (2013), based on a review of literature, found that audit firms are generally opposed to MAFR, based primarily on the perceived loss of knowledge and expertise on rotation. However, Ewelt-Knauer et al. (2013) found the views of audit clients and shareholders overall to be relatively mixed regarding MAFR. This study also finds equity fund manager opinions (i.e. shareholders) to be mixed, but the view of CFOs and AC chairs (i.e. audit clients) were unambiguous and considerably against MAFR.

The key respondents to the IRBA consultation paper, which included the Big Four audit firm leadership, the ASISA, CFOs and others, showed considerable opposition to MAFR (Harber & West, 2017).

The above conclusions provide findings that are not consistent with the following key studies on MAFR:

- Hakwoon et al. (2015), in a Korean context similar to that of Kwon et al. (2014), offer some evidence in support of MAFR, finding that MAFR produces better audit quality than voluntary firm rotation.
Casterella and Johnston (2013), in a review of MAFR studies, reveal that 8 of the 11 studies reviewed that tested MAFR in a jurisdiction that had adopted it provide some evidence in its support. In stark contrast, only 3 of 13 studies reviewed in a system of voluntary firm rotation provide support for audit firm rotation.

9.3.3 A summary of key findings for each participant group

The purpose here is to provide a separate summary of the findings for each participant group on the primary arguments for and against MAFR as well as the IRBA’s three objectives for MAFR in South Africa. This summary therefore addresses only the aspects of auditor independence, client-specific knowledge and expertise, transformation and market concentration, for each participant group.

As noted at the beginning of this chapter, the primary argument of proponents of MAFR is that long-tenure relationships between audit firms and clients can lead to audit failures due to high levels of familiarity that impair auditors’ independence and professional scepticism. MAFR also allows the new incumbent to bring a ‘fresh look’ to the auditing task, which is considered an effective way of ensuring auditor independence and preventing ‘opinion shopping’ (Lu & Sivaramakrishnan, 2009). However, opponents of MAFR argue that long-tenure auditor-client relationships lead to the development of valuable client- and industry-specific knowledge and expertise over time, resulting in enhanced audit quality (Casterella & Johnston, 2013; Fontaine et al. 2016).

9.3.3.1 Key findings from audit partners

a. Impact of MAFR on auditor independence

Responding partners believe that South African auditors of listed companies do not lack the required degree of independence and professional scepticism and that current
regulations and professional standards are sufficient to regulate auditor independence. These respondents reject the notion that longer audit firm tenures result in less auditor independence, as posited by the IRBA, or that MAFR will result in an increase in auditor independence. These sentiments were expressed by both the Big Four and non-Big Four audit firm partners. Considering independence in appearance, i.e. perceptions of independence from the investing public, responding auditors disagree that the view is one of a significant degree of bias or familiarity between auditor and company, causing the investing public to question the quality of the audit opinion and function of the auditor as a whistle-blower. Therefore, the sentiment was that there is no significant problem with public perceptions of auditor independence. Furthermore, MAFR is not considered to be an effective regulatory tool to change perceptions of a lack of independence in the minds of the investing public. These findings are therefore contrary to the IRBA position that auditor independence is compromised for JSE-listed company audits due to excessive audit firm tenures and that the investing public perceives this to be the case.

b. Impact of MAFR on client-specific knowledge and expertise

Responding partners believe that significant institutional client-specific knowledge of the company is developed within the audit firm as the years progress in the auditor-client relationship. Furthermore, the incoming, newly-appointed audit firm is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment and a steep learning curve therefore exists. Both the Big Four and non-Big Four firm partners are in agreement in these respects. As such, the Big Four firm partners believe the incoming, newly-appointed audit firm is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company. Non-Big Four firm partners neither significantly agree nor disagree with this view. However, both groups feel that auditor unfamiliarity and inexperience as well as the potential loss of client-specific knowledge is a significant problem with MAFR. These concerns are believed to be more significant with the larger and more complex multinational companies listed on the exchange, which require a greater degree of experience and expertise to appropriately mitigate audit risk. These
findings provide a strong argument against the IRBA position that audit quality will not drop in the early years of the audit engagement as the newly-appointed auditor attempts to bridge their gap in knowledge of the client.

c. Impact of MAFR on market concentration

It is particularly relevant to separate the findings between Big Four and non-Big Four firm partners regarding their opinions on market concentration. Interestingly, neither group believes that MAFR will reduce the concentration of Big Four audit firms providing audit services for JSE-listed companies. Big Four firm partners express significant reservations with regard to whether non-Big Four audit firms have a sufficient ‘geographical footprint’ to audit large multinational companies on the JSE or whether they possess the necessary industry-specific knowledge and experience. In addition, Big Four partners disagree that medium-sized audit firms possess the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE-listed companies. The consensus was that this will pose a barrier to appointment of these firms. However, partners from the non-Big Four firms believe that their firms do have these qualities i.e. geographical presence and industry-specific knowledge and experience. They also believe that their firms have the required resources – although many did express reservations in this regard. Both groups agree that ACs of JSE-listed companies are unlikely to recommend the non-Big Four firms for appointment, and even if they did, shareholders would be unlikely to appoint them. This is most likely why neither group believes that MAFR will reduce the concentration of Big Four audit firms providing audit services for JSE-listed companies. This is contrary to the IRBA position, which is that MAFR will provide ACs and shareholders with realistic opportunities to appoint mid-tier firms. The comments from respondents did indicate, however, that appointment would be more likely for the smaller and less complex companies listed on the JSE.
d. Impact of MAFR on transformation

The respondents do not believe that the rate of transformation in the audit profession is acceptable. Interestingly, both the Big Four and non-Big Four partners expressed agreement that MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets. In addition, both groups strongly disagree that MAFR will improve transformation in the profession. These findings are significant and stand in opposition to the IRBA position. Understood in context of the findings regarding market concentration considerations, it is clear that the auditors do not believe that the non-Big Four firms, including the ‘black-owned firms’, will be appointed to provide assurance services to the larger exchange-listed companies and furthermore, MAFR will impair the ability of firms to continue progressing towards their own internal transformation objectives. This could prejudice the speed of transformation in the entire profession. These unintended consequences were identified as being due to the additional costs imposed on the audit firms from MAFR, resulting in a reduced ability of firms to invest in transformation and attract talent. Respondents expressed the view that MAFR will impose significant additional costs on the profession, lowering profitability and requiring firms to redirect expenditure away from areas such as training and bursaries and into tendering for work, among other activities. These views are contrary to the view and intentions of the IRBA which believes that, although the regulation is not primarily intended to improve black economic participation in the profession, it will contribute to this objective nonetheless.

9.3.3.2 Key findings from audit committee chairs

a. Impact of MAFR on auditor independence

Responding committee chairs believe that South African auditors of listed companies do not lack the required degree of independence and professional scepticism. They consider that current regulations and professional standards are sufficient to regulate auditor independence. These respondents do not believe that longer audit firm tenures result in
less auditor independence, as posited by the IRBA, nor that MAFR will result in an increase in auditor independence. Considering independence in appearance, i.e. perceptions of independence from the investing public, responding AC chairs disagree that the view is one of a significant degree of bias or familiarity between auditor and company, causing the investing public to question the quality of the audit opinion and function of the auditor as a whistle-blower. Therefore, the sentiment was that there is no significant problem with public perceptions of auditor independence. Furthermore, MAFR is not considered to be an effective regulatory tool to change perceptions of a lack of independence in the minds of the investing public. These findings are therefore contrary to the IRBA position that auditor independence is compromised for JSE-listed company audits due to excessive audit firm tenures and that the investing public perceives this to be the case.

b. Impact of MAFR on client-specific knowledge and expertise

Responding AC chairs believe that significant institutional client-specific knowledge of the company is developed within the audit firm as the years progress in the auditor-client relationship. Furthermore, the incoming, newly-appointed audit firm is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment and a steep learning curve therefore exists. As such, the incoming, newly-appointed audit firm is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company. Auditor unfamiliarity and inexperience as well as the potential loss of client-specific knowledge is therefore believed to be a significant problem with MAFR. These concerns are believed to be more significant with the larger and more complex multinational companies listed on the exchange. These findings provide a strong argument against the IRBA position that audit quality will not drop in the early years of the audit engagement as the newly-appointed auditor bridges any gap in knowledge or expertise.
c. Impact of MAFR on market concentration

Responding AC chairs express disagreement with the IRBA position that MAFR will reduce the concentration of the Big Four firms. As with the sentiments of the Big Four auditors and CFOs, the AC chairs do not believe the non-Big Four audit firms have a sufficient ‘geographical footprint’ to audit large multinational companies on the JSE, nor possess the necessary industry-specific knowledge and experience. In addition, they disagree that medium-sized audit firms possess the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE-listed companies. Considering that appointment as auditor is usually based on the recommendation of the AC, these opinions by the ACs will be a considerable barrier to the appointment of non-Big Four firms. The findings also show that AC chairs do not believe that shareholders are likely to appoint them, even if they were recommended by the committee. The risk associated with appointment of a non-Big Four firm to a large multinational company was considered unnecessary.

d. Impact of MAFR on transformation

The responding AC chairs do not believe that the rate of transformation in the audit profession is acceptable but express a neutral view as to whether MAFR will reduce the ability of audit firms to pursue internal transformation objectives. This may be because the AC members are not actively involved in or knowledgeable about the audit firms’ internal policies and objectives with respect to transformation. However, the AC chairs do not believe that MAFR will improve transformation in the profession. Understood in context of the findings regarding market concentration considerations, it is clear that the AC chairs do not believe that the non-Big Four firms, including the ‘black-owned firms’, will be appointed to provide assurance services to the larger exchange-listed companies. These views are contrary to the view and intentions of the IRBA which believes that, although the regulation is not primarily intended to improve black economic participation in the profession, it will contribute to this objective nonetheless.
9.3.3.3 Key findings from CFOs

a. Impact of MAFR on auditor independence

Responding CFOs believe that South African auditors of listed companies do not lack the required degree of independence and professional scepticism and that current regulations and professional standards are sufficient to regulate auditor independence. These respondents do not believe that longer audit firm tenures result in less auditor independence, as posited by the IRBA, nor that MAFR will result in an increase in auditor independence. Considering independence in appearance, i.e. perceptions of independence from the investing public, responding CFOs disagree that the view is one of a significant degree of bias or familiarity between auditor and company, causing the investing public to question the quality of the audit opinion and function of the auditor as a whistle-blower. Therefore, the sentiment was that there is not a significant problem with public perceptions of auditor independence. MAFR is also not considered to be an effective regulatory tool to change perceptions of a lack of independence in the minds of the investing public. These findings are therefore contrary to the IRBA position that auditor independence is compromised for JSE-listed company audits due to excessive audit firm tenures and that the investing public perceives this to be the case.

b. Impact of MAFR on client-specific knowledge and expertise

Responding CFOs believe that significant institutional client-specific knowledge of the company is developed within the audit firm as the years progress in the auditor-client relationship. Furthermore, the incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment and a steep learning curve therefore exists. As such, the incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company. Auditor unfamiliarity and inexperience, as well as the potential loss of client-specific knowledge is therefore believed to be a significant problem with MAFR. These concerns are believed
to be more significant with the larger and more complex multinational companies listed on the exchange. These findings provide a strong argument against the IRBA position that audit quality will not drop in the early years of the audit engagement as the newly-appointed auditor bridges any gap in knowledge or expertise.

c. Impact of MAFR on market concentration

Responding CFOs express disagreement with the IRBA position that MAFR will reduce the concentration of the Big Four firms. As with the sentiment of the Big Four auditors and AC chairs, the CFOs do not believe the non-Big Four audit firms have a sufficient ‘geographical footprint’ to audit large multinational companies on the JSE nor possess the necessary industry-specific knowledge and experience. In addition, they disagree that medium-sized audit firms possess the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE-listed companies. The findings also show that responding CFOs do not believe that shareholders are likely to appoint them, even if they were recommended by the AC. The risk associated with appointment of a non-Big Four firm to a large multinational company was considered unnecessary.

d. Impact of MAFR on transformation

The CFOs were not surveyed directly regarding transformation of the audit profession as, unlike the AC chairs and audit partners themselves, they were considered to be too far removed from the internal policies, objectives and outcomes of the firms with regards to black economic participation (transformation). However, considering the findings regarding market concentration, it is clear that the CFOs do not believe that the non-Big Four firms, including the ‘black-owned firms’, will be appointed to provide assurance services to the larger exchange-listed companies.
9.3.3.4 Key findings from equity fund managers

i. Impact of MAFR on auditor independence

Responding fund managers express neutral views on the degree of independence and professional scepticism of South African auditors. They express similar views on the adequacy of current regulations and professional standards to regulate auditor independence. Again, the fund managers neither significantly agree nor disagree that longer audit firm tenures result in less auditor independence, as posited by the IRBA, or that MAFR will result in an increase in auditor independence. Considering independence in appearance, i.e. perceptions of independence from the investing public, responding fund managers express neutral views as to the investing public’s perceptions of auditor familiarity and bias. Respondents are unsure (neutral view) whether MAFR is an effective regulatory tool to change perceptions of a lack of independence in the minds of the investing public. These findings neither support nor oppose the IRBA position that auditor independence is compromised for JSE-listed company audits due to excessive audit firm tenures and that the investing public perceives this to be the case.

ii. Impact of MAFR on client-specific knowledge and expertise

Responding fund managers believe that significant institutional client-specific knowledge of the company is developed within the audit firm as the years progress in the auditor-client relationship. Furthermore, the incoming, newly-appointed audit firm is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment and a steep learning curve therefore exists. However, respondents express a neutral view as to whether the newly-appointed audit firm is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company. This is likely because respondents feel that the knowledge and expertise gap can be overcome by the newly-appointed auditor before the completion of the first year’s audit engagement. The potential loss of client-specific knowledge is nonetheless considered a concern by fund
managers that needs to be addressed. These findings provide some evidence in support of the IRBA position. Despite believing that institutional client-specific knowledge is developed over time and lost upon rotation, the fund managers express the view that it may not result in undetected misstatements and reduced audit quality if the newly-appointed auditor bridges the knowledge and expertise gap soon after appointment.

iii. Impact of MAFR on market concentration

The responding equity fund managers neither agree nor disagree significantly with the IRBA position that MAFR will reduce the concentration of the Big Four firms. Likewise, there is a neutral opinion regarding whether the mid-tier firms have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE. However, there was some degree of disagreement with the notion that these firms possess a sufficient international presence to be appointed as auditors of large multinational companies on the JSE. Moreover, the fund managers expressed reservations over the idea that medium-sized audit firms possess the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE-listed companies. Overall, the fund managers, like the other three participant groups, do not believe that the ACs of JSE-listed companies are likely to recommend the non-Big Four firms for appointment, and even if they did, shareholders would be unlikely to appoint them. This is significant as it is the institutional shareholders who represent the greatest shareholding of JSE-listed companies and who therefore control the outcome of the vote for shareholder appointment at the AGM. These responding equity fund managers represent these institutions at the AGMs and they do not believe the vote will be in favour of appointing a non-Big Four firm.

iv. Impact of MAFR on transformation

The equity fund managers were not surveyed directly regarding transformation of the audit profession as, unlike the AC chairs and audit partners themselves, they were considered to be too far removed from the internal policies, objectives and outcomes of the firms with regards to black economic participation (transformation). However,
considering the findings regarding market concentration considerations, it is clear that the fund managers believe it is unlikely that the non-Big Four firms, including the ‘black-owned firms’, will be appointed to provide assurance services to the larger exchange-listed companies.

9.4 STUDY RECOMMENDATIONS

Based on the literature review (Chapters 1 to 6), empirical findings and conclusions (Chapters 8 and 9), the following recommendations are provided for the consideration of those involved in the South African MAFR debate, which include audit industry stakeholders, legislative bodies and regulators, most notably the IRBA. The recommendations are based on the presupposition that the ultimate purpose of auditing regulation is to uphold and improve the quality of audits, to ensure the effective functioning of capital markets and to protect investors and corporate stakeholders.

9.4.1 Key recommendation based on empirical study

It is recommended that the MAFR ruling issued in June 2017 by the IRBA in compliance with section 10(1)(a) of the Auditing Profession Act, 26 of 2005 (Gazette no. 40888) be retracted. Instead, the IRBA and the audit industry should promote and reinforce existing measures that are designed to preserve auditor independence.

This recommendation is based primarily on the following evidence and reasoning, as provided within this study:

i. The academic literature does not provide convincing evidence that MAFR improves audit quality, based on studies that have been performed in jurisdictions where MAFR has been adopted.
ii. The academic literature does not provide convincing evidence that longer audit firm tenure impairs audit quality, which is the central rationale behind MAFR.

iii. The academic literature on stakeholder perceptions of MAFR conducted in other jurisdictions indicates that audit industry stakeholders generally do not believe that MAFR is an appropriate tool to improve audit quality.

Further evidence in support of the above three points is provided in the comments of Mr. Fayez Choudhury, CEO of the International Federation of Accountants (IFAC), in his letter to the IRBA dated 18th January 2017:

On audit quality… IFAC points out that evidence does not clearly support the notion that mandatory audit firm rotation will enhance audit quality. Research is at best mixed, and practical examples are too often confounded by other elements (Choudhury, 2017:2).

iv. Based on a review of the IRBA consultation paper (issued 25 October 2016), the evidence and reasoning provided by the IRBA in support of MAFR is considered to be insufficient and flawed (Harber, 2018). This conclusion is shared by many respondents to the IRBA consultation paper (Harber & West, 2017), including the IFAC:

IFAC is concerned that many parts of the Consultation Paper include assertions, comments, and examples that appear to lack supporting evidence (Choudhury, 2017:3).

v. Based on this empirical study, the overwhelming view of surveyed auditors, CFOs and AC chairs is that MAFR is not necessary in South Africa. The respondents strongly believe, based on their considerable work experience and expertise, that South African auditors of listed companies possess the required degree of independence and professional scepticism. Furthermore, they believe that current
regulations and professional standards in South Africa are sufficient to regulate auditor independence.

vi. Based on this empirical study, the evidence suggests that MAFR may decrease audit quality rather than improve it. This conclusion is based primarily on the findings that indicate that MAFR is likely to result in a substantial loss of client-specific knowledge and experience upon rotation; and that the audit firms will incur significant costs to operate under a dispensation of MAFR, considerably reducing the profitability of the firms in the industry.

vii. Considering the above, it is submitted that it would be unwise to implement MAFR for purposes of positively impacting ‘independence in appearance’, to achieve transformation objectives or to reduce the concentration of audit firms in the market. In other words, if MAFR cannot be demonstrated to bring about needed improvement in audit quality, then it should not be implemented.

9.4.2 Additional recommendations based on empirical study

The IRBA ruling is effective for financial years commencing on or after 1 April 2023. Considering that the IRBA may choose not to retract the MAFR ruling before this date, the findings of this empirical study also contribute the following recommendations for consideration, to assist with the smooth transition into, and application of, the regulations:
Alternative measures (including reinforcing existing measures) to reinforce high levels of auditor independence, as discussed in section 8.5, should be considered by the IRBA, other regulatory bodies, standard-setters, audit firms and audit committees, regardless of the adoption of MAFR.

These measures will enforce the controls and safeguards surrounding auditor independence and audit quality. Specifically, these measures include, but are not limited to:

a. Continued development and enforcement of the auditors’ Code of Professional Conduct;

b. Continued development of effective and independent Engagement Quality Control Review (EQCR) within audit firms;

c. Stronger AC oversight of auditors (strengthening application of corporate governance principles); and

d. Improved disclosure of how the company has assessed the quality and independence of the audit firm as well as how the auditors themselves have ensured that they are independent and will remain independent in the year ahead; and

e. The further development of robust Independent Regulatory Oversight, such as continued investment in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.

MAFR should not be considered as a substitute for continued efforts to improve existing control measures that mitigate the risks of impaired auditor independence and audit quality.
ii. **Practical solutions are required to address concerns surrounding the potential loss on rotation of client-specific knowledge and experience.**

A considerable concern of those opposed to MAFR is that it will result in a decrease of audit quality due to the relative unfamiliarity and inexperience of the incoming audit firm with respect to the complexities and financial risks of the audit client, who is likely to be a large multinational group of companies, perhaps operating in a niche industry such as telecommunications, financial services, mining etc. The learning curve for the new audit firm in the first year of the audit is perceived to be steep, introducing increased audit risk to the engagement. If the incoming auditor does not spend considerable time and resources to bridge this knowledge gap, then it stands to reason that audit quality will inevitably suffer. Respondents identified concern regarding non-Big Four firms that may not have adequate resources to bridge this knowledge gap in the first year of appointment. Therefore, specific and practical measures to intervene to mitigate such risk could include the following:

a. Formalising a system of audit file transfer and communication between outgoing and incoming audit firms. This may provide similar benefits to those currently experienced in firms whereby the incoming partner is able to shadow the outgoing partner before partner rotation, which is one of the internal controls within audit firms to ensure that audit quality is preserved upon rotation. A similar system could be introduced to facilitate a smooth transition between audit firms.

b. The incoming audit firm (newly appointed by shareholders) could be required to ‘shadow’ the outgoing audit firm in the last year before rotation.

c. In the first year of the audit by the incoming audit firm there could be a formalised system of consultation with the previous auditors. This would allow the new audit team to benefit from the experience and expertise of the previous auditors in the form of audit advisory services, similar to the work done on audits by tax and/or technical advisory service teams.
d. The ACs could be encouraged to approve an additional once-off ‘on-boarding fee’ to cover the set-up and transitional costs incurred by the audit firms (refer to section 8.4.2). The IRBA could provide a guideline document for consideration by ACs for the negotiation of such fees. These fees could alleviate the resource pressure experienced by incoming audit firms.

It is acknowledged that the above mentioned specific and practical intervention measures are complicated by issues such as the risk of legal liability and reluctance to aid the incoming audit firm, due to concerns or constraints over cost, availability of staff, competition considerations, or proprietary audit methods, systems and information. This presents therefore, an area for investigation by the profession and the regulator and future research.

iii. Section 90 of the Companies Act, 2008 may need to be amended.

The findings in section 8.3.4 indicate that audit firms may consider non-advisory services to companies preferable to audit services, for a variety of reasons which include engagement risk and profitability considerations. This may result in audit firms being reluctant to resign from existing advisory services, making them unsuitable in terms of section 90 for appointment as auditors after April 2023. Similarly, responding auditors indicated that even if the audit firm is currently not performing advisory services for a company, the prioritisation of this work over assurance services may result in no desire to tender for appointment as auditor under a system of MAFR. Audit firms may wish to remain available for non-assurance work and this will limit the effectiveness of MAFR in promoting competition in the industry.

A further problem identified by respondents was the strict application required by the IRBA (per the IRBA guidance document on section 90) of the prohibitions
detailed in section 90 of the Act, namely the restriction to appoint as auditor any person or firm that has performed certain non-audit services to the company within the past 5 years, such as performing the duties of accountant / bookkeeper, maintenance of any of the company’s financial records or the preparation of any of its financial statements. Given the desire by firms to obtain non-assurance work with companies, a strict interpretation of section 90 may further disincline auditors from tendering for appointment after April 2023. It is submitted that the guidelines for application of section 90 be reviewed by the IRBA in light of the findings of this study. Perhaps a less strict interpretation of prohibited activities or a term restriction of less than 5 years would be more appropriate. It is also submitted that the deterioration of appeal of audit services over advisory services is not conducive to the maintenance of audit quality in South Africa over the longer term. The validity and extent of these perceptions by responding auditors needs to be properly understood and addressed by the IRBA and the audit industry.

iv. A study is needed to understand the causal factors of the deteriorating appeal of the audit profession in South Africa.

The findings in section 8.4.1 provide concerning evidence that the auditing profession is in “a state of crisis”. Respondents, most of whom are chartered accountants, believe that the audit profession is decreasing in appeal to professional accountants, relative to alternative career paths. Auditors expressed especially strong sentiments in this regard. This belief was expressed separately from any considerations with respect to adoption of MAFR regulations. However, responding auditors also perceived MAFR as a further contributing factor in this declining appeal. There is a belief by auditors that MAFR will add further stress and risk to the job of an audit partner.
It is submitted that perhaps the greatest threat to audit quality in South Africa can arise from a disinclination of chartered accountants, newly qualified or experienced, to pursue careers as practicing auditors. This seemingly pervasive attitude will diminish the talent pool from which audit firms can select their audit partners and managers. There is a perception that the risk-reward trade-off from a career as an auditor is imbalanced in comparison to a career in business or consulting. The IRBA needs to urgently investigate the validity and extent of these perceptions and if need be, provide appropriate interventions to restore the appeal of the audit profession, especially in the minds of up-and-coming and newly-qualified chartered accountants.

Events in the South African audit industry in recent years have resulted in the IRBA rightly concluding that “a few errant auditors have wreaked havoc on the auditing profession” and “it is time to draw a line in the sand so that the profession can start to rebuild trust and confidence” (IRBA, 2018:1). The IRBA is to be commended in its efforts in this regard. However, the findings of this study concerning the declining appeal of the audit profession should be considered as a different issue from any lost confidence that the public may have in the profession, although it may no doubt be related.

v. The measurement of transformation statistics and communication of transformation objectives by the IRBA within the audit industry should be reassessed.

Responding auditors and committee chairs expressed concerns, discussed in section 8.3.3, that the audit firms are being unfairly blamed, especially by government and the IRBA, for insufficient transformation outcomes. The primary allegation is that there are too few audit partners and managers in the audit firms.
However, the findings of this study provide evidence that the reason for these low transformation statistics is due to:

a. The disproportionately small pool of black chartered accountants and the disproportionate racial demographic of qualifying chartered accountants. This has been acknowledged by SAICA, which has responded with various transformation initiatives to promote the qualification of greater numbers of black chartered accountants (Nombembe, 2017).

b. The decline in the appeal of the audit profession as a career of choice for chartered accountants results in many black chartered accountants being trained by the audit firms and then choosing to leave the profession for alternative careers paths outside of public practice.

A prevalent theme in the comments of auditors was the frustration around the lack of acknowledgement by the IRBA that newly qualified black chartered accountants leave the audit firms either immediately, or soon after qualifying, to pursue what was described as higher paying and/or lower risk opportunities elsewhere. Despite firms investing considerable time and resources in developing black chartered accountants, transformation statistics quoted by the IRBA do not recognise these contributions to the transformation of the much wider South African accounting profession. Instead, respondents stated that audit firms are criticised for poor transformation statistics.

It is therefore submitted that the IRBA should address the root causes of poor transformation statistics as these causes may lie outside of the control of the audit firms. In addition, alternative measures to assess audit firm performance in achievement of transformation objectives should be employed.
vi. The IRBA should formally review the criticisms surrounding the Consultation Paper released in October 2016 and publish an official response.

The stakeholder responses to the IRBA consultation paper, some of which were summarised in Chapter 5 and by Harber and West (2017), provide scathing criticism of the rationale and evidence provided by the IRBA in support of MAFR. This includes criticism by Mr. Fayez Choudhury, CEO of the International Federation of Accountants (IFAC), in his letter to the IRBA dated 18th January 2017, who states: “IFAC is concerned that many parts of the Consultation Paper include assertions, comments, and examples that appear to lack supporting evidence” (Choudhury, 2017:3). A critique of the IRBA Consultation Paper has also been published by Harber (2018) that identifies many aspects that lack sufficient and appropriate evidence and sound reasoning.

The following opinions of responding auditors present key critiques of the IRBA position as set out in the IRBA consultation paper:

a. Concerning the argument from the IRBA using public inspection findings: The public inspection results show evidence of poor documentation of ethical and independence considerations and procedures; however, this is not indicative of impaired independence in fact and mind. There is also no evidence given that these inspection findings relate to the audits of exchange-listed companies.

b. Concerning the argument from the IRBA using corporate failures: There are multiple reasons for corporate failures and most of them relate to factors other than audit failures and independence concerns. There is no evidence provided indicating that these failures relate to compromised independence.
c. Concerning the argument from the IRBA of long audit firm tenure as evidence for compromised independence: There is no convincing evidence that auditor independence in fact in South Africa is compromised.

(Refer section 8.3.1 for further discussion of these findings).

These sentiments from responding auditors mirror the criticisms of certain stakeholders of the IRBA Consultation Paper as well as the critique of this paper by Harber (2018) (refer to Chapter 5). It is therefore recommended that the IRBA provide a response to these criticisms as they concern issues that are fundamentally important to the rationale of MAFR in South Africa. It is further submitted that the document issued by the IRBA entitled Frequently asked questions: Strengthening auditor independence to enhance public investor protection through mandatory audit firm rotation (MAFR) does not sufficiently address these key concerns.

It is unfortunate that the ruling on MAFR issued in June 2017 was done so without proper and formal response to specific criticisms surrounding the evidence and logic supporting the IRBA position. These specific criticisms were again communicated to the IRBA through the public hearings before the Standing Committee on Finance in 2017. This study’s findings present many of them yet again. It is recommended therefore that the IRBA formally address them.

9.5 LIMITATIONS OF THE STUDY

The limitations of a study are those characteristics of design or methodology that impact or influence the interpretation of the research findings. Limitations may imply constraints on generalisability, application to practice and/or utility of findings that are the result of the chosen design or methodology. The following are the acknowledged limitations of this study, including an assessment of such limitations, with a description of mitigating factors.
a. *The study cut-off date*

The study cut-off date is 30 September 2018. Given the nature of the MAFR debate and the complexity of balancing various stakeholder needs and implementing multiple pieces of legislation and regulation, the regulatory landscape is dynamic rather than static. This study therefore considered relevant research, legislation, regulations (especially those issued by the IRBA), auditing standards and guidance, corporate governance codes and applicable developments as at, and not subsequent to, this cut-off date. Any subsequent developments will be addressed in follow-up research to the thesis.

b. *Contribution of the study after the June 2017 ruling*

The results of this study are provided after the June 2017 ruling on MAFR by the IRBA, and therefore may be considered less relevant or valid. However, as discussed above in the recommendations section, the findings, conclusions and recommendations of the study provide a valuable contribution to the MAFR debate in South Africa, irrespective of whether or not the MAFR ruling is amended or retracted by the IRBA. In addition, the empirical findings contribute to international research on the topic.

c. *Causality limitations*

Care should be taken when drawing inferences from these results, as this study reports only the perceptions of stakeholders, albeit those experienced with auditor appointment. As such, causality implied by the model cannot be tested with this data. The theoretical models in Chapter 7, Figures 7.3 and 7.4, predict causal effects that would best be tested in an experimental study where the researcher has some control over the variables and the impact on audit quality can be observed. This is not possible from perception-based data due to perception bias. As an example of a future study that employs an experimental method, when (or if) MAFR is implemented in South Africa, as discussed in Chapter 2, measurable proxies for audit quality may be employed to test changes in audit quality over the audit firm rotation period.
d. Prejudice against MAFR

It is acknowledged that AC chairs, CFOs and especially auditors may have a preconceived dislike for MAFR and therefore the data could suffer from demand effects due to bias. In addition, there may be bias from respondents since MAFR is only effective in April 2023 and thereby the regulations could be influenced, amended or appealed before this date. This may incentivise respondents to overstate the costs of MAFR and understate the benefits. There is always the possibility that questionnaire results can be biased by personal motives and experiences. The study attempted to counter this somewhat by starting the questionnaire with a clear explanation of the intention of MAFR to protect audit quality and auditor independence. Also, considering the professional roles, seniority and experience of the individuals targeted in this study, it is submitted that the risk to the quality of the data from these biases is limited.

9.6 CONTRIBUTION TO THE EXTANT BODY OF KNOWLEDGE AND AREAS FOR FUTURE RESEARCH

a. The study contribution

As described by Hay (2015) and evident from the literature review performed in Chapters 1 to 6, there is limited research on the effectiveness and consequences MAFR, partly because there are so few practical situations where MAFR has been enforced but also because auditing research in general does not always focus on practical issues of concern to practitioners and regulators. The South African regulator (IRBA) has expressed considerable concern in recent years over the perceived decline in audit quality and auditor independence, especially as it relates to assurance services provided to exchange-listed companies on the JSE. The IRBA has provided evidence of its concerns in the results of its public practice inspection findings, as well as high-profile corporate and audit failures, which the IRBA believes is on the increase in South Africa. This topic of audit quality and MAFR has sparked considerable debate and controversy,
with some audit industry participants claiming that the IRBA is using the regulation as a tool to fast-track black economic transformation in the industry, rather than to address reasonable concerns around auditor independence. Public hearings before a parliamentary committee, together with responses to the IRBA Consultation Paper on MAFR in 2017, have illustrated the push-back against the regulation and the political controversy surrounding its intention to transform the audit industry. No detailed and extensive research has been conducted on this topic in the South African context.

There is also the difficulty encountered in the definition and measurement of audit and financial reporting quality, which inhibits researchers from developing credible proxies for audit quality and measuring quality changes over the rotation periods. Considering this, and the fact that many jurisdictions, like South Africa, have not yet implemented MAFR, research using audit quality proxies to contribute meaningfully to the MAFR debate is not possible. Research that conducts an analysis of stakeholder perceptions is therefore the preferred avenue for contributing to the debate and internationally academics have attempted this to some degree, providing valuable contributions to the understanding of the consequences of MAFR and factors to consider (Casterella & Johnston, 2013; Ewelt-Knauer et al., 2013; Hay, 2015). However, the research of this nature (i.e. stakeholder perceptions) reviewed in Chapter 3 section 3.4 is also sparse and this study has aimed to further it. An underlying presumption of stakeholder perception-based research is that experienced key participants in the audit industry are best informed to contribute to an understanding of the direct and indirect effects of MAFR, including an exploration of the question of the necessity of such regulation. These participants are ‘at the coalface’ so to speak, in terms of managing the audit engagement, assessing auditor independence, appointing auditors, preparing and presenting financial statements, interacting with investors etc. Many of the participants in the public debate surrounding MAFR before the issuance of the IRBA ruling made specific calls for further and more robust research to be performed on the necessity and potential efficacy of MAFR\(^\text{14}\). There was considerable unhappiness concerning the evidence and reasoning provided by the IRBA to support its

position. Neither the IRBA nor any other professional body or researcher has attempted to systematically explore the perceptions of key stakeholder groups concerning MAFR.

This study is therefore a response to the gap in the academic literature and the need in the South African auditing profession to explore the necessity and potential consequences of MAFR. As such, the study aim was to critically assess the perceptions and arguments of key stakeholders in the South African MAFR debate, through application of an established, rigorous and robust research methodology. Due to the specific South African context, emphasis was needed beyond audit quality, to incorporate South Africa’s specific emphasis on socio-economic transformation and market concentration factors, to provide recommendations with regards to implementation and possible unintended consequences.

It is submitted that these study aims, together with the derived study objectives set out in Chapter 1 section 1.7, have been achieved. Based on the findings, conclusions and resultant recommendations, a valuable contribution has been made to academic literature as well as to the jurisdiction-specific professional debate on MAFR. The recommendation that the MAFR ruling, issued in June 2017 by the IRBA in compliance with section 10(1)(a) of the Auditing Profession Act, 26 of 2005 (Gazette no. 40888), be retracted is based on the detrimental effects that MAFR is likely to have on all its intended objectives, especially audit quality. Instead, the IRBA and the audit industry should promote and reinforce existing measures that are designed to preserve auditor independence. Further specific recommendations have also been provided for consideration by the IRBA.

b. Suggested areas for future research

As described above, MAFR “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, 2015:162). Research is currently inconclusive and more effort by academics is required (Ewelt-Knauer et al., 2013; Harber & West, 2017;
Hay, 2015). **Annexure 1** illustrates the calls for additional research on MAFR from academics and practitioners. The following discussion therefore provides some guidance and suggestions for academics who wish to pursue further research on audit quality, auditor independence, the South African audit industry and MAFR.

Given the varying characteristics of individual regulatory environments, research findings cannot easily be generalised to multiple countries/contexts and therefore there is need for more research in the South African context. The research by Ewelt-Knauer *et al.* (2013) entitled *Mandatory Audit Firm Rotation: A Review of Stakeholder Perspectives and Prior Research*, is considered particularly useful for academics to understand the nature and extent of stakeholder perception studies on MAFR. This study reviews the literature in order to identify, consider and evaluate stakeholder views and research evidence to highlight deficiencies in the existing literature, identify opportunities for further research and make recommendations for policy-makers. Ewelt-Knauer *et al.* (2013) demonstrate that stakeholder views vary widely, the research is inconclusive, and views may evolve over time and can be jurisdiction-specific. Recent papers by Professor David Hay entitled *The frontiers of auditing research* and *Opportunities for auditing research: Back to our interdisciplinary roots* (Hay, 2015; 2017), should guide academics in the research of key audit issues surrounding the MAFR debate, such as audit fee determinants, audit quality considerations, auditor independence etc. The paper entitled *Can the academic literature contribute to the debate over mandatory audit firm rotation?* by Casterella and Johnston (2013) is also a valuable guide for academics.

Concerning perceptions-based research that employs interview and questionnaire designs, other key stakeholder groups in the audit industry could be targeted, such as standard-setting bodies, regulators, financial managers, shareholders, accounting academics etc. Considering that opinions on MAFR change over time and are not static, researchers could also target the same participants as previous studies performed in the past. Therefore, in time, the same participants targeted in this study could be surveyed again.
The specific findings of this study also provide opportunities for future research. For example, a further understanding concerning the perceived decline in appeal of the audit industry in the minds of professional accountants is needed. This concern has the possibility of causing considerable damage to audit quality in South Africa and if it does exist, it needs to be addressed urgently. The implication of rotation on audit fees, contributing to the research of audit fee determinants, is another such area identified in this study. The possible need to amend section 90 of the Companies Act, as advised by many auditors in this study (section 8.3.4). Many such examples of areas for further research could be identified from the analysis of findings, conclusions and recommendations of this study.

In the South African context, there is the unique aspect of transformation that requires further attention. It was clear from the public debate on MAFR in South Africa that this is considered a high priority for all stakeholders, especially the regulator and government. The degree of transformation was found to be considered insufficient by auditors and AC chairs in this study. In addition, the conclusion of this study was that MAFR is likely to inhibit the ability of the audit industry to excel in its transformation objectives and hence alternative solutions are required. Researchers are in a position to make valuable contributions to inform audit industry participants, including audit firm executive management and the IRBA, on the best means of progressing black economic participation in the industry in a sustainable and responsible manner.

Finally, there is scope for quantitative research that employs different types of proxies to measure audit quality upon rotation, thereby gaining a better understanding of the causal relationships between factors affected by audit firm rotation and audit quality. Currently, pre-implementation of MAFR in South Africa, these studies could use proxies to measure audit quality before and after instances of voluntary rotation. After April 2023 (as per the IRBA ruling), the proxies could be employed in the context of mandatory rotations, similar to the studies of Ruiz-Barbadillo et al. (2009) in a Spanish context, Kwon et al. (2014) and
Hakwoon et al. (2015) in the South Korean market, and Cameran et al. (2015) in Italy (refer to Annexure 3). MAFR will provide many more rotation events that need to be studied from an audit quality perspective. In the current environment, given that voluntary firm rotation is less common, the rotations occur much less frequently. Research needs to contribute to the development of more robust and defensible proxies to measure audit and financial reporting quality. This is a key limitation in MAFR research internationally.

9.7 CONCLUSION

This study investigated the perceptions and arguments of key stakeholders in the South African MAFR debate, with specific consideration of audit quality, socio-economic transformation and market concentration factors, so as to provide recommendations on the implementation of MAFR and its possible unintended consequences. The empirical study found considerable evidence against MAFR regulations being effective as a means of increasing audit quality in South Africa, improving transformation or significantly decreasing the concentration of large audit firms supplying assurance services to exchange-listed companies. Evidence was found of strong opposition to MAFR by various stakeholder groups, including push-back from the non-Big Four audit firm auditors. The evidence suggests that MAFR is likely to result in outcomes which are contrary to the IRBA’s intentions, most concerningly with respect to audit quality. The primary recommendation of the study is therefore that the MAFR ruling be retracted by the IRBA or significantly amended.

While the conclusions of this study are contrary to the opinions and intentions of the IRBA with respect to MAFR, the overall objective and intention of this study is consistent with that of the IRBA, namely, to:

i. “protect the investing public, and to contribute to ensuring a reliable financial market which will generate confidence and promote investment and growth” (IRBA, 2016:9)

394
ii. “promote investment and as a consequence employment in the Republic” (Auditing Profession Act, 2005: Section 2(c))

A further intention of the study is congruous with the IRBA goal “to contribute meaningfully to the growth of the economy and the empowerment of its people” (IRBA, 2017:3). It is with these intentions that the study’s findings, conclusions and recommendations are submitted. The audit function is ultimately an activity of public protection and a means of promoting and enabling sustainable economic growth and value creation. Further research regarding audit quality in South Africa is strongly encouraged.

BIBLIOGRAPHY


Bam, L. (2017). Chief Executive Officer of Deloitte Inc. South Africa - Response to the IRBA Consultation Paper on MAFR, 20 January 2017 (Received directly from Deloitte Inc.).


Bourne, M. (2017). Professional Practice Director of EY Inc. South Africa - Response to the IRBA Consultation Paper on MAFR, 20 January 2017 (Received directly from EY Inc.).


Bryman, A. (2006). Integrating quantitative and qualitative research: how is it done?
Qualitative Research, 6(1), 97–113.


Campher, L. (2017). ASISA Response to the IRBA Consultation Paper, 20 January 2017 (Received directly from the ASISA).


International Accounting, Auditing and Taxation, 25, 46–66.


Hatfield, R. C., Jackson, S. B., & Vandervelde, S. D. (2011). The effects of prior auditor involvement and client pressure on proposed audit adjustments. *Behavioral...


http://www.iodsa.co.za/?page=AboutKingIV


IRBA. (2016e). The IRBA Consultation Paper. The Independent Regulatory Board for


King, M., & Natesan, P. (2016). *Mandatory Audit Firm Rotation (IoDSA response letter to the IRBA). Received directly from IoDSA.*


Knechel, W., & Vanstraelen, A. (2007). The relationship between auditor tenure and


Oddy, M. (2017). *Chief Executive Officer of KPMG Inc. South Africa - Response to the IRBA Consultation Paper on MAFR, 20 January 2017 (Received directly from KPMG Inc.).*


leads-the-way


Shango, D. (2017). *Chief Executive Officer of PwC Inc. South Africa - Response to the IRBA Consultation Paper on MAFR, 20 January 2017 (Received directly from PwC Inc.).*


413


Titley, J. (2015). Getting it right on rotation, ICAEW, 27 April. Retrieved September 2,


ANNEXURES

Annexure 1: Calls for additional research on MAFR

The following presents a selection of quotations regarding the need for more research to be performed around audit quality and MAFR specifically.

From academic literature:

- “Further research on audit tenure may help achieve a better understanding of the different incentives of audit firms and audit partners.” (Tepalagul & Lin, 2015:113)
- “academic research has been unable to provide clear answers about the consequences of mandatory audit firm rotation” (Lennox, Wu and Zhang, 2014:1780)
- “Issues such as joint audits, or audit firm rotation are very topical now because of the European Union reforms, but only a few years ago they appeared to be off the agenda for regulatory bodies... The topics that are being focused on extensively include auditors providing non-audit services, rotation of audit firms, joint audits and ways to provide increased competition.” (Hay, 2015:165)
- “In spite of the tremendous amount of research already conducted related to audit quality, there is still much room for future research. Such research could address the primary attributes of the audit— incentives, uniqueness, process, uncertainty, and judgment—with the different aspects of the audit—inputs, process, outcomes, and context.” (Knechel et al., 2013:403)
- “Future research of the impact of the introduction of the auditor tendering and rotation policies in Europe will further inform this international debate.” (Simnett et al., 2016:20)
• “Furthermore it is vague, how the EC reforms for a concentration decrease, e.g. the introduction of a mandatory audit firm rotation, are connected to an increased audit quality.” (Velte & Stiglbauer, 2012:158)

• “Examining audit quality across multiple jurisdictions, such as changes in international auditor and corporate governance requirements, has the ability to inform us as to why, due to certain contextual factors such as culture, certain international regulations may differentially impact audit quality in various jurisdictions. As assurance services on other than financial statements have been gaining popularity worldwide, we encourage more research in these areas to better inform related assurance standards. As we document, there is much we have learned from international auditing and assurance research to date, and we encourage more such research to inform the development of future knowledge about audit and assurance quality.” (Simnett et al., 2016:24)

• “How do audit committee members decide on the continuation or change of the external auditor?; How do audit committee members decide on the balance between audit and non-audit work for external auditors, and at what point do they believe independence of the audit might be impaired?” (Ghafran and O’Sullivan, 2013:400)

• “To take the research on audit quality to the next level, researchers need access to new and better data on drivers of audit quality whether it comes from the firms, clients, regulators, or other sources. With such information in hand, the scholarly quest for a better understanding of audit quality can continue.” (Knechel et al., 2013:407)

• “We further highlight the need for future research looking at the implications of measures designed to improve audit quality.” (Ewelt-Knauer, Gold and Pott, 2013:27)
From the auditing profession in South Africa:

The following quotes, in addition to illustrating the frustration felt by many in the auditing profession, highlight the significant resistance by some South African audit firms, especially the larger audit firms, against the IRBA ruling of MAFR.

- “We do not believe that MAFR increases auditor independence or enhances audit quality. There is no empirical evidence that it does. In addition, it does not improve market concentration. MAFR has been implemented and repealed in many other markets, due to not achieving on these objectives and in having unintended consequences including having counter effects than intended.” (Shango from PWC Inc., 2017:5)

- “Forcing changes in the appointment of audit firms will more likely increase instances of the types of deficiency that IRBA maintains it is aiming to resolve. We believe that it would be more appropriate to first try other available and less interventionist solutions before taking the more heavy-handed approach of introducing MAFR which is expected to significantly alter the efficiency of audit markets in South Africa in a manner that will affect not only audit firms but also the users of audit services in our capital markets” (Bourne from EY Inc., 2017:4)

- “We support any measure that enhances audit quality and auditor independence, however there is insufficient evidence that a problem currently exists. Furthermore, there is insufficient evidence that the introduction of the said measure will result in the desired outcome of enhanced quality as a result of improved auditor independence. We do not believe that the IRBA has provided compelling evidence that there is an auditor independence problem in South Africa and that this is negatively impacting the profession in terms of poor audit quality and c challenge to companies in the preparation of annual financial statements.” (Bam from Deloitte Inc., 2017:1)

- “Based on the current information included in the consultation paper there is no evidence to support that MAFR enhances auditor independence given the
extensive governance measures already in place in South Africa. Based on the information provided in the consultation paper we firmly believe that:

- The consultation process has been flawed and rushed;
- Evidence of research conducted on the viability of MAFR is lacking;
- An impact analysis around the unintended consequences of any possible implementation of MAFR needs to be performed;
- Any proposed MAFR provisions need to be dealt with in the Companies Act, as the greatest impact is beyond the auditing profession, and a thorough stakeholder consultation process is thus required;
- MAFR will negatively impact audit quality; MAFR will not enhance auditor independence;
- MAFR will add huge costs to an economy that is already under significant pressure; and
- MAFR will greatly complicate the process of appointing consistent global auditors for multinational companies.”

(Oddy from KPMG Inc., 2017:5)

From other key stakeholders in the South African MAFR debate:

The International Federation of Accountants (IFAC) letter to the IRBA -

- “On audit quality, however, IFAC points out that evidence does not clearly support the notion that mandatory audit firm rotation will enhance audit quality. Academic research is at best mixed, and practical examples are too often confounded by other elements.” (Choudhury, 2017:2)

The Banking Association South Africa -

- “[In respect of MAFR]… we believe that, without proper research or releasing the research performed together with pro-active plans to manage the risks inherent in MAFR, there could be many unintended consequences, particularly for systemically important institutions, such as banks.” (Coovadia, 2017:5)
“SAICA requests the IRBA to provide for the public consultation process to be extended, and additional independent research be commissioned on the feasibility, impact and cost-benefit of any additional regulations on auditor independence.” (SAICA, 2017:8)

The JSE Limited (Johannesburg Stock Exchange) -

“The IRBA have not provided evidence that lack of auditor independence is a problem in South Africa, leading to audit failure, pervasive or otherwise; Issuers have not seen research from the IRBA that would indicate that MAFR is the only and most appropriate response to achieve the IRBA’s three objectives” (Newton-King, 2016:2)

Chairperson of the South Africa JSE CFO Forum –

“we do not believe that it is appropriate for IRBA to continue with implementing MAFR which has significant adverse implications for the affected companies, without ensuring that the proposal to adopt and implement MAFR, has been through a formal, comprehensive and robust consultation process where all stakeholders are allowed to participate and where adequate research is conducted to firstly, confirm if auditor independence is indeed an issue, and secondly, if it is an issue, that MAFR is the best manner to address it or if there might be other more feasible alternatives that might be more effective. We further have not discussed the MAFR proposals with any of our major shareholders and thus are unable to determine whether they support such proposals. This research needs to be undertaken not just in South Africa, against a domestic shareholder base, but also with the international shareholders of South African listed entities.” (Ramon, 2017:4)

The above selection of quotations provides evidence that there is a need for additional research to contribute to the South African MAFR debate.
Annexure 2: List of countries showing application of MAFR

<table>
<thead>
<tr>
<th>Country</th>
<th>Audit Firm Rotation (Rotation periods indicated where possible)</th>
<th>Partner Rotation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>No</td>
<td>5 years</td>
</tr>
<tr>
<td>Austria</td>
<td>Yes (limited) - 5 years for government-owned companies</td>
<td>5 years</td>
</tr>
<tr>
<td>Belarus</td>
<td>Yes (limited) – 3 years for banks</td>
<td></td>
</tr>
<tr>
<td>Belgium</td>
<td>No (reappointment every 3 years with no limits)</td>
<td>6 years</td>
</tr>
<tr>
<td>Bolivia</td>
<td>Yes - 6 years for financial institutions and listed companies; 3 years for insurance and reinsurance companies and pension funds</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>Yes - 5 years for non-bank listed companies; 10 years for companies with statutory audit committees</td>
<td>No</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>No</td>
<td>5 years</td>
</tr>
<tr>
<td>Cambodia</td>
<td>Yes (limited) - 3 years for financial institutions</td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>China</td>
<td>Yes (limited) - 5 years for financial institutions and state-owned enterprises (there must be a tender process every 3 years)</td>
<td>5 years</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Croatia</td>
<td>Yes (limited) - 7 years for banks; 4 years for insurance and leasing companies</td>
<td>7 years</td>
</tr>
<tr>
<td>Cyprus</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Denmark</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Yes (limited) - 5 years for financial institutions; 6 years for insurance companies</td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>Yes - 7 years</td>
<td></td>
</tr>
<tr>
<td>European Union</td>
<td>Yes - 5 years for insurance and investment management companies; 5 year partner or firm rotation recommended</td>
<td></td>
</tr>
<tr>
<td>Finland</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>France</td>
<td>No – 6 years with joint audit but may be renewed</td>
<td>6 years</td>
</tr>
<tr>
<td>Georgia</td>
<td>Yes – 10 years for public-interest entities</td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Greece</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Hungary</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Iceland</td>
<td>Yes (limited) - 5 years for financial institutions and insurance companies</td>
<td></td>
</tr>
<tr>
<td>Country</td>
<td>Requirement</td>
<td></td>
</tr>
<tr>
<td>-------------</td>
<td>------------------------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>Yes - 10 years for listed companies and some unlisted companies, with 5-year cooling-off period; 4 or 5 years for public sector entities; 4 years for banks and insurance companies; 2 years for provident trusts</td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>Yes - 10 years for financial institutions and listed companies, with 2-year cooling-off period; 6 years for public and private companies (however many companies “reconstitute” every 6 years); 5 years for Central bank</td>
<td></td>
</tr>
<tr>
<td>Ireland</td>
<td>No 5 years</td>
<td></td>
</tr>
<tr>
<td>Israel</td>
<td>Yes (limited) - two 3 year rotation periods for government companies, with possible extension in certain circumstances</td>
<td></td>
</tr>
<tr>
<td>Italy</td>
<td>Yes - 9 years for listed companies and public interest entities 7 years</td>
<td></td>
</tr>
<tr>
<td>Kuwait</td>
<td>Yes – 4 years for listed companies; 6 years for government and quasi-government institutions</td>
<td></td>
</tr>
<tr>
<td>Laos</td>
<td>Yes – 3 years for banks; 3 years for listed companies, with possible extension of 1 year in certain circumstances</td>
<td></td>
</tr>
<tr>
<td>Latvia</td>
<td>No 7 years</td>
<td></td>
</tr>
<tr>
<td>Lithuania</td>
<td>No 5 years for PIEs; 7 years for some other legal entities</td>
<td></td>
</tr>
<tr>
<td>Luxembourg</td>
<td>No 7 years</td>
<td></td>
</tr>
<tr>
<td>Macedonia</td>
<td>Yes (limited) - 5 years for banks and insurance companies</td>
<td></td>
</tr>
<tr>
<td>Malta</td>
<td>No 7 years</td>
<td></td>
</tr>
<tr>
<td>Morocco</td>
<td>Yes - 12 years for listed companies; 6 years for banks</td>
<td></td>
</tr>
<tr>
<td>Mozambique</td>
<td>Yes (limited) - 5 years for credit and financial institutions</td>
<td></td>
</tr>
<tr>
<td>Netherlands</td>
<td>No 7 years</td>
<td></td>
</tr>
<tr>
<td>Nigeria</td>
<td>Yes (limited) - 10 years for regulated private companies, with 7-year cooling-off period</td>
<td></td>
</tr>
<tr>
<td>Oman</td>
<td>Yes - 4 years for listed companies, government controlled companies and private joint stock companies</td>
<td></td>
</tr>
<tr>
<td>Pakistan</td>
<td>Yes (limited) - 5 years for financial institutions and insurance companies</td>
<td></td>
</tr>
<tr>
<td>Country</td>
<td>Requirement Details</td>
<td>Duration</td>
</tr>
<tr>
<td>------------------------</td>
<td>---------------------------------------------------------------------------------------</td>
<td>-----------</td>
</tr>
<tr>
<td>Palestine – West Bank &amp; Gaza</td>
<td>Yes (limited) - (of audit firm if audit partner rotation is not possible) for banks and microfinance institutions</td>
<td>5 years</td>
</tr>
<tr>
<td>Paraguay</td>
<td>Yes (limited) - 3 years for financial institutions, insurance and reinsurance companies and listed companies</td>
<td></td>
</tr>
<tr>
<td>Peru</td>
<td>Yes (limited) - 2 years for government entities</td>
<td></td>
</tr>
<tr>
<td>Philippines</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Poland</td>
<td>No</td>
<td>5 years</td>
</tr>
<tr>
<td>Portugal</td>
<td>No (However, 8-9 years for listed companies on a “comply or explain” basis)</td>
<td>7 years</td>
</tr>
<tr>
<td>Qatar</td>
<td>Yes (limited) - 5 years for banks; 3 years is a recommended best practice for Qatar shareholding companies, whether listed or not</td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Russia</td>
<td>Yes (limited) - 5 years for banks</td>
<td></td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Yes – 5 years for joint stock listed companies; for banks upon request from the central bank</td>
<td></td>
</tr>
<tr>
<td>Serbia</td>
<td>Yes (limited) - 5 years for banks and insurance companies, with 10 years allowed when combines with partner rotation</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>No</td>
<td>5 years for listed companies; 7 years for other PIEs</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>Yes (limited) - 5 years for public companies</td>
<td>5 years</td>
</tr>
<tr>
<td>Slovenia</td>
<td>Yes (limited) - 5 years for the banking and insurance industry only</td>
<td>7 years</td>
</tr>
<tr>
<td>South Korea</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Spain</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Sweden</td>
<td>No</td>
<td>7 years</td>
</tr>
<tr>
<td>Tunisia</td>
<td>Yes (limited) - two 3 year rotation periods for financial sector companies; three 3 year rotation periods for listed and non-listed companies with fewer than 3 partners; five 3-year rotation periods for listed and non-listed companies with more than 3 partners, which have partner rotation</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>Yes - 7 years for public firms listed on Instanbul exchange</td>
<td>5 years</td>
</tr>
<tr>
<td>Uganda</td>
<td>No</td>
<td></td>
</tr>
<tr>
<td>Ukraine</td>
<td>Yes (limited) - 7 years for banks; 5 years for National Bank</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>10 years</td>
<td>5 years</td>
</tr>
<tr>
<td>Country</td>
<td>Requirement</td>
<td>Duration</td>
</tr>
<tr>
<td>-----------------------</td>
<td>--------------------------------------------------</td>
<td>----------</td>
</tr>
<tr>
<td>United States of America</td>
<td>No</td>
<td>5 years</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>Yes – 3 years for all companies that require and audit (including financial institutions, joint stock companies, insurance companies, and not-for-profit organisations)</td>
<td></td>
</tr>
<tr>
<td>Venezuela</td>
<td>Yes (limited) - 3 years for banks</td>
<td></td>
</tr>
<tr>
<td>Vietnam</td>
<td>Yes (limited) - 5 years for banks</td>
<td></td>
</tr>
</tbody>
</table>

Source: Author’s own construction based on information from Casterella and Johnston (2013); Cameran, Negri and Pettinicchio (2015); Hakwoon, Hyoik and Jong Eun (2015); Fontaine, Khemakhem and Herda (2016); IRBA (2016); and SAICA (2016)
Studies focusing specifically on audit firm rotation, that measure proxies of audit quality within jurisdictions where MAFR has been implemented, include Ruiz-Barbadillo, Gómez-Aguilar, and Carrera (2009) in a Spanish context, Kwon, Lim and Simnett (2014) and Hakwoon et al. (2015) in the South Korean market, and Cameran et al. (2015) in Italy. Another study referenced here is that of Jackson, Moldrich, and Roebuck (2008) in an Australian context, however, this was in a setting of voluntary rotation (like South Africa), rather than MAFR. Various proxies for audit quality has been employed in such studies (refer to Table 2.1 in Chapter 2) and none of these studies provide substantial evidence in favour MAFR. All five of these studies, with the possible exception of Hakwoon et al. (2015) - refer below - provide evidence against the effectiveness of MAFR to improve audit quality. However, it must be acknowledged that there is a limitation in these approaches in the researchers’ ability to justify measurable proxies that accurately measure audit quality, such as discretionary accruals and going concern opinions. As discussed in Chapter 2, audit quality is a difficult concept to define, let alone measure with a proxy (Casterella & Johnston, 2013).

1. **Jackson et al. (2008)** (voluntary firm rotation) examine auditor switching in exchange-listed Australian companies between 1995 and 2003. The findings show 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, it is concluded that there are minimal, if any, benefits of mandatory audit firm rotation (Jackson et al., 2008).

2. **Ruiz-Barbadillo et al. (2009)**, using Spanish archival data during the years 1988-1995 when MAFR was in effect, find no evidence to suggest that a mandatory
rotation requirement is associated with a higher likelihood of issuing going-concern opinions. Results suggest that auditors’ incentives to protect their reputation have a positive impact on the likelihood of issuing going-concern opinions, while auditors’ incentives to retain existing clients did not impact on their decisions in both the MAFR and post-MAFR periods. Overall, the findings do not support MAFR.

3. **Kwon et al. (2014)**, with South Korean data from 2006-2010 when MAFR was in effect, using abnormal discretionary accruals as the proxy, indicated that MAFR did not significantly change audit quality.

4. **Hakwoon et al. (2015)**, in a Korean context similar to that of Kwon et al. (2014), offer some evidence in support of MAFR. Under MAFR, newly rotated auditors were found to be more likely to issue first-time going-concern audit opinions to financially distressed firms during their first-year of the audit, compared with under voluntary firm change. Moreover, firms audited by mandatorily rotated new auditors have less discretionary accruals and higher accrual quality than those audited by voluntarily switched new auditors during the initial audit engagement. However, it must be noted that this research is not comparing audit firm rotation versus no audit firm rotation scenarios. It is comparing MAFR with voluntary firm rotation. As such, its relevance to the MAFR debate in South Africa is limited. The findings suggest that MAFR produces better audit quality than voluntary firm rotation (Hakwoon et al., 2015).

5. **Cameran et al. (2015)** research the Italian context where MAFR has been implemented since 1975. Findings indicate that outgoing auditors do not shirk on audit effort, but final year fees are 7 percent higher than normal which may indicate opportunistic pricing. The fees of incoming auditors are discounted by 16 percent even though they have abnormally higher engagement hours in the first year.
percent), which is suggestive of low-balling. However, subsequent fees are abnormally higher and exceed the initial fee discount. Thus, Cameran et al. (2015) indicate that the costs of mandatory rotation are nontrivial. In addition, the findings provide evidence that audit quality decreases with firm rotation, as proxied by audited earnings in the first three years following rotation, relative to later years of auditor tenure. Cameran et al. (2015) conclude that, since rotation is costly and earnings quality improves with longer auditor tenure, the evidence from Italy does not support the case for MAFR.

The methodology of the above studies, i.e. attempting to measure changes in audit or financial reporting quality upon implementation of MAFR, cannot be performed in South Africa, as MAFR is only effective April 2023. Hence, this study, rather than using a proxy measure, employs a mixed methods design that seeks to understand the perspectives of key stakeholders in the South African audit industry (refer to the methodology discussion in Chapter 7).
## Annexure 4: Hypotheses and linkages from theoretical model (Direct and Indirect effects)

### Direct effects

<table>
<thead>
<tr>
<th>Hypotheses and linkages from Figure 7.3</th>
<th>Reference to literature</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>H1:</strong> Stakeholders perceive MAFR to have a negative impact on auditor client-specific knowledge. <strong>(Link 2)</strong></td>
<td>Refer to: Chapter 3, Section 3.4; Chapter 5, Sections 5.5, 5.6 and 5.8 Ewelt-Knauer et al. (2013:30); Wilson et al. (2018:1); Harber (2016:7); Fontaine et al. (2016:485); Bam (2017); Bourne (2017); Newton-King (2016); Oddy (2017); Ramon (2016); Shango (2017)</td>
</tr>
<tr>
<td><strong>H2:</strong> Stakeholders perceive MAFR to not have a significant impact on auditors’ independence and professional scepticism. <strong>(Link 1)</strong></td>
<td>Refer to: Chapter 2, Section 2.4; Chapter 3, Sections 3.3 and 3.4; Chapter 5, Sections 5.4, 5.5, 5.6 and 5.8 Daniels and Booker (2011:78); Shockley (1981:785); Tepalagul and Lin (2015:108); Stefaniak et al. (2009:57); Ball et al.(2015:166); Ewelt-Knauer et al. (2013:27); Fontaine et al. (2016:485); Wilson et al. (2018:1); Harber (2016:7); Bam (2017); Bourne (2017); Newton-King (2016); Oddy (2017); Ramon (2016); Shango (2017); Campher (2017)</td>
</tr>
<tr>
<td><strong>H3:</strong> Stakeholders perceive MAFR to increase perceived auditor independence in the minds of the investing public. <strong>(Link 1)</strong></td>
<td>Refer to: Chapter 2, Section 2.5.2; Chapter 3, Sections 3.3 and 3.4; Chapter 5, Sections 5.4, 5.5, 5.6 and 5.8 Ball et al.(2015:166); Harber (2016:7); Bam (2017); Ewelt-Knauer et al. (2013); Fontaine et al. (2016); Oddy (2017); Shango (2017); (IRBA, 2016e)</td>
</tr>
<tr>
<td><strong>H4:</strong> Stakeholders perceive MAFR to increase the degree of market concentration by the big 4 firms in the audit profession. <strong>(Link 4)</strong></td>
<td>Refer to: Chapter 5, Sections 5.4, 5.5, 5.6, 5.7 and 5.8 Russell (2013:17); Chen and Zhou (2007); Harber (2016:7); Bam (2017); Bourne (2017); Oddy (2017); Shango (2017); (IRBA, 2016e)</td>
</tr>
<tr>
<td><strong>H5:</strong> Stakeholders perceive that MAFR will reduce the rate at which transformation is being achieved in the audit profession. <strong>(Link 3)</strong></td>
<td>Refer to: Chapter 5, Sections 5.4, 5.5, 5.6, 5.7 and 5.8 Harber (2016:7); Bam (2017); Bourne (2017); Oddy (2017); Shango (2017); (IRBA, 2016e)</td>
</tr>
<tr>
<td><strong>Link 5:</strong> Increased auditor independence increases audit quality.</td>
<td>Refer to: Chapter 2, Section 2.4 Tepalagul and Lin (2015:103); Cameron, et al. (2005:29); Casterella and Johnston (2013:109); Knechel et al., (2013:386); IFAC Code, Section 290:6 (2016); Daniels and Booker (2011:78)</td>
</tr>
<tr>
<td><strong>Link 6:</strong> Increased knowledge of the client (skill, experience and expertise) increases audit quality.</td>
<td>Refer to: Chapter 1, Figure 1.1; Chapter 2, Section 2.3 Tepalagul and Lin (2015:103); Casterella and Johnston (2013:109); Knechel et al. (2013:392); IFAC Code, Section 100, 210 (2016)</td>
</tr>
<tr>
<td><strong>Link 7:</strong> Increased transformation in the audit industry increases audit quality.</td>
<td>Refer to: Chapter 5, Section 5.7.4 Andrevski et al. (2014:821)</td>
</tr>
<tr>
<td><strong>Link 8:</strong> Increased concentration of the market decreases audit quality.</td>
<td>Refer to: Chapter 5, Section 5.7.1 Francis et al. (2013); Velte and Stiglbauer (2012); Chu et al. (2015)</td>
</tr>
</tbody>
</table>
## Indirect effects

<table>
<thead>
<tr>
<th>Hypotheses and linkages from Figure 7.4</th>
<th>Reference to literature</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>H6:</strong> Stakeholders perceive that MAFR will reduce audit partner quality of work life. (Link 9)</td>
<td>Refer to: Chapter 3, Sections 3.3 and 3.4; Chapter 5, Sections 5.5, 5.6 and 5.8 Daugherty et al. (2012); Harber (2016); Harber and West (2017)</td>
</tr>
<tr>
<td><strong>H7:</strong> Stakeholders perceive that MAFR will require audit partners to undergo significant efforts to upskill and retrain themselves for new industries. (Link 9 and 10)</td>
<td>Refer to: Chapter 3, Sections 3.3 and 3.4; Chapter 5, Sections 5.5, 5.6 and 5.8 Daugherty et al. (2012); Harber (2016); Harber and West (2017)</td>
</tr>
<tr>
<td><strong>H8:</strong> Stakeholders perceive that MAFR will reduce the appeal, in the minds of chartered accountants, of the auditing profession, in comparison to other career options. (Link 10)</td>
<td>Refer to: Chapter 3, Sections 3.3 and 3.4; Chapter 5, Sections 5.5, 5.6 and 5.8 Bam (2017); Bourne (2017); Oddy (2017); Shango (2017); Daugherty et al. (2012); Harber (2016); Harber and West (2017)</td>
</tr>
<tr>
<td><strong>H9:</strong> Stakeholders perceive that MAFR will significantly increase costs to the audit firms. (Link 11)</td>
<td>Refer to: Chapter 3, Section 3.5; Chapter 5, Sections 5.5, 5.6 and 5.8 Bedard and Johnstone (2010); Harber (2016); ICAA (2015); Knechel et al. (2013); Kwon et al. (2014); Stefaniak et al. (2009); Trompeter (1994); Harber and West (2017); Bam (2017); Bourne (2017); Oddy (2017); Shango (2017)</td>
</tr>
<tr>
<td><strong>H10:</strong> Stakeholders perceive that MAFR will significantly increase costs to companies in the form of increased audit fees. (Link 11)</td>
<td>Refer to: Chapter 3, Section 3.5; Chapter 5, Sections 5.5, 5.6 and 5.8 Bedard and Johnstone (2010); Harber (2016); ICAA (2015); Knechel et al. (2013); Kwon et al. (2014); Stefaniak et al. (2009); Trompeter (1994); Harber and West (2017); Bam (2017); Bourne (2017); Oddy (2017); Shango (2017)</td>
</tr>
<tr>
<td><strong>H11:</strong> Stakeholders perceive that MAFR will reduce the ability and/or incentive of the audit committee to apply professional judgement to assess auditor independence and to find the audit firm best able to provide them with a high quality audit. (Link 12)</td>
<td>Refer to: Chapter 4; Chapter 5, Sections 5.5, 5.6 and 5.8 Harber (2016); Harber and McGregor (2017); Harber and West (2017); Bam (2017); Bourne (2017); Oddy (2017); Shango (2017); Ramon (2016)</td>
</tr>
<tr>
<td><strong>H12:</strong> Stakeholders perceive that, in addition to the current measures in place, there are better solutions than MAFR to address the concerns raised by the IRBA.</td>
<td>Refer to: Chapter 3, Section 3.4; Chapter 5, Sections 5.5, 5.6 and 5.8 Bam (2017); Bourne (2017); Campher (2017); Ewelt-Knauer et al. (2013); Fontaine et al. (2016); Harber (2016); ICAA (2015); Newton-King (2016); Oddy (2017); Ramon (2016); Shango (2017); Harber and West (2017)</td>
</tr>
<tr>
<td><strong>Link 13:</strong> Improvements in the quality of work life for audit partners increases audit quality.</td>
<td>Refer to: Chapter 3, Sections 3.3; Chapter 5, Sections 5.6 and 5.8 Daugherty et al. (2012); Harber (2016); Harber and West (2017)</td>
</tr>
<tr>
<td><strong>Link 14:</strong> Increased appeal towards the audit profession in the minds of chartered accountants will increase audit quality.</td>
<td>Refer to: Chapter 3, Sections 3.3; Chapter 5, Sections 5.6 and 5.8 Daugherty et al. (2012); Harber (2016); Harber and West (2017)</td>
</tr>
<tr>
<td><strong>Link 15:</strong> Increased costs in the audit profession decreases audit quality.</td>
<td>Refer to: Chapter 3, Section 3.5; Chapter 5, Sections 5.5, 5.6 and 5.8 Bedard and Johnstone (2010); Harber (2016); ICAA (2015); Knechel et al. (2013); Kwon et al. (2014); Stefaniak et al. (2009); Trompeter (1994); Harber and West (2017); Bam (2017); Bourne (2017); Oddy (2017); Shango (2017)</td>
</tr>
<tr>
<td><strong>Link 16:</strong> Increased allowance for the use of professional judgement by auditors, audit committees and shareholders will increase audit quality.</td>
<td>Refer to: Chapter 4; Chapter 5, Sections 5.5, 5.6 and 5.8 Campher (2017); Cohen et al. (2010); Harber and McGregor (2017); Marx (2009a); Marx (2009b); Ramon (2016)</td>
</tr>
</tbody>
</table>
Annexure 5: Linking the hypotheses to the questionnaire

<table>
<thead>
<tr>
<th>Hypotheses</th>
<th>Relevant section of questionnaire</th>
<th>Selection of relevant statements/questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hypothesis 1</td>
<td>Impact of MAFR on auditor client-specific knowledge</td>
<td>Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>A steep learning curve exists for the incoming, newly-appointed audit firm.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The potential loss of client-specific knowledge is a significant problem with MAFR.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Medium-sized audit firms (non-&quot;big 4&quot;) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.</td>
</tr>
<tr>
<td>Hypothesis 2</td>
<td>Impact of MAFR on auditors’ independence and professional skepticism</td>
<td>In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Longer audit firm tenures result in less auditor independence.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MAFR will increase the independence of audit firms (and audit partners).</td>
</tr>
<tr>
<td>Hypothesis 3</td>
<td>Impact of MAFR on perceived auditor independence in the minds of the investing public</td>
<td>The investing public tend to believe that there is a significant degree of bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistleblower.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Any perceived problems regarding auditor independence by the investing public primarily result from their knowledge of long audit firm tenures.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.</td>
</tr>
<tr>
<td>Hypothesis 4</td>
<td>Impact of MAFR on the degree of market concentration by the “big 4” firms</td>
<td></td>
</tr>
<tr>
<td>-------------</td>
<td>--------------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MAFR will allow other smaller audit firms, such as the mid-tier firms, the opportunity to tender for these audit engagements.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MAFR will reduce the concentration of non-big 4 audit firms providing audit services for JSE listed companies.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The size of an audit firm's geographical footprint (international presence) is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Non-big 4 audit firms (mid-tier firms) have a sufficient geographical footprint (international presence) to be appointed as auditors of large multinational companies on the JSE.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>In order to maintain audit efficiency, effectiveness and reduce the overall cost, the audit committee seeks to appoint (or recommend for appointment) the same audit firm in each of the geographic areas and jurisdictions in which the group operates.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Industry-specific knowledge and experience within the audit firm is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Non-big 4 audit firms (mid-tier firms) have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Audit committees of JSE listed companies are likely to recommend non-big 4 audit firms for appointment as external auditors.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Shareholders of JSE listed companies, in the AGM, are likely to appoint non-big 4 audit firms as external auditors.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Considering that the performance of advisory services (non-audit work) by an audit firm creates an independence threat that limits or prevents that firm from being appointed as auditor, MAFR will reduce the choice of audit firms available for appointment by the audit committee.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Non-big 4 audit firms will be able to obtain more non-audit work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hypothesis 5</th>
<th>Impact of MAFR on transformation in the audit profession</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>According to the IRBA, of the 4,283 registered auditors in South Africa, 74.8% are white and only 10.5% are black Africans. Of the 353 audit partners signing off on listed company audits, only 9 are black African. Based on this, please provide your response to the following statement: The rate of transformation in the audit profession is acceptable.</td>
</tr>
<tr>
<td></td>
<td>MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.</td>
</tr>
<tr>
<td></td>
<td>MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.</td>
</tr>
<tr>
<td></td>
<td>The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.</td>
</tr>
<tr>
<td></td>
<td>MAFR will improve the transformation statistics in the South African audit profession.</td>
</tr>
<tr>
<td></td>
<td>Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.</td>
</tr>
<tr>
<td></td>
<td>The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.</td>
</tr>
</tbody>
</table>
| Hypotheses 6 and 7 | Impact of MAFR on audit partner quality of work life | MAFR will require audit partners to devote more time to preparing and participating in tenders for audit appointments.  
MAFR will put pressure on outgoing audit firm partners and audit firm leadership to replace audit clients and lost revenue streams resulting from firm rotation.  
The pressure on outgoing audit firm partners to replace audit clients and lost revenue streams, resulting from MAFR will cause audit partners to lose focus on the actual audit work, thereby decreasing audit quality in the final years of the rotation period.  
The rotation of audit clients, which will result from MAFR, places additional risk on engagement partners, especially during the initial years of the audit, when the risk of audit failure is greater due to lack of familiarity with the client and industry.  
MAFR will increase the need for registered auditors to retrain and upskill themselves to audit new companies, within industries with which they previously had little (or less) experience.  
The need for registered auditors to retrain and upskill themselves to audit new companies will negatively impact audit quality. |
| --- | --- | --- |
| Hypothesis 8 | Impact of MAFR on the appeal of the audit profession | The audit profession in South Africa is over-regulated (meaning unnecessarily or excessively regulated).  
As a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths.  
MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants.  
MAFR will result in an increased trend of audit managers and audit partners seeking employment outside of assurance services. |
| Hypotheses 9 and 10 | Impact of MAFR on costs to the audit firms | MAFR will require audit firms to spend significant resources (money, time, staff etc.) around the following activities: (Various activities provided)  
Increases in costs will be passed on to companies in the way of increased audit fees.  
Medium-sized audit firms (non-big 4) have the resources (money, time, staff etc.) to provide competitive tender proposals to secure audit appointments.  
Increases in audit costs, or losses in audit revenues to audit firms, caused by MAFR, will be offset by opportunities to provide non-audit services, such as tax and advisory services to previous audit clients.  
MAFR will result in employment instability and retrenchments (within audit firms) due to loss of clients through rotation.  
Any financial losses incurred by the audit firm due to MAFR will be sufficiently offset by new client appointments.  
MAFR will result in significant increases in the premiums of audit firm professional indemnity insurance. |
<table>
<thead>
<tr>
<th>Hypotheses 9 and 10</th>
<th>Impact of MAFR on cost to companies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MAFR will result in significantly increased audit fees, i.e. significant to the companies involved.</td>
</tr>
<tr>
<td></td>
<td>Regarding potential increases in audit fees resulting from MAFR: Audit committees will agree to increased audit fees in the short-term (1-2 years of the new appointment), but not in the longer-term.</td>
</tr>
<tr>
<td></td>
<td>Regarding potential increases in audit fees resulting from MAFR: Audit committees will agree to permanently increased audit fees, i.e. for the duration of the rotation period that the audit firm may be appointed.</td>
</tr>
<tr>
<td></td>
<td>MAFR will result in significant costs to the company in terms of time and resource investment by senior management and audit committees.</td>
</tr>
<tr>
<td></td>
<td>MAFR will introduce a significant added cost to the audit committees of JSE listed companies as they will be required to receive and consider tenders (proposals) to appoint auditors more regularly.</td>
</tr>
<tr>
<td></td>
<td>The additional cost to the company from MAFR will not add any incremental benefits, economic or otherwise, and thus negatively impact on shareholder value.</td>
</tr>
<tr>
<td></td>
<td>The additional investment in time by boards, audit committees and executive management, resulting from MAFR, will be a significant distraction from running the business to those involved at the company.</td>
</tr>
<tr>
<td></td>
<td>MAFR will require significant additional investment in time by the financial managers, supervisors and controllers, including other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team.</td>
</tr>
<tr>
<td></td>
<td>MAFR will cause significant additional cost and time for the group to appoint the same auditor across all group companies as it will require various shareholder approvals and regulatory processes.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hypothesis 11</th>
<th>Impact of MAFR on the need for and use of professional judgement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The audit profession in South Africa is over-regulated (meaning unnecessarily or excessively regulated).</td>
</tr>
<tr>
<td></td>
<td>As a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths.</td>
</tr>
<tr>
<td></td>
<td>MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants.</td>
</tr>
<tr>
<td></td>
<td>MAFR will result in an increased trend of audit managers and audit partners seeking employment outside of assurance services.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Hypothesis 12</th>
<th>Alternatives to MAFR</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>In order to address the concerns being raised by the IRBA with regards to auditor independence on JSE listed company audits, indicate your opinion on the following alternatives, considered in combination, not in isolation, as being preferable to MAFR: (Several alternatives provided)</td>
</tr>
</tbody>
</table>

* Comments were requested (using comment boxes) at the end of each respective section of the questionnaire to facilitate the capturing of comments (qualitative data).  
** The sections and selection of statements/questions do not represent the entirety of the surveys. Each survey was specifically adapted for the perspectives of the respective participant group. This Annexure relates specifically to the registered auditor group questionnaire. Refer to Annexure 7 for each respective questionnaire.
Annexure 6: List of companies, auditors and equity asset managers

**JSE-listed companies:**

<table>
<thead>
<tr>
<th>Company</th>
<th>Auditor/Manager</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acsion Hospitality Property Fund</td>
<td>PSG Konsult</td>
</tr>
<tr>
<td>AECI</td>
<td>Raubex</td>
</tr>
<tr>
<td>African Oxygen</td>
<td>RCL Foods</td>
</tr>
<tr>
<td>Afrimat</td>
<td>Rebosis Property Fund</td>
</tr>
<tr>
<td>Anglo American</td>
<td>Redefine</td>
</tr>
<tr>
<td>AngloGold Ashanti</td>
<td>Remgro</td>
</tr>
<tr>
<td>Arcelor Mittal</td>
<td>Resilient</td>
</tr>
<tr>
<td>Assore</td>
<td>Rhodes Food Group</td>
</tr>
<tr>
<td>Astral Foods</td>
<td>RMB</td>
</tr>
<tr>
<td>Bidvest</td>
<td>Royal Bafokeng Platinum</td>
</tr>
<tr>
<td>Blue Label Telecoms</td>
<td>SA Corporate Real Estate</td>
</tr>
<tr>
<td>Capevin Holdings</td>
<td>Sanlam</td>
</tr>
<tr>
<td>Capital Property</td>
<td>Santam</td>
</tr>
<tr>
<td>Capitec Bank</td>
<td>Sappi</td>
</tr>
<tr>
<td>Cashbuild</td>
<td>Sasol</td>
</tr>
<tr>
<td>City Lodge Hotels</td>
<td>Shoprite</td>
</tr>
<tr>
<td>Clicks</td>
<td>Sibanye Gold</td>
</tr>
<tr>
<td>Clientele</td>
<td>Spar</td>
</tr>
<tr>
<td>Coronation Fund Managers</td>
<td>Standard Bank</td>
</tr>
<tr>
<td>Curro</td>
<td>Sun International</td>
</tr>
<tr>
<td>Datatec</td>
<td>Super Group</td>
</tr>
<tr>
<td>Dischem</td>
<td>Sygnia</td>
</tr>
<tr>
<td>Discovery</td>
<td>Telkom</td>
</tr>
<tr>
<td>Distell</td>
<td>The Foschini Group</td>
</tr>
<tr>
<td>Emira Property Fund</td>
<td>Netcare</td>
</tr>
<tr>
<td>Famous Brands</td>
<td>Tiger Brands</td>
</tr>
<tr>
<td>EOH</td>
<td>Tongaat</td>
</tr>
<tr>
<td>Famous Brands</td>
<td>Transaction Capital</td>
</tr>
<tr>
<td>FirstRand</td>
<td>Truworths</td>
</tr>
<tr>
<td>Goldfields</td>
<td>Tsogo Sun</td>
</tr>
<tr>
<td>Grindrod</td>
<td>Vodacom</td>
</tr>
<tr>
<td>Growthpoint Properties</td>
<td>Vukile Property Fund</td>
</tr>
<tr>
<td>Harmony Gold</td>
<td>WHBO</td>
</tr>
<tr>
<td>HCI</td>
<td>Woolworths</td>
</tr>
<tr>
<td>HCI</td>
<td>Zeder Investment</td>
</tr>
</tbody>
</table>
Accredited audit firms and partners:

<table>
<thead>
<tr>
<th>Audit firm</th>
<th># partners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baker Tilly Greenwoods</td>
<td>6</td>
</tr>
<tr>
<td>BDO South Africa</td>
<td>6</td>
</tr>
<tr>
<td>Certified Master Auditors</td>
<td>4</td>
</tr>
<tr>
<td>Deloitte &amp; Touche South Africa</td>
<td>51</td>
</tr>
<tr>
<td>Ernst &amp; Young</td>
<td>28</td>
</tr>
<tr>
<td>Grant Thornton South Africa</td>
<td>26</td>
</tr>
<tr>
<td>Horwath Leveton Boner</td>
<td>3</td>
</tr>
<tr>
<td>KPMG</td>
<td>52</td>
</tr>
<tr>
<td>Mazars</td>
<td>12</td>
</tr>
<tr>
<td>MMS Group</td>
<td>4</td>
</tr>
<tr>
<td>Middel &amp; Partners</td>
<td>5</td>
</tr>
<tr>
<td>Moore Stephens South Africa</td>
<td>4</td>
</tr>
<tr>
<td>Nexia SAB&amp;T</td>
<td>6</td>
</tr>
<tr>
<td>Nkonki</td>
<td>4</td>
</tr>
<tr>
<td>Nolands SA</td>
<td>4</td>
</tr>
<tr>
<td>PKF South Africa</td>
<td>10</td>
</tr>
<tr>
<td>PwC Southern Africa</td>
<td>61</td>
</tr>
<tr>
<td>RSM South Africa</td>
<td>6</td>
</tr>
<tr>
<td>SizweNtsalubaGobodo</td>
<td>9</td>
</tr>
<tr>
<td>Tuffias Sandberg</td>
<td>4</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>305</strong></td>
</tr>
</tbody>
</table>

Equity Asset Managers:

- Absa Asset Management
- Allan Gray
- Coronation Fund Managers
- Foord Asset Management
- Investec Asset Management
- Old Mutual Investment Group
- Prescient Investment Management
- Prudential Investment Managers
- Sanlam Investments
- Stanlib Asset Management

The list represents the 10 largest asset management companies (asset managers) according to Rand value of funds under management. This list was received directly from the ASISA.
E-MAIL TO THE CHIEF FINANCIAL OFFICER

From: John Burke [mailto:JohnB@jse.co.za]
Sent: 31 August 2017 10:41 AM
To: CFO email
Cc: Michael Harber
Subject: FW: Mandatory Audit Firm Rotation Research

Dear <Personalised Name>

It would be greatly appreciated if you could find the time to complete the included questionnaire.
Would you also please distribute the questionnaire to the chair of your audit committee for completion?

The questionnaires relate to important doctoral research regarding the direct and indirect consequences to the South African business community from the intended adoption of mandatory audit firm rotation (MAFR) by the South African audit industry regulator, the Independent Regulatory Board for Auditors (IRBA). The aim of the research is to gain qualitative and quantitative insights from questioning the key individual participants and stakeholders involved with, and experienced in, the external audit processes of South African companies listed on the stock exchange.

This research is of particular relevance given the clear intention of the IRBA to adopt MAFR and the recent public debate on the topic, which have included Parliamentary hearings before the Standing Committee on Finance. As a business leader and Chief Financial Officer your input is essential.

Mr. Michael Harber has completed his Master’s thesis on the topic of MAFR and has presented on the topic to the Parliamentary Standing Committee on Finance based on their request in 2017. The results of this PhD research is intended to be an objective and academically rigorous contribution to the South African debate on the topic and the findings will be provided to all relevant regulators and stakeholders.

It is estimated that the questionnaire will not take longer than 45 minutes to complete and your input as part of the population of 100 (JSE Top 100 companies) is critical to the success of this research.
As Chief Financial Officer, the link to the CFO questionnaire is here: {LINK}

I also request that you forward this email to your group Audit Committee Chair as there is a separate questionnaire in order to obtain their perspective on MAFR. As Audit Committee Chair, the link to your questionnaire is here: {LINK}

Should you wish to contact Michael Harber, please do so as follows at:

Post: 5.16 Leslie Commerce Building, UCT Upper Campus, Rondebosch, Cape Town, 7405
Email: michael.harber@uct.ac.za
Tel: (021) 650-2272 or (083) 447 8770

Your co-operation is greatly appreciated.

Kind regards

John Burke
Director
Issuer Regulation
T +2711 520 7060
M +2782 655 3364

The views and opinions expressed in this message are those of the individual sender of this message and do not necessarily represent the views and opinions of the JSE. Consequently, the JSE does not accept responsibility for such views and opinions and this message should not be read as representing the views and opinions of the JSE or constitute binding terms and conditions without subsequent written confirmation and an authorizing resolution where required. Each page attached hereto must also be read in conjunction with this disclaimer and should any part of this message be unclear, the issue should be clarified with the Company Secretary of the JSE.

Confidentiality note: The message is intended for the addressee only. If you are not the intended recipient of this message, you are notified that any distribution, use of or copying of this communication is strictly prohibited. If you have received the communication in error, please notify the sender immediately.

JSE Limited, Reg. No. 2005/022939/06
From: John Burke [mailto:JohnB@jse.co.za]
Sent: 31 August 2017 10:41 AM
To: Auditor email
Cc: Michael Harber
Subject: FW: Mandatory Audit Firm Rotation Research

Dear <Personalised Name>

It would be greatly appreciated if you could find the time to complete the included questionnaire.

The questionnaires relate to important doctoral research regarding the direct and indirect consequences to the South African business community from the intended adoption of mandatory audit firm rotation (MAFR) by the South African audit industry regulator, the Independent Regulatory Board for Auditors (IRBA). The aim of the research is to gain qualitative and quantitative insights from questioning the key individual participants and stakeholders involved with, and experienced in, the external audit processes of South African companies listed on the stock exchange.

This research is of particular relevance given the clear intention of the IRBA to adopt MAFR and the recent public debate on the topic, which have included Parliamentary hearings before the Standing Committee on Finance. As a business leader and registered auditor your input is essential.

Mr. Michael Harber has completed his Master’s thesis on the topic of MAFR and has presented on the topic to the Parliamentary Standing Committee on Finance based on their request in 2017. The results of this PhD research is intended to be an objective and academically rigorous contribution to the South African debate on the topic and the findings will be provided to all relevant regulators and stakeholders.

It is estimated that the questionnaire will not take longer than 45 minutes to complete and your input as part of the population of JSE-accredited registered auditors is critical to the success of this research.

As a JSE-accredited registered auditor, the link to the registered auditor questionnaire is here: {LINK}
Should you wish to contact Michael Harber, please do so as follows at:

Post: 5.16 Leslie Commerce Building, UCT Upper Campus, Rondebosch, Cape Town, 7405
Email: michael.harber@uct.ac.za
Tel: (021) 650-2272 or (083) 447 8770

Your co-operation is greatly appreciated.

Kind regards

John Burke
Director
Issuer Regulation
T +2711 520 7060
M +2782 655 3364

The views and opinions expressed in this message are those of the individual sender of this message and do not necessarily represent the views and opinions of the JSE. Consequently, the JSE does not accept responsibility for such views and opinions and this message should not be read as representing the views and opinions of the JSE or constitute binding terms and conditions without subsequent written confirmation and an authorizing resolution where required. Each page attached hereto must also be read in conjunction with this disclaimer and should any part of this message be unclear, the issue should be clarified with the Company Secretary of the JSE.

Confidentiality note: The message is intended for the addressee only. If you are not the intended recipient of this message, you are notified that any distribution, use of or copying of this communication is strictly prohibited. If you have received the communication in error, please notify the sender immediately.

JSE Limited, Reg. No. 2005/022939/06
Dear <Personalised Name>

ASISA has been approached by the JSE to assist with research into mandatory audit firm rotation (MAFR). They have appointed Michael Harber (UCT) to conduct the research. To obtain the relevant information, Michael has developed various questionnaires for the different role players.

The questionnaires relate to important doctoral research regarding the direct and indirect consequences to the South African business community of the intended adoption of mandatory audit firm rotation (MAFR) by the South African audit industry regulator, the Independent Regulatory Board for Auditors (IRBA). The aim of the research is to gain qualitative and quantitative insights from questioning key individual participants and stakeholders involved with, and experienced in, the external audit processes of South African companies listed on the stock exchange.

This research is of particular relevance given the recent ruling of the IRBA to adopt MAFR and the recent public debate on the topic, which has included Parliamentary hearings before the Standing Committee on Finance. For your reference, we attach the ASISA submission that was made on MAFR.

Michael has identified the importance of gaining the view and insight of investment managers on how the introduction of MAFR will impact on listed companies they invest in.

In this regard, Michael will contact you directly with a link to the questionnaire. Can you please distribute this link/questionnaire to your equity managers and request their individual participation - it should not take more than 10min of their time.

Please feel free to contact us for additional information.
Kind Regards

Leon & Sunette

Leon Campher

1 Mariendahl Lane
Newlands
Western Cape
South Africa

T: +27 (21) 673.1621
F: +27 (21) 673.1630

Boundary Terraces

ASSOCIATION FOR SAVINGS & INVESTMENT SA

For the ASISA Legal - Communications & Privacy Policy notification please go to

http://protect-za.mimecast.com/s/8VNd81vrmXX5iq

Annexure 9: Cover letters provided by the study leader (Questionnaire distribution)

COVERING LETTER FROM STUDY LEADER TO THE CHIEF FINANCIAL OFFICER

Dear Sir/Madam

Date: 15 August 2017

DOCTORAL RESEARCH
Research Title - Mandatory Audit Firm Rotation (MAFR): A South African Perspective

Doctoral research in the field is currently being undertaken by Mr Michael Harber, an academic at the University of Cape Town, and a doctoral candidate registered at the University of Johannesburg. His study is entitled “Mandatory Audit Firm Rotation: A South African Perspective”. The aim of the research is to gain qualitative and quantitative insights from questioning the key individual participants and stakeholders involved with, and experienced in, the external audit processes of South African publically listed companies.

The results of this PhD research are intended to be an objective and academically rigorous contribution to the South African debate on the topic and the processes to follow. The findings will be made available to all relevant regulators and stakeholders.

It is estimated that the questionnaire will not take longer than 20 minutes to complete and your input as part of the population of 100 (JSE Top 100 primary listed companies) is critical to the success of this research.

There are separate questionnaires for the CFO and the Audit Committee Chair, with the respective links provided in the accompanying email. As such, would you also please forward the email to the chair of your audit committee for completion?

Should you wish to contact Michael Harber, his details are as follows:
   Post: 5.16 Leslie Commerce Building, UCT Upper Campus, Rondebosch, Cape Town, 7405
   Email: michael.harber@uct.ac.za
   Tel: (021) 650-2272 or (083) 447 8770

Your co-operation is greatly appreciated.

SIGNED

Professor Director Ben Maria (Study Leader)

UNIVERSITY OF JOHANNESBURG
SCHOOL OF ACCOUNTING

Tel: (011) 559-3086 email: benm@uj.ac.za
COVERING LETTER FROM STUDY LEADER TO REGISTERED AUDITORS ACCREDITED WITH THE JSE

Date: 15 August 2017

Dear Sir/Madam

DOCTORAL RESEARCH

Research Title - Mandatory Audit Firm Rotation (MAFR): A South African Perspective

Doctoral research in the field is currently being undertaken by Mr Michael Harber, an academic at the University of Cape Town, and a doctoral candidate registered at the University of Johannesburg. His study is entitled “Mandatory Audit Firm Rotation: A South African Perspective”. The aim of the research is to gain qualitative and quantitative insights from questioning the key individual participants and stakeholders involved with, and experienced in, the external audit processes of South African publicly listed companies.

The results of this PhD research are intended to be an objective and academically rigorous contribution to the South African debate on the topic and the affected processes to follow. The findings will be made available to all relevant regulators and stakeholders.

It is estimated that the questionnaire will not take longer than 20 minutes to complete. Your input as a registered auditor, accredited with the JSE, is critical to the success of this research.

Should you wish to contact Michael Harber, his details are as follows:

Post: 5.16 Leslie Commerce Building, UCT Upper Campus, Rondebosch, Cape Town, 7405
Email: michael.harber@uct.ac.za
Tel: (021) 650-2272 or (083) 447 8770

Your co-operation is greatly appreciated.

Professor Doctor Ben Marx (Study Leader)
UNIVERSITY OF JOHANNESBURG
SCHOOL OF ACCOUNTING
Tel: (011) 559-3086 Email: benm@uj.ac.za
COVERING LETTER FROM STUDY LEADER TO ASISA MEMBERS

Date: 15 August 2017

ATTENTION: Name

Dear Sir/Madam

DOCTORAL RESEARCH

Research Title - Mandatory Audit Firm Rotation (MAFR): A South African Perspective

Doctoral research in the field is currently being undertaken by Mr Michael Harber, an academic at the University of Cape Town, and a doctoral candidate registered at the University of Johannesburg. His study is entitled “Mandatory Audit Firm Rotation: A South African Perspective”. The aim of the research is to gain qualitative and quantitative insights from questioning the key individual participants and stakeholders involved with, and experienced in, the external audit processes of South African publically listed companies.

The results of this PhD research are intended to be an objective and academically rigorous contribution to the South African debate on the topic and the affected processes to follow. The findings will be made available to all relevant regulators and stakeholders.

It is estimated that the questionnaire will not take longer than 20 minutes to complete. Your input as an investment manager and member of ASISA, is critical to the success of this research.

Should you wish to contact Michael Harber, his details are as follows:
Post: 5.16 Leslie Commerce Building, UCT Upper Campus,
Rondebosch, Cape Town, 7405
Email: michael.harber@uct.ac.za
Tel: (021) 650-2272 or (083) 447 8770

Your co-operation is greatly appreciated.

SIGNED

Professor Doctor Ben Marx (Study Leader)
UNIVERSITY OF JOHANNESBURG
SCHOOL OF ACCOUNTING
Tel: (011) 559-3086 Email: benm@uj.ac.za
Annexure 10: QUESTIONNAIRE for the JSE accredited registered auditor

Mandatory Audit Firm Rotation (MAFR)

INSTRUCTIONS

This questionnaire is only intended for a person who is a JSE accredited registered auditor.

Please complete the questionnaire electronically and then click “Submit” when finished.

If you wish to complete the questionnaire manually, please contact the researcher as per below.

Please answer this questionnaire as a means to express your personal opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as a registered auditor.

Please note that the context of all questions and statements in the questionnaire is with reference to JSE listed companies and the June 2017 IRBA ruling on MAFR.

The researcher, Michael Harber, can be contacted on:
Email: michael.harber@uct.ac.za
Work: (021) 650-2272 or Cell: (083) 447 8770

This survey has been distributed by email with the assistance of the Johannesburg Stock Exchange (JSE).

Your willingness to voluntarily participate in this survey is greatly appreciated and contributes to the creation of new knowledge. Results from all of the respondents will be collated and reported-on as a unit; and your specific responses will not be reported individually. Your participation in this study is entirely voluntary. Your responses will be collected anonymously, and the data will be treated confidentially. The researchers undertake not to engage in any activities aimed at identifying participants’ personal information, for example, personal or company names or IP addresses.

You are reminded and informed hereby, that you are not obligated in any way to participate in this study. Your participation is voluntary, and you may choose to withdraw from the process at any stage without fear or consequence. As a respondent, you are reminded and informed that your right to privacy, confidentiality, anonymity, equality, justice, human dignity, freedom of choice, freedom of expression, access to information and access to the research community will be respected and guaranteed.

- Please answer this questionnaire as a means to express your opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as an individual registered auditor.
Please respond as openly and as frankly as possible to the questions.
Please acknowledge that you have read and understand the above information and that the researchers have provided appropriate information regarding the nature of the research.
The Faculty of Economic and Financial Sciences Research Ethics Committee of the University of Johannesburg have provided ethical clearance for the survey. The ethics clearance number is FEFSREC2017081401.

☐ (Tick box) I, as respondent, by ticking this box, understand my rights in this process and proceed willingly and voluntarily with the survey.

Your participation is greatly appreciated.

**Brief background to mandatory audit firm rotation (MAFR):**

In June 2017 the Independent Regulatory Board for Auditors (IRBA) published the rule on Mandatory Audit Firm Rotation (MAFR) for auditors of all public interest entities, as defined in section 290.25 to 290.26 of the amended IRBA Code of Professional Conduct for Registered Auditors, which includes all publically listed companies. In terms of this ruling, an audit firm, including a network firm as defined in the IRBA Code of Professional Conduct for Registered Auditors, shall not serve as the appointed auditor of a public interest entity for more than 10 consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years (‘cooling-off period’).

The regulator’s primary reason for changing regulations in favour of MAFR is the concern that audit firms, mostly due to long tenures with their clients, lack the required degree of independence and professional skepticism. According to the IRBA, the audit firms of listed companies can become too familiar with the senior management of these companies and this presents as undue bias in their role as external auditors. However, the IRBA also believes that MAFR will improve transformation within the audit industry and reduce the dominance and concentration of the “big 4” audit firms as assurance providers in this market.

The MAFR rule is effective for financial years commencing on or after 1 April 2023. Significant debate has already occurred on this topic and will continue in the years ahead. The topic is controversial and there are numerous stakeholders in the debate. Your views in your capacity as a key and experienced participant in the external audit engagement will contribute significantly to this ongoing debate.
Demographic data:
The following is a request for personal demographic data. The request for gender and race classification is relevant considering the priority of transformation in South Africa and possible impact that MAFR may have on transformation. Please note that responses are voluntary, and you may select “prefer not to answer” or leave the section unfilled.

The questionnaire data and demographic information will be coded so that it will not be linked to your name. Your identity will not be revealed while the study is being conducted or when the study is published in academic or professional journals and/or research reports. Any information that is obtained in connection with this study that can be identified with you will remain confidential and will be disclosed only with your permission or as required by law. The information received during the research will be used only for research purposes and will not be released for any employment-related performance evaluation, promotion and/or disciplinary purposes.

Please provide your age in years.

Please provide the number of years that you have acted as a registered auditor.

Please provide your gender.
☐ Female
☐ Male
☐ Prefer not to answer

Please provide your race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013.
☐ African black
☐ Coloured
☐ Indian/Asian
☐ White
☐ Prefer not to answer

Please provide the audit firm type to which you would best categorise your audit firm.
☐ “Big 4” Audit Firm
☐ Non-“Big 4” Audit Firm

Please estimate the ranking of your audit firm network nationally in terms of audit fee revenue, with 1st being the largest in estimated national audit fee revenue.
☐ Between 1st and 4th
Overall position on Mandatory audit firm rotation (MAFR):

1. Are you of the opinion that changing regulations in favour of MAFR, as ruled by the IRBA, is appropriate for South Africa?
   YES ☐
   NO ☐

2. South African auditors of listed companies lack the required degree of independence and professional scepticism.
   Strongly disagree Disagree Neutral Agree Strongly agree
   ☐ ☐ ☐ ☐ ☐

3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.
   Strongly disagree Disagree Neutral Agree Strongly agree
   ☐ ☐ ☐ ☐ ☐

The Public Inspections Report 2015/2016 recently released by the IRBA shows an overall regression in the inspection results, with an increase in unsatisfactory inspection results. The IRBA believes that this is a worrying trend. According to the IRBA the root cause identified for a number of these findings was the failure to strengthen and maintain independence as an underlying principle for high audit quality. Based on this, please provide your response to the following statement:

4. The IRBA inspection findings strengthen the argument of the IRBA in favour of MAFR.
   Strongly disagree Disagree Neutral Agree Strongly agree
   ☐ ☐ ☐ ☐ ☐

The IRBA makes the argument that high-profile corporate failures have caused the investing public to question the role and the independence of auditors. According to the
IRBA, investors are demanding more information and transparency and have become more aware of their rights, which need to be protected. Based on this, please provide your response to the following statement:

5. The above line of reasoning by the IRBA strengthens their case in favour of MAFR.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on auditor client-specific knowledge:

6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

8. A steep learning curve exists for the incoming, newly-appointed audit firm.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.
10. Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.

11. Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.

12. The potential loss of client-specific knowledge is a significant problem with MAFR.

13. Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on auditors’ independence and professional skepticism:

14. In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.
15. Longer audit firm tenures result in less auditor independence.

16. MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.

17. MAFR will increase the independence of audit firms (and audit partners).

Impact of MAFR on perceived auditor independence in the minds of the investing public:

18. The investing public tend to believe that there is a significant degree of bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistle-blower.
19. ny perceived problems regarding auditor independence by the investing public primarily result from their knowledge of long audit firm tenures.

```latex
<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
```

20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.

```latex
<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
```

21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.

```latex
<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
```

22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.

```latex
<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
```

Comments:

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

**Impact of MAFR on costs to the audit firms:**

23. MAFR will require audit firms to spend significant resources (money, time, staff etc.) around the following activities:
   a. **Activity:** Senior leadership time investment in getting to know the new client

```latex
<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
```
b. **Activity:** Additional meetings both locally and internationally with management

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Check)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

c. **Activity:** Additional time spent on understanding the business and industry

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Check)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

d. **Activity:** Additional industry specialist involvement including technical input

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Check)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

e. **Activity:** Marketing and proposal (tendering) presentation costs

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Check)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

f. **Activity:** National and international travel costs

<table>
<thead>
<tr>
<th></th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Check)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________
24. Increases in costs will be passed on to companies in the way of increased audit fees.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

25. Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to provide competitive tender proposals to secure audit appointments.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

26. Increases in audit costs, or losses in audit revenues to audit firms, caused by MAFR, will be offset by opportunities to provide non-audit services, such as tax and advisory services to previous audit clients.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

27. MAFR will result in employment instability and retrenchments (within audit firms) due to loss of clients through rotation.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

28. Any financial losses incurred by the audit firm due to MAFR will be sufficiently offset by new client appointments.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

29. MAFR will result in significant increases in the premiums of audit firm professional indemnity insurance.
Impact of MAFR on costs to companies:

30. MAFR will result in significantly increased audit fees, i.e. significant to the companies involved.
   
   Strongly disagree  Disagree  Neutral  Agree  Strongly agree
   ☐          ☐         ☐       ☐        ☐

31. Regarding potential increases in audit fees resulting from MAFR:
   Audit committees will agree to increased audit fees in the short-term (1-2 years of the new appointment), but not in the longer-term.

   Strongly disagree  Disagree  Neutral  Agree  Strongly agree
   ☐          ☐         ☐       ☐        ☐

32. Regarding potential increases in audit fees resulting from MAFR:
   Audit committees will agree to permanently increased audit fees, i.e. for the duration of the rotation period that the audit firm may be appointed.

   Strongly disagree  Disagree  Neutral  Agree  Strongly agree
   ☐          ☐         ☐       ☐        ☐

33. MAFR will result in significant costs to the company in terms of time and resource investment by senior management and audit committees.
34. MAFR will introduce a significant added cost to the audit committees of JSE listed companies as they will be required to receive and consider tenders (proposals) more regularly to appointment auditors.

35. The additional cost to the JSE listed companies from MAFR will not add any incremental benefits, economic or otherwise, to the business and thus negatively impact on shareholder value.

36. The additional investment in time by boards, audit committees and executive management, resulting from MAFR, will be a significant distraction from running the business and performing the respective duties to those involved at the company.

37. MAFR will require significant additional investment in time by the financial managers, supervisors and controllers, including other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team.

38. MAFR will cause significant additional cost and time for the group to appoint the same auditor across all group companies as it will require various shareholder approvals and regulatory processes.
Impact of MAFR on the degree of market concentration by the “big 4” firms:

39. MAFR will allow other smaller audit firms, such as the mid-tier firms, the opportunity to tender for these assurance engagements.

40. MAFR will reduce the concentration of “big 4” audit firms providing assurance services for JSE listed companies.

41. The size of an audit firm’s “geographical footprint” (international presence) is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.

42. Non-“big 4” audit firms (mid-tier firms) have a sufficient “geographical footprint” (international presence) to be appointed as auditors of large multinational companies on the JSE.
43. In order to maintain audit efficiency, effectiveness and reduce the overall cost, the audit committee seeks to appoint (or recommend for appointment) the same audit firm in each of the geographic areas and jurisdictions in which the group operates.

44. Industry-specific knowledge and experience within the audit firm is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.

45. Non-“big 4” audit firms (mid-tier firms) have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE.

46. Audit committees of JSE listed companies are likely to recommend non-“big 4” audit firms for appointment as external auditors.

47. Shareholders of JSE listed companies, in the AGM, are likely to appoint non-“big 4” audit firms as external auditors.
48. Considering that the performance of advisory services (non-assurance work) by an audit firm creates an independence threat that limits or prevents that firm from being appointed as auditor, MAFR will reduce the choice of audit firms available for appointment by the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

49. Non-“big 4” audit firms will be able to obtain more non-assurance work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on transformation in the audit profession:

According to the IRBA, of the 4,283 registered auditors in South Africa, 74.8% are white and only 10.5% are black Africans. Of the 353 audit partners signing off on listed company audits, only 9 are black African. Based on this, please provide your response to the following statement:

50. The rate of transformation in the audit profession is acceptable.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

51. MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
52. MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td></td>
</tr>
</tbody>
</table>

53. The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td></td>
</tr>
</tbody>
</table>

54. MAFR will improve the transformation statistics in the South African audit profession.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td></td>
</tr>
</tbody>
</table>

55. Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td></td>
</tr>
</tbody>
</table>

56. The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td></td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________
Impact of MAFR on audit partner quality of work life:

57. MAFR will require audit partners to devote more time to preparing and participating in tenders for audit appointments.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td>☐</td>
</tr>
</tbody>
</table>

58. MAFR will put pressure on outgoing audit firm partners and audit firm leadership to replace audit clients and lost revenue streams resulting from firm rotation.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td>☐</td>
</tr>
</tbody>
</table>

59. The pressure on outgoing audit firm partners to replace audit clients and lost revenue streams, resulting from MAFR will cause audit partners to lose focus on the actual audit work, thereby decreasing audit quality in the final years of the rotation period.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td>☐</td>
</tr>
</tbody>
</table>

60. The rotation of audit clients, which will result from MAFR, places additional risk on engagement partners, especially during the initial years of the audit, when the risk of audit failure is greater due to lack of familiarity with the client and industry.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on the appeal of the audit profession:

61. The audit profession in South Africa is over-regulated (meaning unnecessarily or excessively regulated).
62. As a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths.

63. MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants.

64. MAFR will result in an increased trend of audit managers and audit partners seeking employment outside of assurance services.

Comments:

Impact of MAFR on the need for and use of professional judgement:

65. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit firm and individual audit partner.
66. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

67. The consideration as to which audit firm is best able to provide the company with a high-quality audit, is a fundamentally important responsibility of the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

68. MAFR will reduce the need for auditors to apply their minds in regard to the independence of the audit firm and the individual audit partner.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

69. MAFR will reduce the need for audit committees to apply their minds in regard to the independence and suitability of the audit firm and the individual audit partner.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

70. MAFR will interfere with, and/or restrict, the ability of the audit committee to decide the appropriate time to replace the auditor, or place the audit out for tender to the market, considering the company’s specific context and circumstances.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:

____________________________________________________________________
____________________________________________________________________
____________________________________________________________________
Alternatives to MAFR:

71. In order to address the concerns being raised by the IRBA with regards to auditor independence on JSE listed company audits, indicate your opinion on the following alternatives, considered in combination, not in isolation, as being preferable to MAFR:

a. **Alternative:** Mandatory tendering (rather than mandatory firm rotation).

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

b. **Alternative:** A system of joint audits.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

c. **Alternative:** Continued development and enforcement of the auditors’ Code of Professional Conduct.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

d. **Alternative:** Further development of robust Independent Regulatory Oversight, such as continued investment in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

e. **Alternative:** Continued development in effective and independent Engagement Quality Control Review (EQCR) within the audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

f. **Alternative:** Stronger audit committee oversight of auditors.
72. MAFR will result in a significant additional cost and administrative burden in the wider South African economy.

73. Please estimate, based on your experience with JSE listed company audits, the cost of the audit fee (for assurance services only) to the company as a percentage (%) of company revenue (before adoption of MAFR). (Answer as a percentage amount.)

74. Consider the costs incurred to tender/proposal for a listed company. Approximately what percentage of the first year’s audit fee would these tender/proposal costs amount to?
75. In order to secure the appointment of a top 100 JSE listed company, estimate the Rand amount of investment required in the tender/proposal process.

- 0- R100,000
- R100,000-R200,000
- R200,000-R300,000
- R300,000-R400,000
- R400,000-R500,000
- R500,000-R600,000
- R600,000-R700,000
- R700,000-R800,000
- R800,000-R900,000
- R900,000-Over
- Over-R1,000,000
- Over-R1,500,000
- Over-R2,000,000

76. In order to secure the appointment of a listed client outside of the top 100 JSE listed companies, estimate the Rand amount of investment required in the tender/proposal process.

- 0- R100,000
- R100,000-R200,000
- R200,000-R300,000
- R300,000-R400,000
- R400,000-R500,000
- R500,000-R600,000
- R600,000-R700,000
- R700,000-R800,000
- R800,000-R900,000
- R900,000-Over
- Over-R1,000,000
- Over-R1,500,000
- Over-R2,000,000

77. Consider the set-up and transitional costs incurred for a listed company. These are the additional costs, additional to the following years, incurred to understand the audit client and perform the audit in the first year. What percentage of the first year’s audit fee would these set-up and transitional costs amount to for a top 100 JSE listed company?

- >10%
- 10-30%
- 30-50%
- 50-70%
- 70-100%
- <100%
78. What percentage of the first year’s audit fee would these set-up and transitional costs amount to for a listed company outside of the top 100 JSE companies?

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;10%</td>
<td>☐</td>
</tr>
<tr>
<td>10-30%</td>
<td>☐</td>
</tr>
<tr>
<td>30-50%</td>
<td>☐</td>
</tr>
<tr>
<td>50-70%</td>
<td>☐</td>
</tr>
<tr>
<td>70-100%</td>
<td>☐</td>
</tr>
<tr>
<td>&lt;100%</td>
<td>☐</td>
</tr>
</tbody>
</table>

79. An additional once-off “on-boarding” cost is a fee paid to the new auditor in the first year appointed, in addition to that year’s audit fee, billed by the auditor to cover additional work around opening balances, understanding the business, reimburse set-up and transitional costs or perform an interim audit. What percentage of the annual audit fee do you believe this once-off fee will be? (Answer as a percentage amount; answer with 0% if you do not believe there will be such a fee charged to the company.)

80. Please comment on any other economic impacts (positive or negative) that you foresee could arise if MAFR is implemented.

_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________
_____________________________________________________________________

Final Questions:

81. The MAFR ruling in June 2017 stated a 10 year rotation period. In your opinion, what is an optimal rotation period? (Please provide a response, even if you may be against MAFR.)

☐ 1-3 years
☐ 4-6 years
☐ 7-9 years
☐ 10 years (per the IRBA’s intention)
☐ 11-15 years
☐ 16-20 years
☐ > 20 years

82. The MAFR ruling in June 2017 stated a “cooling-off” period of 5 years. In your opinion, what is an optimal “cooling-off” period? (Please provide a response, even if you may be against MAFR)
83. Finally, on an overall cost-benefit analysis, considering the possible benefits and consequences of MAFR, financial and non-financial, do you believe MAFR, as ruled by the IRBA, is appropriate for South Africa?

YES ☐

NO ☐

Comments:

________________________________________________________________________
________________________________________________________________________
________________________________________________________________________

THANK YOU FOR COMPLETING THE QUESTIONNAIRE.
WE APPRECIATE THE TIME YOU HAVE PUT IN TO COMPLETE THIS.
YOUR INPUT WILL CONTRIBUTE TO THE SOUTH AFRICAN DEBATE ON MAFR.
Annexure 11: QUESTIONNAIRE for the JSE Audit Committee Chair

Mandatory Audit Firm Rotation (MAFR)

INSTRUCTIONS

This questionnaire is only intended for a person who is a chair of a JSE top 100 company audit committee.

Please complete the questionnaire and then click “Submit” when finished.

Please answer this questionnaire as a means to express your personal opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as an audit committee chair.

Please note that the context of all questions and statements in the questionnaire is with reference to JSE listed companies and the June 2017 IRBA ruling on MAFR.

The researcher, Michael Harber, can be contacted on:

Email: michael.harber@uct.ac.za
Work: (021) 650-2272 or Cell: (083) 447 8770

This survey has been distributed by email with the assistance of the Johannesburg Stock Exchange (JSE).

Your willingness to voluntarily participate in this survey is greatly appreciated and contributes to the creation of new knowledge. Results from all of the respondents will be collated and reported-on as a unit; and your specific responses will not be reported individually. Your participation in this study is entirely voluntary. Your responses will be collected anonymously, and the data will be treated confidentially. The researchers undertake not to engage in any activities aimed at identifying participants' personal information, for example, personal or company names or IP addresses.

You are reminded and informed hereby, that you are not obligated in any way to participate in this study. Your participation is voluntary, and you may choose to withdraw from the process at any stage without fear or consequence. As a respondent, you are reminded and informed that your right to privacy, confidentiality, anonymity, equality, justice, human dignity, freedom of choice, freedom of expression, access to information and access to the research community will be respected and guaranteed.

- Please answer this questionnaire as a means to express your opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as an individual registered auditor.
- Please respond as openly and as frankly as possible to the questions.
Brief background to mandatory audit firm rotation (MAFR):

In June 2017 the Independent Regulatory Board for Auditors (IRBA) published the rule on Mandatory Audit Firm Rotation (MAFR) for auditors of all public interest entities, as defined in section 290.25 to 290.26 of the amended IRBA Code of Professional Conduct for Registered Auditors, which includes all publically listed companies. In terms of this ruling, an audit firm, including a network firm as defined in the IRBA Code of Professional Conduct for Registered Auditors, shall not serve as the appointed auditor of a public interest entity for more than 10 consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years (‘cooling-off period’).

The regulator’s primary reason for changing regulations in favour of MAFR is the concern that audit firms, mostly due to long tenures with their clients, lack the required degree of independence and professional skepticism. According to the IRBA, the audit firms of listed companies can become too familiar with the senior management of these companies and this presents as undue bias in their role as external auditors. However, the IRBA also believes that MAFR will improve transformation within the audit industry and reduce the dominance and concentration of the “big 4” audit firms as assurance providers in this market.

The MAFR rule is effective for financial years commencing on or after 1 April 2023. Significant debate has already occurred on this topic and will continue in the years ahead. The topic is controversial and there are numerous stakeholders in the debate. Your views in your capacity as a key and experienced participant in the external audit engagement will contribute significantly to this ongoing debate.

Demographic data:

The following is a request for personal demographic data. The request for gender and race classification is relevant considering the priority of transformation in South Africa and possible impact that MAFR may have on transformation. Please note that responses are voluntary, and you may select “prefer not to answer” or leave the section unfilled.
The questionnaire data and demographic information will be coded so that it will not be linked to your name. Your identity will not be revealed while the study is being conducted or when the study is published in academic or professional journals and/or research reports. Any information that is obtained in connection with this study that can be identified with you will remain confidential and will be disclosed only with your permission or as required by law. The information received during the research will be used only for research purposes and will not be released for any employment-related performance evaluation, promotion and/or disciplinary purposes.

Please provide your age in years.

Please provide the number of years that you have acted as a registered auditor.

Please provide your gender.

☐ Female
☐ Male
☐ Prefer not to answer

Please provide your race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013.

☐ African black
☐ Coloured
☐ Indian/Asian
☐ White
☐ Prefer not to answer

**Overall position on Mandatory audit firm rotation (MAFR):**

1. Are you of the opinion that changing regulations in favour of MAFR, as ruled by the IRBA, is appropriate for South Africa?
   YES ☐
   NO ☐

2. South African auditors of listed companies lack the required degree of independence and professional scepticism.
3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.

4. The IRBA inspection findings strengthen the argument of the IRBA in favour of MAFR.

5. The above line of reasoning by the IRBA strengthens their case in favour of MAFR.

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________
Impact of MAFR on auditor client-specific knowledge:

6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
</tr>
</tbody>
</table>

7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
</tr>
</tbody>
</table>

8. A steep learning curve exists for the incoming, newly-appointed audit firm.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
</tr>
</tbody>
</table>

9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
</tr>
</tbody>
</table>

10. Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☑</td>
</tr>
</tbody>
</table>
11. Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

12. The potential loss of client-specific knowledge is a significant problem with MAFR.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

13. Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on auditors’ independence and professional skepticism:

14. In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

15. Longer audit firm tenures result in less auditor independence.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
16. MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

17. MAFR will increase the independence of audit firms (and audit partners).

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on perceived auditor independence in the minds of the investing public:

18. The investing public tend to believe that there is a significant degree of bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistle-blower.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

19. Any perceived problems regarding auditor independence by the investing public primarily result from their knowledge of long audit firm tenures.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.
21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.

\[
\begin{array}{ccccc}
\text{Strongly disagree} & \text{Disagree} & \text{Neutral} & \text{Agree} & \text{Strongly agree} \\
\hline
\square & \square & \square & \square & \square \\
\end{array}
\]

22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.

\[
\begin{array}{ccccc}
\text{Strongly disagree} & \text{Disagree} & \text{Neutral} & \text{Agree} & \text{Strongly agree} \\
\hline
\square & \square & \square & \square & \square \\
\end{array}
\]

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

**Impact of MAFR on costs to companies:**

23. MAFR will result in significantly increased audit fees, i.e. significant to the companies involved.

\[
\begin{array}{ccccc}
\text{Strongly disagree} & \text{Disagree} & \text{Neutral} & \text{Agree} & \text{Strongly agree} \\
\hline
\square & \square & \square & \square & \square \\
\end{array}
\]

24. Regarding potential increases in audit fees resulting from MAFR:

Audit committees will agree to increased audit fees in the short-term (1-2 years of the new appointment), but not in the longer-term.

\[
\begin{array}{ccccc}
\text{Strongly disagree} & \text{Disagree} & \text{Neutral} & \text{Agree} & \text{Strongly agree} \\
\hline
\square & \square & \square & \square & \square \\
\end{array}
\]
25. Regarding potential increases in audit fees resulting from MAFR:

Audit committees will agree to permanently increased audit fees, i.e. for the duration of the rotation period that the audit firm may be appointed.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

26. MAFR will result in significant costs to the company in terms of time and resource investment by senior management and audit committees.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

27. MAFR will introduce a significant added cost to the audit committees of JSE listed companies as they will be required to receive and consider tenders (proposals) more regularly to appointment auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

28. The additional cost to the JSE listed companies from MAFR will not add any incremental benefits, economic or otherwise, to the business and thus negatively impact on shareholder value.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

29. The additional investment in time by boards, audit committees and executive management, resulting from MAFR, will be a significant distraction from running the business and performing the respective duties to those involved at the company.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
30. MAFR will require significant additional investment in time by the financial managers, supervisors and controllers, including other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

31. MAFR will cause significant additional cost and time for the group to appoint the same auditor across all group companies as it will require various shareholder approvals and regulatory processes.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
____________________________________________________________________
____________________________________________________________________
____________________________________________________________________

Impact of MAFR on the degree of market concentration by the “big 4” firms:

32. MAFR will allow other smaller audit firms, such as the mid-tier firms, the opportunity to tender for these assurance engagements.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

33. MAFR will reduce the concentration of “big 4” audit firms providing assurance services for JSE listed companies.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

34. The size of an audit firm’s “geographical footprint” (international presence) is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.
35. Non-“big 4” audit firms (mid-tier firms) have a sufficient “geographical footprint” (international presence) to be appointed as auditors of large multinational companies on the JSE.

36. In order to maintain audit efficiency, effectiveness and reduce the overall cost, the audit committee seeks to appoint (or recommend for appointment) the same audit firm in each of the geographic areas and jurisdictions in which the group operates.

37. Industry-specific knowledge and experience within the audit firm is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.

38. Non-“big 4” audit firms (mid-tier firms) have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE.

39. Audit committees of JSE listed companies are likely to recommend non-“big 4” audit firms for appointment as external auditors.
40. Shareholders of JSE listed companies, in the AGM, are likely to appoint non-“big 4” audit firms as external auditors.

41. Considering that the performance of advisory services (non-assurance work) by an audit firm creates an independence threat that limits or prevents that firm from being appointed as auditor, MAFR will reduce the choice of audit firms available for appointment by the audit committee.

42. Non-“big 4” audit firms will be able to obtain more non-assurance work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors.

Comments:

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on transformation in the audit profession:

According to the IRBA, of the 4,283 registered auditors in South Africa, 74.8% are white and only 10.5% are black Africans. Of the 353 audit partners signing off on listed company audits, only 9 are black African. Based on this, please provide your response to the following statement:

43. The rate of transformation in the audit profession is acceptable.
44. MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

45. MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

46. The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

47. MAFR will improve the transformation statistics in the South African audit profession.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

48. Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

49. The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.
Impact of MAFR on audit partner quality of work life:

50. MAFR will require audit partners to devote more time to preparing and participating in tenders for audit appointments.

51. MAFR will put pressure on outgoing audit firm partners and audit firm leadership to replace audit clients and lost revenue streams resulting from firm rotation.

52. The pressure on outgoing audit firm partners to replace audit clients and lost revenue streams, resulting from MAFR will cause audit partners to lose focus on the actual audit work, thereby decreasing audit quality in the final years of the rotation period.

53. The rotation of audit clients, which will result from MAFR, places additional risk on engagement partners, especially during the initial years of the audit, when the risk of audit failure is greater due to lack of familiarity with the client and industry.
Impact of MAFR on the appeal of the audit profession:

54. The audit profession in South Africa is over-regulated (meaning unnecessarily or excessively regulated).
   
   Strongly disagree  Disagree  Neutral  Agree  Strongly agree
   □          □          □          □          □

55. As a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths.
   
   Strongly disagree  Disagree  Neutral  Agree  Strongly agree
   □          □          □          □          □

56. MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants.
   
   Strongly disagree  Disagree  Neutral  Agree  Strongly agree
   □          □          □          □          □

57. MAFR will result in an increased trend of audit managers and audit partners seeking employment outside of assurance services.
Strongly disagree Disagree Neutral Agree Strongly agree
☐ ☐ ☐ ☐ ☐

Comments:

Impact of MAFR on the need for and use of professional judgement:

58. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit firm and individual audit partner.

Strongly disagree Disagree Neutral Agree Strongly agree
☐ ☐ ☐ ☐ ☐

59. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit committee.

Strongly disagree Disagree Neutral Agree Strongly agree
☐ ☐ ☐ ☐ ☐

60. The consideration as to which audit firm is best able to provide the company with a high-quality audit, is a fundamentally important responsibility of the audit committee.

Strongly disagree Disagree Neutral Agree Strongly agree
☐ ☐ ☐ ☐ ☐

61. MAFR will reduce the need for auditors to apply their minds in regard to the independence of the audit firm and the individual audit partner.

Strongly disagree Disagree Neutral Agree Strongly agree
☐ ☐ ☐ ☐ ☐
62. MAFR will reduce the need for audit committees to apply their minds in regard to the independence and suitability of the audit firm and the individual audit partner.

63. MAFR will interfere with, and/or restrict, the ability of the audit committee to decide the appropriate time to replace the auditor, or place the audit out for tender to the market, considering the company’s specific context and circumstances.

Alternatives to MAFR:

64. In order to address the concerns being raised by the IRBA with regards to auditor independence on JSE listed company audits, indicate your opinion on the following alternatives, considered in combination, not in isolation, as being preferable to MAFR:


   c. Alternative: Continued development and enforcement of the auditors’ Code of Professional Conduct.
d. **Alternative**: Further development of robust Independent Regulatory Oversight, such as continued investment in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>


e. **Alternative**: Continued development in effective and independent Engagement Quality Control Review (EQCR) within the audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>


f. **Alternative**: Stronger audit committee oversight of auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>


g. **Alternative**: Improved disclosure of how the company has assessed the quality and independence of the audit firm, as well as how the auditors themselves have ensured that they are independent and will remain independent in the year ahead.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________
**Additional Economic Impact Analysis Issues**

The following questions and statements are part of a study attempting to quantify and describe the overall economic impact that mandatory audit firm rotation (MAFR) will have on the South African economy.

65. MAFR will result in a significant additional cost and administrative burden in the wider South African economy.

[ ] Strongly disagree  [ ] Disagree  [ ] Neutral  [ ] Agree  [ ] Strongly agree

66. Please estimate, based on your experience with JSE listed company audits, the cost of the audit fee (for assurance services only) to the company as a percentage (%) of company revenue (before adoption of MAFR). (Answer as a percentage amount.)

67. Can you please estimate the Rand value of the total audit fee paid to the audit firm in the past financial year for audit services only. (Answer as a Rand amount.)

68. Can you please estimate the average percentage (%) increase in ongoing costs to the company that will likely be introduced by the adoption of MAFR. Please provide your response as a percentage (%) of the annual audit fee (from the above question). Please consider all ongoing financial costs to the company associated with MAFR. (Answer as a percentage amount.)

69. Please comment on any other economic impacts (positive or negative) that you foresee could arise if MAFR is implemented.

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

**Final Questions:**

70. The MAFR ruling in June 2017 stated a 10 year rotation period. In your opinion, what is an optimal rotation period? (Please provide a response, even if you may be against MAFR)

[ ] 1-3 years
☐ 4-6 years
☐ 7-9 years
☐ 10 years (per the IRBA’s intention)
☐ 11-15 years
☐ 16-20 years
☐ > 20 years

71. The MAFR ruling in June 2017 stated a “cooling-off” period of 5 years. In your opinion, what is an optimal “cooling-off” period? (Please provide a response, even if you may be against MAFR.)

☐ 1-2 years
☐ 3-4 years
☐ 5 years (per the IRBA’s intention)
☐ 6-7 years
☐ 8-10 years
☐ >10 years

72. Finally, on an overall cost-benefit analysis, considering the possible benefits and consequences of MAFR, financial and non-financial, do you believe MAFR, as ruled by the IRBA, is appropriate for South Africa?

YES ☐
NO ☐

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

THANK YOU FOR COMPLETING THE QUESTIONNAIRE.
WE APPRECIATE THE TIME YOU HAVE PUT IN TO COMPLETE THIS.
YOUR INPUT WILL CONTRIBUTE TO THE SOUTH AFRICAN DEBATE ON MAFR.
Annexure 12: QUESTIONNAIRE for the JSE chief financial officer (CFO)

Mandatory Audit Firm Rotation (MAFR)

<table>
<thead>
<tr>
<th>INSTRUCTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>This questionnaire is only intended for a person who is a JSE top 100 company CFO.</td>
</tr>
<tr>
<td>Please complete the questionnaire and then click “Submit” when finished.</td>
</tr>
<tr>
<td>Please answer this questionnaire as a means to express your personal opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as a CFO.</td>
</tr>
<tr>
<td>Please note that the context of all questions and statements in the questionnaire is with reference to JSE listed companies and the June 2017 IRBA ruling on MAFR.</td>
</tr>
<tr>
<td>The researcher, Michael Harber, can be contacted on:</td>
</tr>
<tr>
<td>Email: <a href="mailto:michael.harber@uct.ac.za">michael.harber@uct.ac.za</a></td>
</tr>
<tr>
<td>Work: (021) 650-2272 or Cell: (083) 447 8770</td>
</tr>
</tbody>
</table>

This survey has been distributed by email with the assistance of the Johannesburg Stock Exchange (JSE).

Your willingness to voluntarily participate in this survey is greatly appreciated and contributes to the creation of new knowledge. Results from all of the respondents will be collated and reported-on as a unit; and your specific responses will not be reported individually. Your participation in this study is entirely voluntary. Your responses will be collected anonymously, and the data will be treated confidentially. The researchers undertake not to engage in any activities aimed at identifying participants’ personal information, for example, personal or company names or IP addresses.

You are reminded and informed hereby, that you are not obligated in any way to participate in this study. Your participation is voluntary, and you may choose to withdraw from the process at any stage without fear or consequence. As a respondent, you are reminded and informed that your right to privacy, confidentiality, anonymity, equality, justice, human dignity, freedom of choice, freedom of expression, access to information and access to the research community will be respected and guaranteed.

- Please answer this questionnaire as a means to express your opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as an individual registered auditor.
- Please respond as openly and as frankly as possible to the questions.
- Please acknowledge that you have read and understand the above information and that the researchers have provided appropriate information regarding the nature of the research.
- The Faculty of Economic and Financial Sciences Research Ethics Committee of the University of Johannesburg have provided ethical clearance for the survey. The ethics clearance number is FEFSREC2017081401.
(Tick box) I, as respondent, by ticking this box, understand my rights in this process and proceed willingly and voluntarily with the survey.

Your participation is greatly appreciated.

**Brief background to mandatory audit firm rotation (MAFR):**

In June 2017 the Independent Regulatory Board for Auditors (IRBA) published the rule on Mandatory Audit Firm Rotation (MAFR) for auditors of all public interest entities, as defined in section 290.25 to 290.26 of the amended IRBA Code of Professional Conduct for Registered Auditors, which includes all publically listed companies. In terms of this ruling, an audit firm, including a network firm as defined in the IRBA Code of Professional Conduct for Registered Auditors, shall not serve as the appointed auditor of a public interest entity for more than 10 consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years ('cooling-off period').

The regulator’s primary reason for changing regulations in favour of MAFR is the concern that audit firms, mostly due to long tenures with their clients, lack the required degree of independence and professional scepticism. According to the IRBA, the audit firms of listed companies can become too familiar with the senior management of these companies and this presents as undue bias in their role as external auditors. However, the IRBA also believes that MAFR will improve transformation within the audit industry and reduce the dominance and concentration of the “big 4” audit firms as assurance providers in this market.

The MAFR rule is effective for financial years commencing on or after 1 April 2023. Significant debate has already occurred on this topic and will continue in the years ahead. The topic is controversial and there are numerous stakeholders in the debate. Your views in your capacity as a key and experienced participant in the external audit engagement will contribute significantly to this ongoing debate.

**Demographic data:**

The following is a request for personal demographic data. The request for gender and race classification is relevant considering the priority of transformation in South Africa and possible impact that MAFR may have on transformation. Please note that responses are voluntary, and you may select “prefer not to answer” or leave the section unfilled.

The questionnaire data and demographic information will be coded so that it will not be linked to your name. Your identity will not be revealed while the study is being conducted or when the study is published in academic or professional journals and/or research reports. Any information that is obtained in connection with this study that can be identified with you will remain confidential and will be disclosed only with your permission or as required by law. The information received during the research will be used only for
research purposes and will not be released for any employment-related performance evaluation, promotion and/or disciplinary purposes.

Please provide your age in years.

Please provide the number of years that you have acted as a registered auditor.

Please provide your gender.

☐ Female
☐ Male
☐ Prefer not to answer

Please provide your race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013.

☐ African black
☐ Coloured
☐ Indian/Asian
☐ White
☐ Prefer not to answer

Overall position on Mandatory audit firm rotation (MAFR):

1. Are you of the opinion that changing regulations in favour of MAFR, as ruled by the IRBA, is appropriate for South Africa?
   YES ☐
   NO ☐

2. South African auditors of listed companies lack the required degree of independence and professional scepticism.
The Public Inspections Report 2015/2016 recently released by the IRBA shows an overall regression in the inspection results, with an increase in unsatisfactory inspection results. The IRBA believes that this is a worrying trend. According to the IRBA the root cause identified for a number of these findings was the failure to strengthen and maintain independence as an underlying principle for high audit quality. Based on this, please provide your response to the following statement:

4. The IRBA inspection findings strengthen the argument of the IRBA in favour of MAFR.

The IRBA makes the argument that high-profile corporate failures have caused the investing public to question the role and the independence of auditors. According to the IRBA, investors are demanding more information and transparency and have become more aware of their rights, which need to be protected. Based on this, please provide your response to the following statement:

5. The above line of reasoning by the IRBA strengthens their case in favour of MAFR.
### Impact of MAFR on auditor client-specific knowledge:

6. Audit firms develop institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

8. A steep learning curve exists for the incoming, newly-appointed audit firm.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

9. The incoming, newly-appointed audit firm, is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

10. Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

11. Enhanced communication between the outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
12. The potential loss of client-specific knowledge is a significant problem with MAFR.  

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

13. Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.  

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:  
______________________________________________________________________  
______________________________________________________________________  
______________________________________________________________________  

Impact of MAFR on auditors’ independence and professional skepticism:  

14. In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.  

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

15. Longer audit firm tenures result in less auditor independence.  

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

16. MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.
17. MAFR will increase the independence of audit firms (and audit partners).

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on perceived auditor independence in the minds of the investing public:

18. The investing public tend to believe that there is a significant degree of bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistle-blower.

19. Any perceived problems regarding auditor independence by the investing public primarily result from their knowledge of long audit firm tenures.

20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.
21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on costs to companies:

23. MAFR will result in significantly increased audit fees, i.e. significant to the companies involved.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

24. Regarding potential increases in audit fees resulting from MAFR:

Audit committees will agree to increased audit fees in the short-term (1-2 years of the new appointment), but not in the longer-term.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

25. Regarding potential increases in audit fees resulting from MAFR:
Audit committees will agree to permanently increased audit fees, i.e. for the duration of the rotation period that the audit firm may be appointed.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

26. MAFR will result in significant costs to the company in terms of time and resource investment by senior management and audit committees.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

27. MAFR will introduce a significant added cost to the audit committees of JSE listed companies as they will be required to receive and consider tenders (proposals) more regularly to appointment auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

28. The additional cost to the JSE listed companies from MAFR will not add any incremental benefits, economic or otherwise, to the business and thus negatively impact on shareholder value.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

29. The additional investment in time by boards, audit committees and executive management, resulting from MAFR, will be a significant distraction from running the business and performing the respective duties to those involved at the company.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

30. MAFR will require significant additional investment in time by the financial managers, supervisors and controllers, including other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team.
31. MAFR will cause significant additional cost and time for the group to appoint the same auditor across all group companies as it will require various shareholder approvals and regulatory processes.

32. MAFR will allow other smaller audit firms, such as the mid-tier firms, the opportunity to tender for these assurance engagements.

33. MAFR will reduce the concentration of “big 4” audit firms providing assurance services for JSE listed companies.

34. The size of an audit firm’s “geographical footprint” (international presence) is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.
35. Non-“big 4” audit firms (mid-tier firms) have a sufficient “geographical footprint” (international presence) to be appointed as auditors of large multinational companies on the JSE.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

36. In order to maintain audit efficiency, effectiveness and reduce the overall cost, the audit committee seeks to appoint (or recommend for appointment) the same audit firm in each of the geographic areas and jurisdictions in which the group operates.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

37. Industry-specific knowledge and experience within the audit firm is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

38. Non-“big 4” audit firms (mid-tier firms) have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

39. Audit committees of JSE listed companies are likely to recommend non-“big 4” audit firms for appointment as external auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
40. Shareholders of JSE listed companies, in the AGM, are likely to appoint non-“big 4” audit firms as external auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

41. Considering that the performance of advisory services (non-assurance work) by an audit firm creates an independence threat that limits or prevents that firm from being appointed as auditor, MAFR will reduce the choice of audit firms available for appointment by the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

42. Non-“big 4” audit firms will be able to obtain more non-assurance work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:
______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Impact of MAFR on transformation in the audit profession:

According to the IRBA, of the 4,283 registered auditors in South Africa, 74.8% are white and only 10.5% are black Africans. Of the 353 audit partners signing off on listed company audits, only 9 are black African. Based on this, please provide your response to the following statement:

43. The rate of transformation in the audit profession is acceptable.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
44. MAFR will reduce the ability of audit firms to pursue internal transformation objectives, i.e. hinder the ability of firms to achieve transformation targets.

Strongly disagree  Disagree  Neutral  Agree  Strongly agree
☐   ☐   ☐   ☐   ☐

45. MAFR will impose additional costs on the audit firms, resulting in a negative financial impact on the ability of firms to invest in transformation and attract talent.

Strongly disagree  Disagree  Neutral  Agree  Strongly agree
☐   ☐   ☐   ☐   ☐

46. The additional costs MAFR will impose on the audit firms will require a redirection of spending away from areas such as training and bursaries and into tendering for work.

Strongly disagree  Disagree  Neutral  Agree  Strongly agree
☐   ☐   ☐   ☐   ☐

47. MAFR will improve the transformation statistics in the South African audit profession.

Strongly disagree  Disagree  Neutral  Agree  Strongly agree
☐   ☐   ☐   ☐   ☐

48. Transformation of the audit profession will best be progressed via MAFR, rather than through existing and/or improved efforts within the audit firms themselves.

Strongly disagree  Disagree  Neutral  Agree  Strongly agree
☐   ☐   ☐   ☐   ☐

49. The lack of black registered auditors in South Africa is primarily indicative of the disproportionately small pool of black Chartered Accountants and the disproportionate racial demographic of qualifying chartered accountants.
### Impact of MAFR on the appeal of the audit profession:

50. The audit profession in South Africa is over-regulated (meaning unnecessarily or excessively regulated).

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

51. As a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

52. MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

53. MAFR will result in an increased trend of audit managers and audit partners seeking employment outside of assurance services.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Comments:

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

502
Impact of MAFR on the need for and use of professional judgement:

54. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit firm and individual audit partner.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

55. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

56. The consideration as to which audit firm is best able to provide the company with a high-quality audit, is a fundamentally important responsibility of the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

57. MAFR will reduce the need for auditors to apply their minds in regard to the independence of the audit firm and the individual audit partner.
58. MAFR will reduce the need for audit committees to apply their minds in regard to the independence and suitability of the audit firm and the individual audit partner.

59. MAFR will interfere with, and/or restrict, the ability of the audit committee to decide the appropriate time to replace the auditor, or place the audit out for tender to the market, considering the company’s specific context and circumstances.

Comments:

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________

Alternatives to MAFR:

60. In order to address the concerns being raised by the IRBA with regards to auditor independence on JSE listed company audits, indicate your opinion on the following alternatives, considered in combination, not in isolation, as being preferable to MAFR:
   a. **Alternative:** Mandatory tendering (rather than mandatory firm rotation).

   b. **Alternative:** A system of joint audits.
c. **Alternative:** Continued development and enforcement of the auditors’ Code of Professional Conduct.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

d. **Alternative:** Further development of robust Independent Regulatory Oversight, such as continued investment in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

e. **Alternative:** Continued development in effective and independent Engagement Quality Control Review (EQCR) within the audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

f. **Alternative:** Stronger audit committee oversight of auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

g. **Alternative:** Improved disclosure of how the company has assessed the quality and independence of the audit firm, as well as how the auditors themselves have ensured that they are independent and will remain independent in the year ahead.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
Additional Economic Impact Analysis Issues

The following questions and statements are part of a study attempting to quantify and describe the overall economic impact that mandatory audit firm rotation (MAFR) will have on the South African economy.

61. MAFR will result in a significant additional cost and administrative burden in the wider South African economy.

   Strongly disagree   Disagree   Neutral   Agree   Strongly agree
   ☐                  ☐         ☐           ☐       ☐

62. Please estimate, based on your experience with JSE listed company audits, the cost of the audit fee (for assurance services only) to the company as a percentage (%) of company revenue (before adoption of MAFR). (Answer as a percentage amount.)

63. Can you please estimate the Rand value of the total audit fee paid to the audit firm in the past financial year for audit services only. (Answer as a Rand amount)

64. Can you please estimate the average percentage (%) increase in ongoing costs to the company that will likely be introduced by the adoption of MAFR. Please provide your response as a percentage (%) of the annual audit fee (from the above question). Please consider all ongoing financial costs to the company associated with MAFR. (Answer as a percentage amount.)

65. Please comment on any other economic impacts (positive or negative) that you foresee could arise if MAFR is implemented.

______________________________________________________________________
______________________________________________________________________
______________________________________________________________________
Final Questions:

66. The MAFR ruling in June 2017 stated a 10 year rotation period. In your opinion, what is an optimal rotation period? (Please provide a response, even if you may be against MAFR.)

☐ 1-3 years
☐ 4-6 years
☐ 7-9 years
☐ 10 years (per the IRBA's intention)
☐ 11-15 years
☐ 16-20 years
☐ > 20 years

67. The MAFR ruling in June 2017 stated a “cooling-off” period of 5 years. In your opinion, what is an optimal “cooling-off” period? (Please provide a response, even if you may be against MAFR.)

☐ 1-3 years
☐ 4-6 years
☐ 7-9 years
☐ 10 years (per the IRBA’s intention)
☐ 11-15 years
☐ 16-20 years
☐ > 20 years

68. Finally, on an overall cost-benefit analysis, considering the possible benefits and consequences of MAFR, financial and non-financial, do you believe MAFR, as ruled by the IRBA, is appropriate for South Africa?

YES ☐
NO ☐
THANK YOU FOR COMPLETING THE QUESTIONNAIRE.
WE APPRECIATE THE TIME YOU HAVE PUT IN TO COMPLETE THIS.
YOUR INPUT WILL CONTRIBUTE TO THE SOUTH AFRICAN DEBATE ON MAFR.
Annexure 13: QUESTIONNAIRE for the equity fund manager

Mandatory Audit Firm Rotation (MAFR)

INSTRUCTIONS

This questionnaire is only intended for a person who is an equity fund manager of a representative member of the Association for Savings and Investment South Africa (ASISA).

Please complete the questionnaire electronically and then click "Submit" when finished.

If you wish to complete the questionnaire manually, please contact the researcher as per below.

Please answer this questionnaire as a means to express your personal opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as an experienced institutional investor and ASISA member.

Please note that the context of all questions and statements in the questionnaire is with reference to JSE listed companies and the June 2017 IRBA ruling on MAFR.

The researcher, Michael Harber, can be contacted on:
Email: michael.harber@uct.ac.za
Work: (021) 650-2272 or Cell: (083) 447 8770

This survey has been distributed by email with the assistance of the Johannesburg Stock Exchange (JSE).

Your willingness to voluntarily participate in this survey is greatly appreciated and contributes to the creation of new knowledge. Results from all of the respondents will be collated and reported-on as a unit; and your specific responses will not be reported individually. Your participation in this study is entirely voluntary. Your responses will be collected anonymously, and the data will be treated confidentially. The researchers undertake not to engage in any activities aimed at identifying participants’ personal information, for example, personal or company names or IP addresses.

You are reminded and informed hereby, that you are not obligated in any way to participate in this study. Your participation is voluntary, and you may choose to withdraw from the process at any stage without fear or consequence. As a respondent, you are reminded and informed that your right to privacy, confidentiality, anonymity, equality, justice, human dignity, freedom of choice, freedom of expression, access to information and access to the research community will be respected and guaranteed.
• Please answer this questionnaire as a means to express your opinions on MAFR as proposed by the IRBA, drawing on your experience in your role as an experienced institutional investor and ASISA member.
• Please respond as openly and as frankly as possible to the questions.
• Please acknowledge that you have read and understand the above information and that the researchers have provided appropriate information regarding the nature of the research.
• The Faculty of Economic and Financial Sciences Research Ethics Committee of the University of Johannesburg have provided ethical clearance for the survey. The ethics clearance number is FEFSREC2017081401.

☐ (Tick box) I, as respondent, by ticking this box, understand my rights in this process and proceed willingly and voluntarily with the survey.

Your participation is greatly appreciated.

**Brief background to mandatory audit firm rotation (MAFR):**

In June 2017 the Independent Regulatory Board for Auditors (IRBA) published the rule on Mandatory Audit Firm Rotation (MAFR) for auditors of all public interest entities, as defined in section 290.25 to 290.26 of the amended IRBA Code of Professional Conduct for Registered Auditors, which includes all publically listed companies. In terms of this ruling, an audit firm, including a network firm as defined in the IRBA Code of Professional Conduct for Registered Auditors, shall not serve as the appointed auditor of a public interest entity for more than 10 consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years (‘cooling-off period’).

The regulator’s primary reason for changing regulations in favour of MAFR is the concern that audit firms, mostly due to long tenures with their clients, lack the required degree of independence and professional skepticism. According to the IRBA, the audit firms of listed companies can become too familiar with the senior management of these companies and this presents as undue bias in their role as external auditors. However, the IRBA also believes that MAFR will improve transformation within the audit industry and reduce the dominance and concentration of the “big 4” audit firms as assurance providers in this market.

The MAFR rule is effective for financial years commencing on or after 1 April 2023. Significant debate has already occurred on this topic and will continue in the years ahead. The topic is controversial and there are numerous stakeholders in the debate. Your views in your capacity as a key and experienced participant in the external audit engagement will contribute significantly to this ongoing debate.
Demographic data:
The following is a request for personal demographic data. The request for gender and race classification is relevant considering the priority of transformation in South Africa and possible impact that MAFR may have on transformation. Please note that responses are voluntary, and you may select “prefer not to answer” or leave the section unfilled.

The questionnaire data and demographic information will be coded so that it will not be linked to your name. Your identity will not be revealed while the study is being conducted or when the study is published in academic or professional journals and/or research reports. Any information that is obtained in connection with this study that can be identified with you will remain confidential and will be disclosed only with your permission or as required by law. The information received during the research will be used only for research purposes and will not be released for any employment-related performance evaluation, promotion and/or disciplinary purposes.

Please confirm that you are an investment manager:
☐ I confirm that I am an investment manager

Please provide your age in years.

Please provide the number of years that you have acted as an investment manager, responsible for investing third-party funds.

Please provide your gender.
☐ Female
☐ Male
☐ Prefer not to answer

Please provide your race, as per the categories provided in section 1 of the Broad-Based Black Economic Empowerment Amendment Act, 2013.
☐ African black
☐ Coloured
☐ Indian/Asian
☐ White
☐ Prefer not to answer
Overall position on Mandatory audit firm rotation (MAFR):

1. Are you of the opinion that changing regulations in favour of MAFR, as ruled by the IRBA, is appropriate for South Africa?
   YES ☐
   NO ☐
   MAYBE ☐

2. South African auditors of listed companies lack the required degree of independence and professional scepticism.
   Strongly disagree Disagree Neutral Agree Strongly agree
   ☐ ☐ ☐ ☐ ☐

3. Current regulations and professional standards in South Africa are sufficient to regulate auditor independence.
   Strongly disagree Disagree Neutral Agree Strongly agree
   ☐ ☐ ☐ ☐ ☐

4. The Public Inspections Report 2015/2016 recently released by the IRBA shows an overall regression in the inspection results, with an increase in unsatisfactory inspection results. The IRBA believes that this is a worrying trend. According to the IRBA the root cause identified for a number of these findings was the failure to strengthen and maintain independence as an underlying principle for high audit quality. Based on this, please provide your response to the following statement:
   Are you of the opinion that the IRBA inspection findings strengthen the argument of the IRBA in favour of MAFR?
   YES ☐
   NO ☐

5. The IRBA makes the argument that high-profile corporate failures have caused the investing public to question the role and the independence of auditors. According to the IRBA, investors are demanding more information and transparency and have become more aware of their rights, which need to be protected. Based on this, please provide your response to the following statement:
   Are you of the opinion that the above line of reasoning by the IRBA strengthens the case of the IRBA in favour of MAFR?
Impact of MAFR on auditor client-specific knowledge:

6. Audit firm develops institutional client-specific knowledge of the company as the years progress in the auditor-client relationship.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

7. In comparison to the outgoing audit firm, an incoming, newly-appointed audit firm, is less familiar with the financial reporting processes, financial reporting risks and industry risks associated with the company in the first year of the appointment.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

8. A steep learning curve for the incoming, newly-appointed audit firm.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

9. The incoming, newly-appointed audit firm is less likely than the outgoing audit firm to detect misstatements in the financial statements of the company.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

10. Auditor unfamiliarity and inexperience is a greater concern under a system of MAFR in comparison with the current system of audit partner rotation.

    | Strongly disagree | Disagree | Neutral | Agree | Strongly agree |
    |-------------------|----------|---------|-------|---------------|
    | ☐                 | ☐        | ☐       | ☐     | ☐             |

11. Enhanced communications between outgoing and incoming audit firms could mitigate the loss in client-specific and industry-specific knowledge.
12. The potential loss of client-specific knowledge is a significant problem with MAFR.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

13. Medium-sized audit firms (non-“big 4”) have the resources (money, time, staff etc.) to appropriately perform the audits of the larger JSE listed companies.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

**Impact of MAFR on auditors’ independence and professional scepticism:**

14. In your experience, failure by auditors to detect material financial reporting misstatements (due to fraud or error) is due to a lack of auditor independence.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

15. Longer audit firm tenures result in less auditor independence.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

16. MAFR provides auditors with the incentive to be more alert and pay closer attention to detail, since they know that their work will be reviewed by another firm after rotation occurs.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
17. MAFR will increase the independence of audit firms (and audit partners).

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

**Impact of MAFR on perceived auditor independence in the minds of the investing public:**

18. The investing public tend to believe that there is a significant degree of bias or familiarity between auditor and company, causing them to question the quality of the audit opinion and function of the auditor as a whistle-blower.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

19. Any perceived problems regarding auditor independence by the investing public primarily result from their knowledge of long audit firm tenures.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

20. It is common during company AGMs for the audit committee to be questioned by shareholders on the perception of the independence of the auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

21. During company AGMs, it is common for shareholders to vote against the resolution to reappoint auditors, on the grounds of concerns regarding long audit firm tenure?

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

22. MAFR will be effective in changing any perceptions of a lack of independence in the minds of the investing public.
Impact of MAFR on costs to companies:

23. MAFR will result in increased audit fees, i.e. significant to the companies involved.

24. Regarding potential increases in audit fees resulting from MAFR:
   Audit committees will agree to increased audit fees in the short-term (1-2 years of the new appointment), but not in the longer-term.

25. Regarding potential increases in audit fees resulting from MAFR:
   Audit committees will agree to permanently increased audit fees, i.e. for the duration of the rotation period that the audit firm may be appointed.

26. MAFR will result in significant costs to the company in terms of time and resource investment by senior management and audit committees.

27. MAFR will introduce a significant added cost to the audit committees of JSE listed companies as they will be required to receive and consider tenders (proposals) to appoint auditors more regularly.
28. The additional cost to the company from MAFR will not add any incremental benefits, economic or otherwise, and thus negatively impact on shareholder value.

29. The additional investment in time by boards, audit committees and executive management, resulting from MAFR, will be a significant distraction from running the business to those involved at the company.

30. MAFR will require significant additional investment in time by the financial managers, supervisors and controllers, including other staff with whom the audit team engages, as a result of dealing with a less experienced incoming audit team.

Impact of MAFR on the degree of market concentration by the “big 4” firms:

31. MAFR will allow other smaller audit firms, such as the mid-tier firms, the opportunity to tender for these audit engagements.

32. MAFR will reduce the concentration of “big 4” audit firms providing audit services for JSE listed companies.
33. The size of an audit firm’s “geographical footprint” (international presence) is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.

34. Non-“big 4” audit firms (mid-tier firms) have a sufficient “geographical footprint” (international presence) to be appointed as auditors of large multinational companies on the JSE.

35. In order to maintain audit efficiency, effectiveness and reduce the overall cost, the audit committee seeks to appoint (or recommend for appointment) the same audit firm in each of the geographic areas and jurisdictions in which the group operates.

36. Industry-specific knowledge and experience within the audit firm is an important consideration for the audit committee and shareholders in the appointment of a suitable audit firm.

37. Non-“big 4” audit firms (mid-tier firms) have evident industry-specific knowledge and experience to be appointed as auditors of large multinational companies on the JSE.
38. Audit committees of JSE listed companies are likely to recommend non-“big 4” audit firms for appointment as external auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

39. Shareholders of JSE listed companies, in the AGM, are likely to appoint non-“big 4” audit firms as external auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

40. Considering that the performance of advisory services (non-audit work) by an audit firm creates an independence threat that limits or prevents that firm from being appointed as auditor, MAFR will reduce the choice of audit firms available for appointment by the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

41. Non-“big 4” audit firms will be able to obtain more non-audit work if larger firms restrict their advisory (non-audit) services in order to make themselves available for appointment as auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Impact of MAFR on the appeal of the audit profession:

42. The audit profession in South Africa is over-regulated (meaning unnecessarily or excessively regulated).

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

43. As a career choice for young professional accountants, the audit profession is decreasing in appeal relative to alternative career paths.
<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

44. MAFR will reduce the appeal of the audit profession as a career of choice for professional accountants.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

45. MAFR result in an increased trend of audit managers and audit partners seeking employment outside of audit services.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

**Impact of MAFR on the need for and use of professional judgement:**

46. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit firm and individual audit partner.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

47. Actively assessing and safeguarding the independence of the auditor is a fundamentally important responsibility of the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

48. The consideration as to which audit firm is best able to provide the company with a high-quality audit, is a fundamentally important responsibility of the audit committee.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>
49. MAFR will reduce the need for auditors to apply their minds in regard to the independence of the audit firm and the individual audit partner.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

50. MAFR will reduce the need for audit committees to apply their minds in regard to the independence and suitability of the audit firm and the individual audit partner.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

51. MAFR will interfere with, and/or restrict, the ability of the audit committee to decide the appropriate time to replace the auditor, or place the audit out for tender to the market, considering the company’s specific context and circumstances.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

Alternatives to MAFR:

52. In order to address the concerns being raised by the IRBA with regards to auditor independence on JSE listed company audits, indicate your opinion on the following alternatives, considered in combination, not in isolation, as being preferable to MAFR:

a. **Alternative**: Mandatory tendering (rather than mandatory firm rotation).

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

b. **Alternative**: A system of joint audits.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

c. **Alternative**: Continued development and enforcement of the auditors’ Code of Professional Conduct.
d. **Alternative:** Further development of robust Independent Regulatory Oversight, such as continued investment in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

e. **Alternative:** Continued development in effective and independent Engagement Quality Control Review (EQCR) within the audit firms.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

f. **Alternative:** Stronger audit committee oversight of auditors.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

g. **Alternative:** Improved disclosure of how the company has assessed the quality and independence of the audit firm, as well as how the auditors themselves have ensured that they are independent and will remain independent in the year ahead.

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

**Final Questions:**

53. The MAFR ruling in June 2017 stated a 10 year rotation period. In your opinion, what is an optimal rotation period? (Please provide a response, even if you may be against MAFR)

| ☐ | 1-3 years |
| ☐ | 4-6 years |
54. The MAFR ruling in June 2017 stated a “cooling-off” period of 5 years, i.e. the period that must expire before a previously-appointed audit firm shall be eligible to serve again as auditor. In your opinion, what is an optimal “cooling-off” period? (Please provide a response, even if you may be against MAFR)

☐ 1-2 years
☐ 3-4 years
☐ 5 years (per the IRBA’s intention)
☐ 6-7 years
☐ 8-10 years
☐ >10 years

55. Please comment on any other economic impacts (positive or negative) that you foresee could arise if MAFR is implemented.

56. Finally, on an overall cost-benefit analysis, considering the possible benefits and consequences of MAFR, financial and non-financial, do you believe MAFR, as ruled by the IRBA, is appropriate for South Africa?

☐ Yes
☐ No
THANK YOU FOR COMPLETING THE QUESTIONNAIRE.
WE APPRECIATE THE TIME YOU HAVE PUT IN TO COMPLETE THIS.
YOUR INPUT WILL CONTRIBUTE TO THE SOUTH AFRICAN DEBATE ON MAFR.
Annexure 14: Ethical clearances

Ethical approval was received from both the University of Johannesburg (PhD student research) and the University of Cape Town (Staff research).

University of Johannesburg
FEFS RESEARCH ETHICS COMMITTEE
Ethical clearance number: FEFSREC2017081401
(Refer below)
FEFS RESEARCH ETHICS COMMITTEE
ETHICAL CLEARANCE REPORT

<table>
<thead>
<tr>
<th>Applicant</th>
<th>Michael Harber</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student/staff number</td>
<td>217064360</td>
</tr>
<tr>
<td>Title</td>
<td>Mandatory Audit Firm Rotation: A South African Perspective</td>
</tr>
<tr>
<td>Decision date at FEFS REC meeting</td>
<td>14 August 2017</td>
</tr>
<tr>
<td>Reviewers</td>
<td>A Kruger, S Naidu, K Heathcote</td>
</tr>
<tr>
<td>Ethical clearance number</td>
<td>FEFSREC2017081401</td>
</tr>
<tr>
<td>Rating of most recent application</td>
<td>CODE 02</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CODE 01</th>
<th>CODE 02</th>
<th>CODE 03</th>
<th>CODE 04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Approved</td>
<td>Approved with suggestions without re-submission</td>
<td>Suggestions with re-submission</td>
<td>Not approved, re-application required</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>RESEARCH COMPLIES WITH</th>
<th>COMPLIANCE</th>
<th>NON-COMPLIANCE</th>
</tr>
</thead>
<tbody>
<tr>
<td>The right to privacy, confidentiality and anonymity</td>
<td>Yes</td>
<td>See comment</td>
</tr>
<tr>
<td>The right to equality, justice, human dignity, life and protection against harm</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>The right to freedom of choice, expression and access to information</td>
<td>Yes</td>
<td>See comment</td>
</tr>
<tr>
<td>Right of the community and science community</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Informed consent/letters of request</td>
<td>Yes</td>
<td>See comment</td>
</tr>
</tbody>
</table>

Additional comments

1. The FEFS REC has scrutinised the proposal, covering letter and questionnaire and re-submission to it on this application, and engaged in discussion with the relevant supervisors on concerns and questions raised. The reviewers are satisfied that relevant ethical considerations have been addressed by the answers provided and discussions had.

2. The committee provides ethical clearance for the abovementioned study to proceed, and has the following three comments/suggestions that it would like the applicant to consider (without the need to re-submit to the committee, as approval has already been granted), which have been discussed with the supervisors and whom are in agreement with these suggestions/comments:
a. Reference to the word “anonymous” should be removed in the questionnaire and covering letter, as the respondents are known to the researcher. The fact that their responses will be treated as confidential and not reported on individually/by name or affiliation, should however be highlighted to respondents.

b. A section in the questionnaire should be dedicated to the consent of participants. A suggestion would be for participants to indicate their willingness to participate voluntarily in the study, and if applicable, that they confirm that they are in a position of authority to provide answers in their capacity to represent the entity/firm/committee they serve on.

c. The FEFS REC suggests that the participants be provided with a copy/link of the final manuscript, so that the persons who contributed to the creation of new knowledge, have access to such.

FEFS REC CHAIR SIGNATURE:

DATE: 14 August 2017