Mandatory audit firm rotation in South Africa: Suggested solutions to prospective problems

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DECLARATION

I, Liné van Deventer (28410769), hereby declare that this dissertation is my own, original work.

I further declare that:

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ABSTRACT AND KEYWORDS

Abstract:

In response to the increasing number of financial scandals, many jurisdictions introduced more prescriptive rules with the aim to enhance the independence of auditors. Similarly, the Independent Regulatory Board for Auditors (IRBA) issued a rule on mandatory audit firm rotation (MAFR) for South African public interest entities (PIEs) effective from 1 April 2023. This regulation forbids auditors of PIEs to be appointed as auditors for more than ten consecutive years. Contrasting views exist on the effectiveness of MAFR in South Africa. Proponents believe that this rule will increase audit quality due to improved auditor independence, however, opponents argue that MAFR will reduce audit quality due to the loss of client and industry-specific knowledge by the auditor.

This research study aims to contribute to auditing literature by examining the consequences MAFR had in other jurisdictions which implemented similar rules. Differences between South Africa and the identified countries are used to anticipate how specific problems could manifest in a South African context. The difficulties experienced by other countries are then combined with the expectations of affected parties in South Africa. Suggested solutions to prospective problems are explored with the aim to help audit firms and the IRBA set pro-active measures in place to ensure that MAFR has the desired effect on audit quality in South Africa. The primary research objective of this study is to determine what pro-active measures could reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa.

This study consists of both a literature study and a qualitative empirical study. The literature study provided background for the implementation of MAFR in South Africa and includes a detailed comparison with eight other jurisdictions around the world that already implemented MAFR. The empirical study supplemented the findings of the literature study by exploring the views on auditor independence as well as on potential problems and possible solutions through semi-structured interviews with six registered auditors and six academics teaching auditing.

The study found that MAFR will likely improve auditors' independence in appearance which would help restore the public's opinion of the audit profession. Possible solutions proposed to mitigate the effect of client specific knowledge loss include the up-skilling of audit trainees and the management of audit clients with problem solving abilities and encouraging knowledge sharing between the predecessor and the successor audit firms. Furthermore, it is suggested that the IRBA should introduce an audit fee framework to assist auditors in determining and explaining audit fees to clients to prevent low-balling. Besides the possible contribution towards improved independence in

appearance, it is believed that MAFR will have a limited effect on the audit market concentration and the transformation in the audit profession.

This dissertation contributes to the gap in literature on MAFR in South Africa by anticipating possible problems based on experiences in other jurisdictions. Furthermore, the suggested solutions which were gathered provides the IRBA as well as audit firms with measures that can be put in place to help limit likely negative consequences that will be caused by MAFR. The empirical evidence of this study could also assist countries which are still deliberating on introducing MAFR by providing an understanding of how knowledgeable parties would react to the implementation of such a regulation; and which problems should be addressed from the start.

Keywords:
Audit; assurance; mandatory audit firm rotation; independence; implementation; audit quality.

ABBREVIATIONS

APC	Assessment of Professional Competence
CFO	Chief financial officer
CEO	Chief executive officer
COPC	Code of Professional Conduct
CPD	Continuing Professional Development
CR	Concentration ratio
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IESBA	International Ethics Standards Board for Accountants
IESBA Code	Code of Ethics for Professional Accountants
IFAC	International Federation of Accountants
IMD	Institute for Management Development
IRBA	Independent Regulatory Board for Auditors
ISA	International Standards on Auditing
ISQC	International Standard on Quality Control
ISQM	International Standard on Quality Management
JSE	Johannesburg Stock Exchange
MAFR	Mandatory audit firm rotation
PIEs	Public interest entities
QDA	Qualitative data analysis
SAICA	South African Institute of Chartered Accountants
WCR	IMD world competitive ranking

Abbreviations used per country in Chapter 3

3.1.1 United States

AICPA	American Institute of Certified Public Accountants
GAO	United States General Accounting Office
PCAOB	Public Company Accounting Oversight Board
SEC	U.S. Securities and Exchange Commission
SOX	Sarbanes-Oxley
U.S.	United States of America

3.1.2 European Union

CEAOB	Committee of European Auditing Oversight Bodies
EC	European Commission
ECC	European Economic Community
EGAOB	European Group of Auditors' Oversight Bodies
EU	European Union

3.1.3 Italy

CNDCEC	*Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili* [National Council of Chartered Accountants and Accounting Experts]
CONSOB	*Commissione Nazionale per le Società et la Borsa* [Companies and Stock Exchange Commission]

3.1.4 Canada

CPA	Chartered Professional Accountants
CPAB	Canadian Public Accountability Board
OSFI	Office of the Superintendent of Financial Institutions

3.1.5 Spain

ICAC	*Instituto de Contabilidad y Auditoría de Cuentas* [Institute of Accounting and Accounts Auditing]

3.1.6 Singapore

AASC	Auditing and Assurance Standards Committee
ACRA	Accounting and Corporate Regulatory Authority
ISCA	Institute of Singapore Chartered Accountants
MAS	Monetary Authority of Singapore
SGX-ST	Singapore Exchange Securities Trading Limited
SSA	Singapore Standards on Auditing

3.1.7 Costa Rica

CCPA	*Colegio de Contadores Públicos de Costa Rica* [College of Public Accountants of Costa Rica]
CONASSIF	*Consejo Nacional de Supervisión del Sistema Financiero* [National Council of Supervision of the Financial System]
SUGEVAL	*Superintendencia General de Valores* [Stock Market Supervisory Authority]

3.1.8 Nigeria

CAMA	Companies and Allied Matters Act of 1990
CBN	Central Bank of Nigeria
FRC	Financial Reporting Council of Nigeria
FRC Act	Financial Reporting Council of Nigeria Act of 2011
NASB	Nigerian Accounting Standards Board

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CHAPTER 1: INTRODUCTION, OBJECTIVES AND METHOD OF THE STUDY

1.1 Introduction and background

Hay (2015:160) is quite blunt in his assessment that "[a]uditing is in a state of crisis" globally. An increase in the number of financial scandals have raised concerns about the effectiveness of auditors. Examples of financial scandals are not hard to come by. Globally companies like Enron (United States of America) and Parmalat (Italy) immediately come to mind, while local companies like BOSASA and Steinhoff are currently under scrutiny for auditing irregularities. In response to these, and similar concerns, many jurisdictions introduced more prescriptive rules aimed at enhancing the independence of auditors (IRBA, 2017:2).

The *Independent Regulatory Board for Auditors* (IRBA) is a statutory body in South Africa established by Section 3 of the Auditing Profession Act 26 of 2005. The general functions of the IRBA are to promote the integrity of the auditing profession in South Africa and to protect the financial interest of the public. This is done by prescribing auditing standards to ensure that registered auditors deliver services of the highest quality. In 2017, the IRBA issued a regulation on mandatory audit firm rotation (MAFR) for public interest entities (PIEs), which will be effective from 1 April 2023 (Agulhas, 2017:1). Primarily, the IRBA created this rule to enhance auditor independence, protect public interest and to comply with international standards. In addition to this goal, the IRBA also proposed two secondary goals, namely market concentration and transformation objectives (Harber & Marx, 2019:118). According to Cameran *et al.* (2015:1) the mandatory rotation rule requires periodical breaks to audit engagements after a certain period to avoid long relationships between an audit firm and audit client. Long relationships are believed to damage the independence of the auditor and the quality of the audit (DeAngelo, 1981:115).

The MAFR introduced by the IRBA forbids audit firms to serve as appointed auditors of PIEs for more than ten consecutive years. Thereafter, the audit firm will only be eligible for reappointment as the auditor after no less than five financial years (Agulhas, 2017:1). Currently, the IRBA Code of Professional Conduct for Registered Auditors (revised November 2018) and the Companies Act 71 of 2008 require the rotation of audit partners from the same audit firm after seven and five years respectively, with "cooling-off" periods between two and

five years[1]. Nonetheless, the IRBA (2017:18) does not consider the rotation of audit partners to be sufficient. This is due to the fact that no cases have, as of yet, been brought to their attention "where partners from the same audit firm report each other should a partner have given an incorrect opinion or missed important facts during an audit" (IRBA, 2017:18). This statement raises the question of whether the primary goal of MAFR in South Africa is indeed to enhance auditor independence, or whether it is rather meant to introduce a form of regulated investigation into the work of previous auditors by the newly appointed auditors; a mandate which currently falls within the ambit of the IRBA itself. Besides the fact that there seems to be a misinterpretation of the objective of MAFR, a controversy also exists as to whether MAFR will succeed in its supposed primary goal, namely, to improve auditor independence (Harber & Marx, 2019:2).

The main benefit of MAFR, as stated by its proponents, include increased audit quality because of improved auditor independence and professional scepticism (Kim *et al.*, 2015:1103; Dopuch *et al.,* 2003:83). However, opponents argue that MAFR reduces audit quality because of the loss of client and industry-specific knowledge (Harber & Hart, 2018:101; GAO, 2003:18).

Although many contrasting views on the effectiveness of MAFR exist, researchers agree that there is a gap in the literature related to a proper understanding of the consequences and impact of MAFR on audit quality and the audit profession (Harber & Marx, 2020:4; Cameran *et al.*, 2015:25). The need for more research in order to understand the necessity and implications of the MAFR regulation was likewise emphasised by respondents to the IRBA Consultation Paper in 2017 (Harber & Marx, 2020:16).

MAFR has recently received substantial international attention following the increasing number of countries that began the implementation thereof as a measure to ensure auditor independence (Harber & Marx, 2020:3).

Table 1 illustrates the increasing number of countries that began implementing MAFR in recent years; these countries are indicated with an asterisk (countries not indicated with an asterisk have already implemented MAFR).

[1] A cooling-off period refers to a requirement that a certain amount of time must pass before a former audit firm may accept employment with an audit client (Wright and Booker, 2005:24).

Table 1: Countries that have implemented or are implementing* MAFR according to IRBA (2017:15)

Africa	Europe	Asia	South America
Kenya*	Albania	Abu Dhabi	Argentina
Mauritius	European Union*	Chinese Taipei	Brazil
Morocco	Italy*	Dubai	
Mozambique	Lichtenstein	Thailand	
Nigeria	Netherlands*	India*	
Tunisia	Norway	Indonesia	
South Africa*	United Kingdom*	Korea	
		Russia*	
		Singapore	
		South Korea	
		Turkey*	

The European Union (EU) is one of the major jurisdictions currently implementing MAFR, with their MAFR legislation having gone into effect on 17 June 2016 (Deloitte, 2015:3). As can be seen from the table above, the introduction of MAFR in South Africa is in line with the international trend.

South African literature on MAFR is quite recent because the announcement of the rule by IRBA was made in 2017 and, as mentioned earlier, the implementation date is April 2023. Harber (2016:26) argues that the unique South African environment justifies a South African-specific outlook on MAFR. The uniqueness of the South African environment resides in the following:

- The difference in legislative requirements as opposed to other jurisdictions. In South Africa, the Companies Act 71 of 2008 and The Auditing Profession Act 26 of 2005 contain statutory regulations for the auditing profession (Rademeyer & Schutte, 2018:417). Furthermore, registered auditors are also required to comply with the International Auditing Standards, the IRBA Code of Professional Conduct for Registered Auditors and the South African Institute of Chartered Accountants (SAICA) Code of Professional Conduct[2]. The King Code on Corporate Governance (King IV) is also relevant to external auditors in South Africa.

[2] In order to become a registered auditor, one first needs to be qualified as a chartered accountant (IRBA, 2021). Thus, all registered auditors will automatically be required to also comply with the SAICA Code of Professional Conduct.

- Black economic empowerment (BEE) is a priority in the South African economy and employment sector and aims to address the inequalities created by an exclusive economic policy in South Africa in the past (Southall, 2007:67).
- The two secondary objectives that the IRBA articulated for MAFR, whereas other countries considered MAFR purely from an audit quality perspective (Harber, 2016:27).

Prior research consists of a qualitative study interviewing a sample (14) of audit partners in order to gain their views on MAFR, possible alternatives to it and the unintended consequences thereof (Harber, 2016:28). The conclusion reached indicated that the participants interviewed were strongly against the implementation of MAFR in South Africa. It should, however, be stressed that these interviews were all conducted before the rule of MAFR was introduced by the IRBA in 2017. People's natural resistance to change might have influenced the opinions of the interviewees.

Harber and Hart (2018:101) also conducted a quantitative study where South African academics' perceptions toward MAFR was investigated. After receiving 65 usable responses from academics lecturing Auditing at SAICA-accredited universities, they concluded that academics are of the opinion that MAFR would probably improve the perception of independence even if it does not improve audit quality itself. Similar research in which 22 audit committee members in South Africa were interviewed to explore their positions on MAFR was conducted by Thomson (2018:65). The overall conclusion was that these audit committee members believed that MAFR will not achieve any of the objectives of the IRBA. However, Thompson (2018:29) notes that these interviews were conducted before the KPMG incident came to light in 2017 and that this incident may impact the view audit committee members have on auditor independence in South Africa.

Harber and Marx (2020) also used a quantitative research approach to gain an understanding of the views of audit committee chairs (41), chief financial officers (CFOs) (53) and audit partners (112) on the necessity and potential effectiveness of MAFR (Harber & Marx, 2020:6). Ndaba *et al.* (2021:477) likewise focused on the possible impact MAFR might have on audit quality. This qualitative research was performed by means of interviews with 24 audit partners and 25 non-auditors (consisting of academics lecturing Auditing, individuals managing third party capital, and senior employees of the IRBA, accounting bodies or the Johannesburg Stock Exchange (JSE)). The findings of this study will be elaborated on in Chapter 2, which focuses on auditor independence.

A further quantitative study was conducted with the aim to explore the possible financial consequences of MAFR in South Africa (Harber *et al.,* 2020:215). This study's population consisted of audit partners (112), CFOs (53), auditing committee chairs (41) and institutional investors (21). Research was also conducted to establish the role of the new external auditor, the previous external auditor and the audit client regarding MAFR in KwaZulu-Natal (Chetty & Deodutt, 2021:31). In that qualitative study, in-depth interviews were conducted with seven audit practitioners and three audit clients.

Other South African-specific research on MAFR involved quantitative research on the opinion of audit committee chairs regarding the secondary objectives of transformation and market concentration (Harber & Marx, 2019:16). Wesson (2020:5) also explored the expected consequences MAFR might have on market concentration in South Africa. That research was quantitative in nature as audit reports from all companies listed on the JSE between 2010 and 2018 were used to draw conclusions about market concentration in the audit industry.

Table 2: Summary of South African specific research on MAFR

Year of publication	Description of the study	Quantitative /Qualitative	Facts to consider
2016 (Harber)	Audit partners (14) were interviewed in order to gain their views on MAFR, possible alternatives to it and unintended consequences thereof.	Qualitative	These interviews were conducted before the rule of MAFR was introduced by the IRBA in 2017.
2018 (Harber)	South African academics' (65) perceptions toward MAFR were investigated.	Quantitative	None to mention.
2018 (Thomson)	Audit committee members (22) in South Africa were interviewed to explore their positions on MAFR.	Qualitative	These interviews were conducted before the KPMG incident came to light in 2017; this incident may impact the view audit committee members have on audit independence in South Africa.

2019 (Harber & Marx)	The opinion of audit committee chairs regarding the secondary objectives of MAFR.	Quantitative	None to mention.
2020 (Harber & Marx)	The research objective was to gain an understanding of the views of audit committee chairs (41), CFOs (53) and audit partners (112) on the necessity and potential effectiveness of MAFR.	Quantitative	None to mention.
2020 (Harber *et al*.)	The aim of this study was to explore the possible financial implications MAFR might have. The perceptions of audit partners (112), CFOs (53), audit committee chairs (41) and institutional investors (21) were used to provide explanations and estimates on the perceived direct and indirect consequences of MAFR.	Quantitative	Consistent with all research on MAFR after June 2017 and before April 2023, this study might have been impacted by bias because respondents may possibly try to influence the implementation thereof before the implementation date in April 2023.
2020 (Wesson)	This study explored the expected consequences MAFR might have on market concentration in South Africa, and used audit reports from all companies listed on the JSE between 2010 and 2018 to draw conclusions.	Quantitative	None to mention.
2021 (Chetty & Deodutt)	The research objective was to establish the role of the new external auditor, the previous external auditor and the audit client in MAFR in KwaZulu-Natal through in-depth interviews with audit practitioners (7) and audit clients (3).	Qualitative	None to mention.

2021 (Ndaba *et al.)*	In this study, interviews with 24 audit partners and 25 non-auditors were conducted with the objective to conclude on the impact MAFR might have on audit quality.	Qualitative	None to mention.

Table 2 provides an overview of South African research conducted on the topic of MAFR. The table is sorted according to the date the research was conducted and summarises each study. This table shows that the qualitative research done in the past included audit partners and audit committee members, and that only a few (two) qualitative research projects were conducted after the KPMG incident came to light in 2017.

The table further outlines that the current South African specific research is aimed at presenting the opinions of those parties directly affected by MAFR. The current research study contributes to audit literature by examining the consequences MAFR has had in other jurisdictions that already implemented similar rules. A comparison between South Africa and the identified countries is used to anticipate how specific problems already experienced in these countries would manifest in a South African context. These possible difficulties South Africa might encounter were combined with the stated expectations of affected parties in South Africa, which was retrieved through a qualitative study. Lastly, suggested solutions to the prospective problems are explored with the aim of helping firms and the IRBA to pro-actively set measures in place to ensure that MAFR has the desired effect on audit quality in South Africa. The remainder of this chapter will discuss how this aim was achieved.

1.2 Problem statement

Regulators around the world have begun to consider ways in which audit quality could be enhanced in order to address the increasing number of accounting scandals that have come to light (Cameran *et al*., 2015:2). In line with the implementation of more robust measures with the objective of improving the independence of auditors by international role players, a project to explore ways in which the independence of auditors could be strengthened was initiated by the IRBA in July 2015. The IRBA board resolved at its meeting in July 2016 that the appropriate measure to be introduced would be MAFR (IRBA, 2017:2).

This rule, which will take effect for financial years commencing on or after 1 April 2023, establishes the following requirements:

1. An audit firm shall not serve as the appointed auditor of a PIE for more than 10 consecutive years.
2. Thereafter, the audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years (Agulhas, 2017:1).

As noted above, the IRBA expressed three objectives for MAFR, namely: to strengthen auditor independence; to address market concentration; and lastly, to promote transformation (Harber & Hart, 2018:102). As stated by Cameran *et al.* (2015:2) this rule unfortunately comes at a cost. Changing an auditor leads to organisational disruptions, loss of client-specific knowledge, additional start-up costs and could even impact the quality of the audit (Kwon *et al*., 2014:192).

Prior studies on MAFR were unable to prove that the benefits outweigh the costs of this rule (Cameran *et al.*, 2015:26). In order to enable South Africa to benefit from MAFR, pro-active measures should be put in place to reduce the cost of this new rule and to assist with a smoother transition to a new dispensation.

Based on the discussion above, the research question of this study is:

- What pro-active measures can be put in place to limit the potential negative consequences of MAFR, to ensure that MAFR has the desired effect on audit quality in South Africa?

1.3 Paradigmatic perspective

Maree (2020:37) defines paradigmatic perspective as “a way of viewing the world”. The current research takes a nominalist stance as the respondents’ subjective experiences will determine their views on MAFR. Thus, the reality of “the world” is dependent on many factors and circumstances. When researchers choose a paradigmatic perspective, it is believed that they make certain assumptions (Maree, 2020:37). In the following paragraphs, assumptions relevant to this research on MAFR will be discussed briefly.

1.3.1 Meta-theoretical assumptions

A meta-theory is defined as a theory involving the analysis of a theory itself (Merriam-Webster Inc., 2020a). Before one can begin to make presumptions on prospective problems MAFR might create in South Africa, the reasoning behind MAFR must be understood through examining the meta-theoretical background thereto. Firstly, the role and/or need of auditors in general provide a good starting point in understanding MAFR. According to Peng (cited by

Rademeyer & Schutte, 2018:414) the agency theory is often used as rationale for auditing. The agency theory relates to a situation where one party, a principal, uses another party, an agent, to create value for the principal (Bosse & Phillips, 2016:276). In the business environment, shareholders (principals) appoint directors (agents) to maximise shareholder wealth (Rademeyer & Schutte, 2018:414). The agency problem is created by the different interests of the principal and the agent. Bosse and Phillips (2016:278) explain this divergent interest by stating that directors might seek to increase their personal interest by withholding effort or increasing their wealth by acts to enrich themselves but at the expense of the firm. To counter these agency costs, the principal can decide to introduce a monitoring mechanism, which is where the auditor joins the relationship. The auditor's main aim is to provide the shareholders with an independent view of the business' activities (Rademeyer & Schutte, 2018:414).

In contrast to the above, Antle (1982:504) refers to the auditor as yet another economic agent and mentions a "two-agent agency model" where one agent is the director, and the other is the auditor. As already established, the agents create costs to the principal because of a potential conflict in the role-player's interest. The agency costs brought about by auditors may, for instance, be the result of self-interest and familiarity threats; in turn, this leads to non-compliance with the fundamental principles of ethics for professional accountants[3] as established by SAICA's Code of Professional Conduct (SAICA, 2020:40). Just as auditors are introduced to lessen the agency cost related to the directors, MAFR can be seen as one of the mechanisms introduced to counteract the possibility of agency cost related to auditors. This idea is presented in Figure 1.

[3] In order to become a registered auditor, one must first be qualified as a professional accountant, therefore SAICA's Code of Professional Conduct also applies to registered auditors.

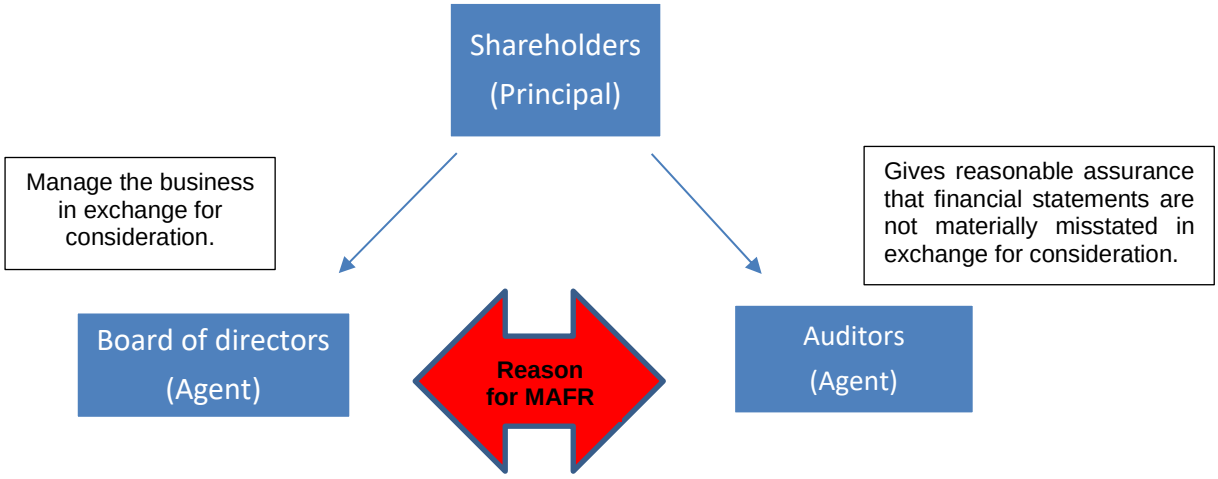

Figure 1: MAFR's role in the "two-agent agency model" (author's own illustration; based on the discussion by Antle [1982:504]).

Figure 1 illustrates where MAFR legislation fits into the "two-agent agency model" that was mentioned above. MAFR is introduced to improve the independence of auditors (agents) with the objective to protect the principal (shareholders) from a possible collusion between the agents, namely the board of directors and the auditors.

1.3.2 Theoretical assumptions

Theoretical assumptions are the grounds on which a theory is based. The assumptions on which the agency theory is built can be seen as pessimistic since it focuses on the possibility of misusing opportunities established by a relationship of trust wherein individuals can choose to enrich themselves at the cost of other stakeholders (Shapiro, 2005:266).

In respect of the agency theory, Bosse and Phillips (2016:276) articulate these assumptions:

- All actors (agent and principal) are narrowly self-interested;
- All actors are bounded rationally (thus establishing the idea that the rationality by which actors make decisions are limited due to, for example, information and time available);
- Agents are more risk adverse than principals; and
- Shapiro (2005:266) adds that the agency theory also assumes that complex organisational structures can be simplified to a two-party relationship between an agent and a principal.

1.3.3 Methodological assumption

Methodology can be defined as the examination of research methods; it establishes the relationship which exists between the researcher's opinion, theory, hypothesis, and the research methods (Gelo *et al.,* 2008:271). This study utilises a qualitative design, as the assumption exists that this type of research design allows a researcher to obtain a deeper understanding of the participants' opinions. The fact should be stressed that previous studies on MAFR in a South African context after the KPMG incident came to light in 2017 (as shown in Table 2 earlier) mostly followed quantitative research approaches.

1.4 Research aim and objectives

1.4.1 Research aim

The aim of this study was to outline pro-active measures to mitigate possible problems that the implementation of MAFR might have in South Africa.

1.4.2 Research objectives

The research aim gave rise to the following primary research objective:

- {PRO} To determine what pro-active measures could reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa.

The primary research objective was supported by the following secondary research objectives:

- {SRO1} To provide a literature overview of the theoretical aspects underpinning auditor independence. This objective is primarily addressed in **Chapter 2**.
- {SRO2} To provide a historical overview of the practical implementation of MAFR in other countries. This objective is primarily addressed in **Chapter 3**.
- {SRO3} To explore the potential negative consequences the implementation of MAFR may have in South Africa. This objective is primarily addressed in **Chapter 4**.

Information and findings from the three secondary objectives supported the determination of pro-active measures in accordance with the primary research objective.

1.5 Research methodology

This study is comprised of both a literature study and a qualitative empirical study. This is elucidated in the subsections that follow.

1.5.1 Literature review

Hart (2018:13) defines a literature review as an evaluation of documents which contain information based on a specific viewpoint that are used to express certain ideas in relation to the research being proposed. A literature study provided background for the implementation of MAFR in South Africa.

In order to address the research objectives stated above, and respond to the research question, relevant and recent literature was consulted in order to establish a theoretical basis on which potential negative consequences of the implementation of MAFR in South Africa could be plotted, together with possible solutions thereto.

The literature review covered, among others, the following:

- An overview of the theoretical aspects underpinning auditor independence reported in articles published in acknowledged research journals {SRO1}
- A history of MAFR or similar rules in countries around the world together with problems and advantages the countries experienced while implementing MAFR {SRO2}.
- A history of MAFR in South Africa and similar rules considered by the IRBA {SRO3}.
- An in-depth analysis of the objectives of MAFR articulated by the IRBA in reports the IRBA published {SRO3}.
- A comparison between the economy and audit profession of the foreign countries and those in South Africa was used to identify possible problems South Africa might encounter during the implementation of MAFR {SRO3}.
- An analysis of advantages and disadvantages associated with MAFR based on previous research conducted, specifically with reference to the identified goals of MAFR as stated by the IRBA {SRO3}.

1.5.2 Empirical research

The empirical research component consists of a qualitative study, which is mostly exploratory in nature. The goal was to supplement the findings of the literature study by gathering the views of participants on auditor independence, as well as on potential problems and possible solutions through interviewing specific stakeholders as discussed below.

1.5.2.1 Data collection

To supplement the findings of the literature study, semi-structured interviews were conducted. A semi-structured interview is described as an interview where responses to open-ended

questions will be followed by further clarification; allowing the interpreter to explore the responses of the participants further (Maree, 2020:108). According to Dearnley (cited by Thomson, 2018:25), open-ended questions contribute to new concepts coming forward by encouraging depth. The questions were developed from themes identified while conducting the literature review (i.e., from a thematic analysis of the literature). The list of questions that was used is attached as Annexure D.

The duration of the interviews was approximately 30-60 minutes each. In order to provide for the uncertainty surrounding the coronavirus pandemic, interviews were conducted and recorded over an electronic platform (Zoom). Consent for recording these interviews were obtained before each interview started. All the recorded interviews were transcribed using Microsoft Word dictation software, edited, and used in the qualitative analysis with ATLAS.ti software. One of the registered auditors however requested to rather submit the answers to the questions in writing instead of having an interview. The written response was included as a data document and analysed with ATLAS.ti. The researcher considered the fact that responses from this one participant was collected via a different route, but regarded inclusion of the responses (to report a larger sample of participant responses) of more importance. The participant responded on exactly the same questions that were posed to interviewed participants, and the researcher/author had the opportunity to clarify responses telephonically with the participant – although this was found unnecessary as the written responses by the participant were clearly articulated.

1.5.2.2 Population and sampling

Population

The participants in the study consisted of two homogenous groups who shared their experience relating to the research question, namely: registered auditors (of which most were audit partners) and academics lecturing Auditing. The registered auditors were included in the study because of their direct practical experience with the audit environment. The academics lecturing Auditing were involved in the study because of their specialised knowledge of the auditing standards, rules/regulations and legislation. In addition, all the auditing academics were professionally qualified with prior experience in audit practice and a thorough understanding of the audit environment and related risks.

The purpose of the interviews with the above participants was to understand the opinions that these stakeholders had regarding MAFR to pro-actively suggest measures which would reduce the possible problems the implementation of MAFR might create. Thus, the findings of

the interviews were not intended to be representative of the entire population of the respective groups, but rather to illustrate different viewpoints to anticipate other problems to which solutions can pro-actively be set in place.

Sampling

a) Sampling technique

From the previous sections, it flows that purposeful, convenient sampling was the appropriate technique to use when selecting samples from the two participant groups. Purposeful sampling refers to sampling where members are chosen with a "purpose" and are generally used in qualitative research (Maree, 2020:93).

b) Sample size

The sample size in qualitative studies depends on when data saturation[4] occurs. According to Romney (cited by Maree, 2020:92) samples as small as four individuals can produce accurate information if the individuals possess a high degree of competence in the field of study that is being researched. As the participants of this study were highly educated individuals with deep knowledge of the research topic, a small sample succeeded in creating a high confidence level. After interviewing a sample of six individuals per group, data saturation occurred i.e. the same or similar themes started to repeat often. Thus, the total sample consisted out of 12 individuals.

This sample size is also in line with prior South African specific qualitative research conducted on MAFR which was discussed in section 1.1 and summarised in Table 2. Harber (2016:28) interviewed 14 audit partners while Chetty and Deodutt (2021:31) held in-depth interviews with seven audit practitioners and three audit clients, creating a total sample size of ten participants. The largest sample for a qualitative study on this topic was 22 audit committee members (Thomson, 2018:65).

c) Inclusion and exclusion criteria

The qualities of the populations that were used to select individuals within each of the two participant groups were as follow:

[4] Maree (2020:2) defines data saturation as: "that point where all the themes and categories have been saturated and no new data are generated."

1. Six registered auditors

This population group consisted of registered auditors in practise who consisted mainly of audit partners. The population included audit partners from both the "Big 4"[5] and non-Big 4 audit firms. In order to get a more extensive understanding regarding the populations' view on MAFR, only one audit partner of each specific firm was interviewed. Registered auditors contributed to the understanding of the auditors' view of MAFR.

Chauke (2019) mentions that the MAFR rule is required to be applied retrospectively. Consequently, if an audit firm served as an auditor of a PIE for an uninterrupted period of ten or more financial years on 1 April 2023, the audit firm will be required to rotate off the audit prior to that date (Degirmenci, 2019). Subsequently, a few PIEs already started to appoint new auditors prior to the effective date of the MAFR rule. In order to hedge against the possible bias that may exist among audit partners who have not yet experienced MAFR, audit partners who signed off audit reports of PIEs who rotated auditors between 2016 and 2020 were also included.

Figure 2 gives a visual exposition of the registered auditor sample.

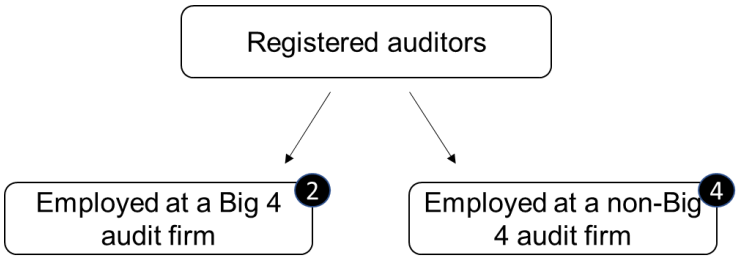

Figure 2: Registered auditor sample

2. Six academics lecturing auditing

This population consisted of academics who lectured auditing from 2017 onwards at any SAICA-accredited universities, because auditing and assurance form an important part of SAICA's competency framework. 2017 was chosen as baseline since MAFR was announced in that year. In this study, it was presumed that audit lecturers would have gained knowledge about this regulation after the announcement thereof by the IRBA. Academics lecturing auditing to third years or postgraduate students in the chartered accountancy (CA) stream was included in this population. The inclusion of this group was further based on their presumed

[5] KPMG, Deloitte, PricewaterhouseCoopers (PwC) and Ernst & Young (EY)

objectiveness in MAFR considerations and their knowledge of the existing rules, laws and governance principles.

1.5.2.3 Recruitment of participants

Given the fact that the participants consisted of highly educated or corporate, professional individuals with limited time and who might have already participated in studies on MAFR, they were recruited based on convenience. Data saturation occurred quite fast and limited the number of participants that were required to successfully execute the study.

Research participants in each of the two participant groups (audit partners and academics lecturing auditing) were approached via email by utilising existing networks of the student and the study leader. Publicly available information such as lists of registered auditors listed on the IRBAs' site, websites of universities and information provided in the annual financial statements of PIEs were also utilised. Refer to Annexure B for the recruitment material used.

1.5.2.4 Process of obtaining informed consent

In order to access the participants in the selected institutions or firms, permission was obtained from the different institutions via emails. After receiving informed consent from the institutions, the communication documentation (Annexure B) was sent to each possible research participant. When the possible research participant agreed to partake in the study, a consent form in which consent was given that the interview may be recorded and data used for research purposes, was emailed to the participants. The signed consent form (see Annexure C) was retrieved before the commencement of each interview. Figure 3 illustrates the process which was followed to obtain consent from the various parties to conduct the qualitative research.

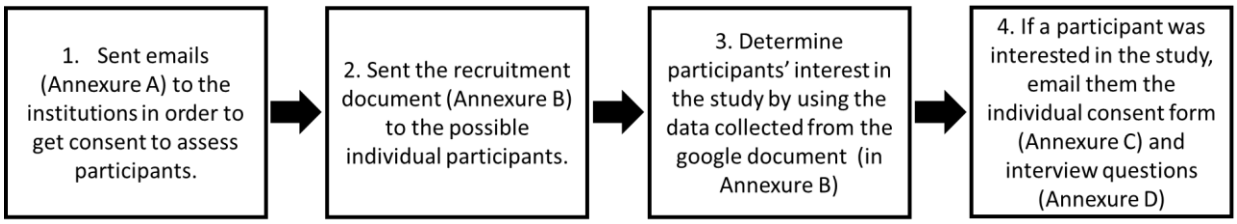

Figure 3: The process followed to recruit participants

1.5.2.5 Data analysis

The transcribed data was analysed using qualitative data analysis (QDA) software, namely ATLAS.ti (version 9). The twelve transcribed interviews were imported into ATLAS.ti. Before

the data were analysed using the QDA software, a proper understanding of the working of ATLAS.ti was first obtained through tutorials (ATLAS.ti – Qualitative Data Analysis, 2022).

The data was analysed based on codes the researcher created. According to Miles *et al.* (cited by Elliott, 2018:2852), "codes are labels that assign symbolic meaning to the descriptive … information compiled during a study". Researchers make use of codes to gain an understanding of their data to enable them to develop a "professional vision" about their data (Elliott, 2018:2851).

The creation of codes was driven by the interview questions, but open codes were also developed throughout the analysis. Thus, the priori coding approach was mainly used since most codes were determined before the data analysis started. Stemler (2001:2) explained that the priori coding approach entails that codes are created before analysing the data since the codes are based upon theory. In this case the "theory" refers to the interview questions. During the analysis of the transcribed data, "quotations" were identified which were then linked to the created codes. After the quotations were selected from all twelve interviews, 320 quotations under 27 codes were produced. The codes were allocated into 20 code groups as set out in the table below:

Table 3: Code groups

No.	Code group	Number of quotations
1	Definition of independence	17
2	Independence of mind vs in appearance	32
3	Auditor independence vs audit quality	18
4	Definition of audit quality	5
5	Perception of audit quality caused by MAFR	21
6	Auditor independence vs knowledge	17
7	Advantages of MAFR/ Goals of the IRBA	18
8	Other identified problems	4
9	Solution to other problems	4
10	Problem loss of client knowledge	16
11	Solution loss of client knowledge	43
12	Higher audit fees	19
13	Cost cuttings/ attract talent	27
14	Solution: fee guide	13
15	Specialisation problem	15

16	Specialisation solution	14
17	Problem market concentration	17
18	Solution market concentration	10
19	Dominance specific Big 4 firm	10
20	Select best suited audit firm	15
	TOTAL	**335**

The total number of quotations allocated to code groups (335) exceeds to total number of quotations (320), because some quotations were linked to more than one code group.

After a Microsoft Excel quotation report of the data were exported from ATLAS.ti, the analysis of the qualitative data continued. The quotation report provided the researcher with a table consisting of the quotations and code names. This report was used to identify further themes, make conclusions and to identify sections which required to be directly quoted in this dissertation.

1.6 Rigour / validity and reliability

Guby (cited by Maree, 2020:144) mentions four criteria that should be considered by qualitative researchers in their pursuit of a trustworthy study, namely: credibility, transferability, dependability, and confirmability. Using the well-established research methods, purposeful sampling, and neutrality the trustworthiness of this research was established.

It should, however, be mentioned that Harber and Marx (2020:18) concluded that, at present, empirical research on this topic in South Africa may be biased since MAFR will only become effective in April 2023; people might feel that the regulations could still be influenced, amended or appealed before this date. Accordingly, respondents may have the incentive to perceive MAFR in a negative light by overstating the cost while understating the benefits. The inclusion of audit partners who already experienced MAFR before 2021 may possibly hedge against this prejudice. An empirical study conducted through surveys or interviews with audit partners in countries who already implemented MAFR may provide a more objective reflection of the consequences of MAFR. Such a procedure falls outside the scope (and budget) of the present research study, but could be considered for future research on this topic.

1.7 Ethical considerations

The NWU policy for ethical research guided all ethical aspects related to this study. Ethical clearance for this study was obtained from the Economic and Management Sciences

Research Ethics Committee (EMS-REC) of the North-West University (ethics approval number NWU-00961-21-A4), which regarded the research as a minimal risk study. The primary ethical considerations are further elucidated below.

1.7.1 Literature study

While conducting the literature study, relevant scholarly literature received equal attention to give an unbiased, objective reflection on the current situation with regard to the future implementation of MAFR in South Africa.

1.7.2 Empirical study

In Section 5 above, a number of ethical issues directly related to the empirical research was noted and explained. The possible participants who met the stated criteria (see 5.2.2.2 above) were contacted by email and requested to consider participating in the study, after consent was received by their institutions where necessary. Thus, in most instances, there was a double layer of consent, first at an institutional level and then at the individual participant level. Participation was completely voluntary, and participants were able to withdraw at any time. The participants and their institutions' or firms' anonymity were guaranteed with regard to the perspectives given and all data obtained was stored on the researcher's computer and protected with passwords. As already noted in the preceding sections, written consent was secured before any interviews were recorded (Annexure C).

1.8 Chapter overview

This study comprises of the following chapters:

Chapter 1 Introduction, objectives and method of the study

The objective of this chapter was to discuss challenges the audit profession faces, together with actions taken with specific reference to the new MAFR rule. The research problem was stated, and the research objectives were formulated. The research methodology was explained, namely a literature review related to international MAFR, and problems faced because of the implementation thereof, together with a qualitative study consisting of semi-structured interviews with two different participant groups.

The purpose of this chapter was to sketch the background of MAFR internationally and in South Africa. The problem statement, research objectives and research methodology provide for a guideline upon which the rest of the dissertation is built.

Chapter 2 Literature review: Auditor independence

This chapter elaborates on the definition of independence since auditor independence is the main reason for the implementation of MAFR. Attention is given to independence requirements contained in South African standards and legislation. Lastly, the relationship between auditor independence and audit quality is deliberated on; and the connection between MAFR and auditor independence is discussed.

This chapter provides context in order to address the first secondary research objective **{SRO1}** by providing a literature overview of the theoretical aspects underpinning auditor independence.

Chapter 3 Literature review: MAFR in other countries

In this chapter, the relevant scholarly literature on the topic of MAFR is reviewed to gain an understanding of the international implementation of MAFR. A brief analysis of the major advantages associated with MAFR as observed in other countries is provided.

This chapter continues to provide background for the remainder of the study. The literature review relating to the practical implementation of MAFR in other countries is performed in order to meet the second secondary research objective **{SRO2}**.

Chapter 4 Potential negative consequences in South Africa

A historical outline of MAFR in South Africa is presented together with a brief analysis of the objectives the IRBA articulated for MAFR. This chapter sets out the anticipated problems audit firms and clients in South Africa might face in the wake of the implementation of MAFR. These probable problems were based on the experiences in countries which implemented MAFR prior to South Africa and possible problems which were indicated in previous South African research. The potential problems identified in the semi-structured interviews are also added to the potential problems identified though the literature study. This chapter therefore also includes a detailed discussion of the themes that emanated from the analysis of the interview transcripts.

The purpose of this chapter is to fulfil the third secondary research objective **{SRO3}** by concluding on the potential negative consequences the implementation of MAFR may have in South Africa.

Chapter 5 Suggested solutions to prospective problems

In this chapter, solutions are formulated based on the anticipated problems in order to set out pro-active measures to limit the potential negative impact of MAFR in South Africa. These solutions are based on measures other countries introduced and on empirical evidence collected through the interviews with affected groups in South Africa.

The primary research objective **{PRO}**, namely, to determine what pro-active measures could reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa, is addressed in this chapter. The chapter therefore also serves to collate findings in other chapters to support the fulfilment of the primary research objective of the study.

Chapter 6 Conclusion and further research recommendations

This chapter summarises the study by reflecting on the prospective effectiveness of MAFR with reference to the goals the IRBA articulated, possible problems identified and the suggested solutions. Thus, the chapter concludes on whether the identified measures will likely reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa. Lastly, the limitations of the study are noted, and recommendations are made for future research.

CHAPTER 2: LITERATURE REVIEW: AUDITOR INDEPENDENCE

2.1 Introduction

In Chapter 1 it was noted that the IRBA issued the MAFR rule primarily to strengthen auditor independence (IRBA, 2017:5). The conceptual framework for financial reporting, issued by the IASB (International Accounting Standards Board), classify relevance and faithful representation as the fundamental qualitative characteristics of financial statements (SAICA, 2018b:13). Auditor independence plays an important role, because it contributes to the faithfulness and consequently the ongoing reliability of accounting information (Wallman, 1996:77). It can be stated that auditor independence goes further than merely ensuring unbiased audit opinions, towards the more extensive targets of: 1) reliance on the financial information by its users, and 2) the enhancement of equity markets' efficiency (McGrath *et al.,* 2001:40). This chapter explores the understanding of independence through a review of scholarly literature, legislation, and empirical evidence on the topic. The different views on the existence of a relationship between auditor independence and audit quality are also deliberated on. As mentioned in Chapter 1, this chapter provides context in order to address the first secondary research objective {SRO1}, namely, to provide a literature overview of the theoretical aspects underpinning auditor independence.

Maree and Radloff (2007:2) mention that independent auditing gained its importance during the industrial revolution. The industrial revolution led to the establishment of companies, which replaced sole trading that used to be the traditional mode of business prior to this period. Companies came into existence because outside funds became necessary to increase the productive capacity of expensive equipment. The issuing of shares, which led to shared ownership, began to be used as a way of gaining capital and caused a separation between management and ownership (Maree & Radloff, 2007:2) in line with agency theory. This separation introduced the need for an independent third party to express an opinion on the financial information of a company, which indicates the point where the auditor joins the picture.

According to ISA 200, the role of an auditor is to "obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion…" (IAASB, 2009a:82). Reasonable assurance mentioned is defined as "high, but not absolute" assurance (IAASB, 2009a:85).

The inherent limitations brought about by audits cause the “reasonable” assurance requirement, which means that it is impossible to reduce the audit risk to zero and therefore absolute assurance cannot be obtained (IAASB, 2009a:99).

ISA 200 states that the inherent limitations of audits are created by:

- The nature of financial reporting;
- The nature of audit procedures; and
- The need for the audit to be conducted within a reasonable period and at reasonable cost (IAASB, 2009a:99).

Wallman (1996:79) points out that any system of accounting involves a fair degree of judgement. This judgement plays a role in both the development of accounting standards and in the application of these standards and their related principles. A few examples of these estimates and policy decisions when financial statements are being prepared includes selecting depreciable lives for non-current assets, deciding on inventory costing systems and accounting for provisions (Holtzman, 2007:42). This confirms the subjective nature of accounting. The ISAs require auditors to consider the reasonableness of accounting estimates and to identify possible management bias. Thus, the auditor is required to draw objective conclusions based on information that is subjective in nature.

The nature of audit procedures creates limitations in the sense that an auditor relies on the management of the entity to supply them with information. An audit is not an investigation into suspected misconduct; therefore, an auditor does not have legal powers such as the power to search for information without consent. Thus, the risk exists that management, whether intentionally or unintentionally, may provide incomplete information (IAASB, 2009a:100). Furthermore, an entity could try to conceal fraud which may cause audit evidence to be ineffective in identifying deliberate misstatements. A few years after the Steinhoff scandal, Mr. Markus Jooste was charged for misconduct by SAICA. Charge 4.2 (Nomvalo, 2021) illustrates the limitation of audit evidence when it reads:

> “Mr. Jooste committed an offence in that he committed a breach of section 100.1 read with section 360 of the Code: responding to non-compliance with the prevailing laws and regulations as a chartered accountant, he was or ought to have been aware of and yet failed to disclose various accounting irregularities contained in Steinhoff’s annual financial statements and instead he made misrepresentations regarding these accounting irregularities and the existence of proof to disprove the irregularities and to exonerate himself of any wrongdoing” (own emphasis added).

Arens *et al.* (cited by Law, 2008:161) argue that, if an auditor were to be responsible for ensuring that all information in the financial statements is correct, the audit evidence required and the resulting cost of the audit would be economically impractical. The cost-benefit analysis of a more comprehensive audit would not make sense. Because the value of information reduces over time, certain legislation like the Companies Act No. 71 of 2008 require companies to prepare annual financial statements within six months after the end of its financial year, which should be audited in the case of public interest companies. This expectation that an audit needs to be completed within a reasonable period and at a reasonable cost, recognises that it is impractical to address all information contained in the annual financial statements.

Even though audits have inherent limitations, the objectivity and independence of an auditor together with the nature, extent and objectivity of the audit evidence, plays an important role in outcomes achieved (Law, 2008:161). One of the research participants in the current study noted: *What is the objective of an audit? It is to provide reasonable assurance from an independent source that the financial statements are free from material misstatement. So, you will not be able to meet this objective if the auditor may have been influenced by other parties* (10:2). The definition of independence is elaborated on in the next section.

2.2 Definition of independence

Independence is described as "the quality or state of being independent" (Merriam-Webster Inc., 2020b). Wallman (1996:89) suggests that "independence is nothing more than the flip side of dependence" since bias is likely to exist when certain circumstances establish dependency on the auditor's side. Independence of an auditor is also defined as the probability that the auditor will report discovered misconduct (De Angelo, 1981:115).

According to SAICA (2020:112), independence is connected to the fundamental principles of objectivity and integrity. Integrity[6] and objectivity[7] form part of the five fundamental principles of ethics for professional accountants. Furthermore, SAICA (2020:112) divides independence into two elements, namely: independence of mind and independence in appearance (Dopuch, *et al.* 2003:83).

[6] : "to be straightforward and honest in all professional and business relationships" (SAICA, 2020:33).

[7] "not to compromise professional or business judgements because of bias, conflict of interest or undue influence of others" (SAICA, 2020:33).

From the empirical study, the research participants' description of "auditor independence" can be summarised with the following phrase: *The ability to express an opinion or come to a conclusion based on the cold, hard facts and evidence collected/presented without being influenced in any way by anything and or anyone be it the client, a regulator or the public or financial consequences* (12:1).

The research participants all agreed that auditor independence refers to the auditor's ability to give their unbiased audit opinion. A few research participants linked independence to the fundamental principles of integrity and objectivity. One research participant even noted: *I think some people sort of mistake independence for one of the fundamental principles, but for me it's sort of, is the combination of all five, these fundamental principles from the Code* (11:2).

2.2.1 Independence of mind

Independence of mind is defined as "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" (SAICA, 2020:112). This element focuses on "the mind" of the auditor itself. The term "independence of fact" is often used to refer to this element. However, independence cannot be measured objectively or be established as a fact; therefore, the SAICA Code of Professional Conduct (hereafter the SAICA COPC) prefers the term "independence of mind" (Myring & Bloom, 2003:32).

The research participants had similar views regarding the meaning of independence of mind. One of the research participants described independence of mind as: *independence of mind is one of reality, one of fact, one of actuality or reality. So, it's the state of affairs regardless of how it's perceived by a third party* (4:4). Another research participant stated that, when independence of mind exists, the auditor would be comfortable with the fact that they will be able to report and give their opinion on anything they pick up during the audit (7:3).

Bazerman *et al.* (1997:87) concluded that psychological research shows that bias occurs unconsciously when judgements are made. Judgements are usually biased because they will unintentionally be based on the self-interest of the judge. As noted previously, the nature of accounting requires judgement in preparing, and consequently also in reviewing financial statements. Because of the limitations in the way auditors process information, independence of mind can be argued to be impossible (Bazerman *et al*., 1997:87). Wallman (1996:78) suggests that circumstances which creates a dependency for the auditor would probably

cause the auditor to be biased and should be used to assess independency. Part 4 of the COPC (which is discussed later in this chapter) reacts to this dependency by describing threats and accompanying safeguards to independence.

In the empirical study, research participants had opposing views regarding which type of independence would be more difficult to prove. One research participant argued that independence of mind is difficult to convey to the users of the financial statements due to the fact that the users are "*most probably looking at independence in appearance*" (1:3). Thus, if there are no independence in appearance it will likely be difficult to convey independence of mind. Another research participant had a contrasting view and stated that the easiest component to prove is independence of mind: *You can set up a set of rules to say: I have formed my own opinion, I am independent, I do not own shares etc.* (8:5)[8]. Thus, opposing views existed between the research participants. Some believed that independence of mind cannot be proven without independence in appearance, while other participants believed that independence of mind is easier to prove than the other component of independence.

2.2.2 Independence in appearance

Independence in appearance is defined as "the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm, or an audit team member's, integrity, objectivity or professional scepticism has been compromised". This element places the focus on a third party's perception of the auditor's independence. One of the research participants describe independence in appearance as follows: *Independence in appearance is: how does it seem from a third party's perspective. So, are they (the auditors) too familiar with the clients and do they have longstanding relationships? These third parties then observe whether they think the auditors are independent or not. It's not necessarily the actual independence or whether they can come to the right conclusion, it's how does it appear for a third party* (3:2). One of the registered auditors made the statement that: *independence in appearance is much more difficult to sort of manage and control, because my perception of something is not necessarily yours* (11:4). Because auditors are viewed as fulfilling a watchdog function that serves the general public (Wallman, 1996:83), public perception is of utmost importance. The expectation gap which exists among the public's perception of the role of auditors makes it difficult to draw conclusions about the public opinion since it might be misimpressions.

[8] Translated from Afrikaans

Among the general public, accounting is often perceived as an exact science where little to no judgement is required. This view of accounting may cause the public to view independence in a manner that does not actually improve public interest (Wallman, 1996:84). Wallman (1996:82) explains this statement by using the supply of non-audit work by audit firms to their clients as subject matter. Although the supply of non-audit work can be seen to affect independence negatively, it can also be regarded as a positive factor towards gathering information on the client in the process of establishing appropriate audit procedures. The same rationale can be used in the discussion of MAFR. Although audit firms that provide audit services for longer than 10 consecutive years to a specific client threatens independence, it may also provide confidence in the audit firms' knowledge of the client. Third parties often neglect to take into consideration the importance of client knowledge, which plays a vital role in the planning and execution phases of audits. This neglection is caused by their misperception relating to the nature of accounting.

The understanding of the client and their environment by the auditor is necessary to identify and assess the risk of material misstatements (Marx *et al.*, 2018:8-11). In practice, a risk-based audit approach is usually followed. Marx *et al*. (2018:8-20) explains that this approach entails that the auditor would act upon the identified risk by adjusting the audit approach accordingly. If a client is unfamiliar to an auditor, risks may be missed during the initial risk assessment by the auditor, which would influence the audit approach to be followed. The relationship between auditor independence and audit quality is discussed later in this chapter.

According to Wallman (1996:79), some argue that an examination of auditor independence should be independent of the public's perception. Schuetze (1994:70) confirms this in the statement that a special committee of the American Institute of Certified Public Accountants (AICPA) proposed that "the reasonable third party's perception" should be replaced with "a well-informed auditor's perception" in 1992. The proposal was not successful and thus in line with the emphasis the Supreme Court placed on the appearance of independence in the case *U.S. vs Arthur Young* (1984): "Public faith in the reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional". Wallman (1996:79) states that, although public perception may not necessarily be based on facts, the perception of reasonable users will be influenced if the realities are well explained.

When the research participants were asked whether they believed one of the components of independence (namely independence of mind or independence in appearance) was more important than the other, a difference was noted between the answers of academics lecturing

auditing and the registered auditors. The majority (67%) of the academics lecturing auditing believed that independence of mind is more important, while the majority (75%) of the registered auditors deemed both components to be of equal importance. One reason for the different opinions between the two population groups could have been that academics argue from a more theoretical perspective. The registered auditors on the other hand, are very cautious of the public's opinion (independence in appearance) because of the significant negative effect that reputation damage can have on an audit firm. An example is that, after the KPMG South Africa scandal in 2017, the company lost one-third of their revenue and their workforce shrank from 3400 to 2200 employees (Dludla, 2020).

2.3 Independence requirements in South African standards and legislation

The International Standard on Quality Control (ISQC 1) describes a firm's responsibility regarding quality control systems designed for assurance engagements (IAASB, 2009b:50). Independence, as one of the quality control components, is discussed in detail under the subheading: "relevant ethical requirements" (IAASB, 2009b:50). Policies and procedures that necessitate the rotation of the audit engagement partner is listed among other independence requirements. It should, however, be noted that the IAASB introduced the International Standard on Quality Management (ISQM) in December 2020 (Almond & Klonaridis, 2021:3). ISQM 1 and ISQM 2 are effective from 15 December 2022 and will replace ISQC 1. The purpose for the new ISQM is essentially to improve audit quality (ICAEW, 2021).

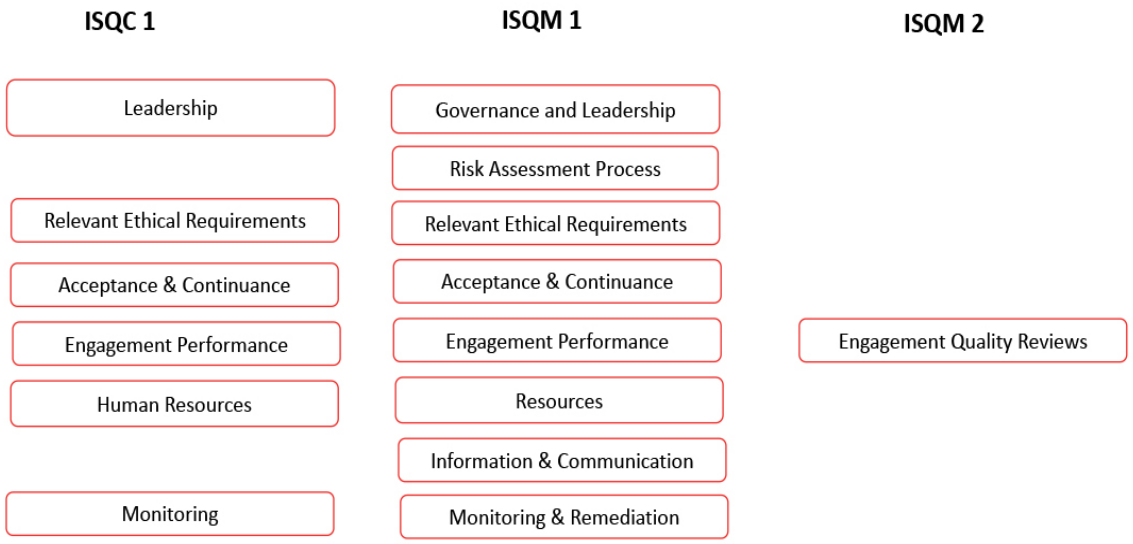

Figure 4: Comparison between ISQC 1, ISQM 1 and ISQM 2 (Tan Chiu Ping, 2021)

The figure above compares the new ISQM to the ISQC. The new standards require a proactive approach to quality management, whereas the ISQC focused on a reactive approach and the establishment of policies and procedures (Tan Chiu Ping, 2021). The ICAEW (2021) states that “ISQM 1 introduces a new risk-based approach to quality management at the firm level”. The ISQM 1 requires firms to proactively design and implement responses to quality risks. The ISQM 2, however, addresses the appointment and duties of an engagement quality reviewer (ICAEW, 2021). The ISQM 2 extended the scope of engagements subject to engagement quality review and enhanced the criteria for engagement quality reviewers (ICAEW, 2021).

ISA 220 deals specifically with auditing as assurance engagement (IAASB, 2009a:139). It describes the responsibilities of the auditor to provide a quality audit and requires the audit engagement partner to conclude on independence requirements applicable to the audit engagement. ISA 220 (Revised) is effective for audits for periods starting on or after 15 December 2022 and provides clarity on the responsibilities of the engagement partner regarding audit quality.

The SAICA COPC was created with the objective to establish a framework of ethical and professional standards, which members of the SAICA need to comply with (Maree & Radloff, 2007:3). According to Shedahl (cited by Maree and Radloff, 2007:3), an effective code of conduct encourages trust and respect of the people (the users of financial statements for the purpose of this dissertation) towards service providers (the auditors). The SAICA is a member of the International Federation of Accountants (IFAC) and adopted the ethical code the IFAC issued in collaboration with the International Ethics Standards Board for Accountants (IESBA) (IFAC, 2019). This code is often referred to as the IESBA Code. The SAICA made minor modifications to the IESBA code to address issues specific to the South African environment. In 2018, the SAICA COPC was restructured with the aim to make it easier to use and to improve the enforcement and effectiveness thereof (SAICA, 2018a:4). The figures below illustrate the restructuring which was effective as of 15 June 2019.

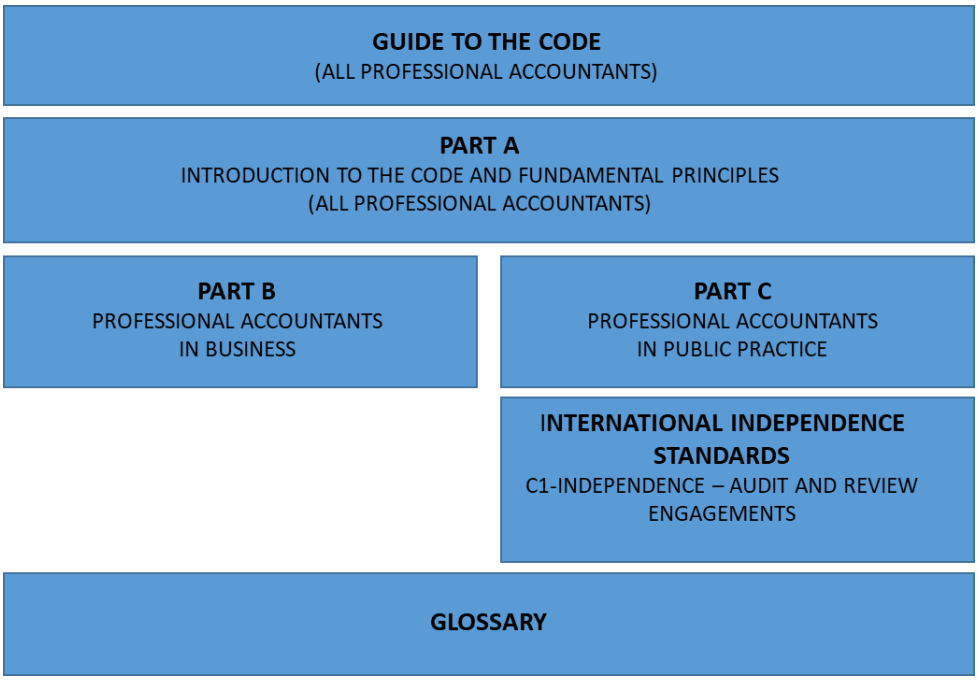

Figure 5: The layout of the SAICA COPC prior to the 2018 restructuring (Steenekamp, 2016)

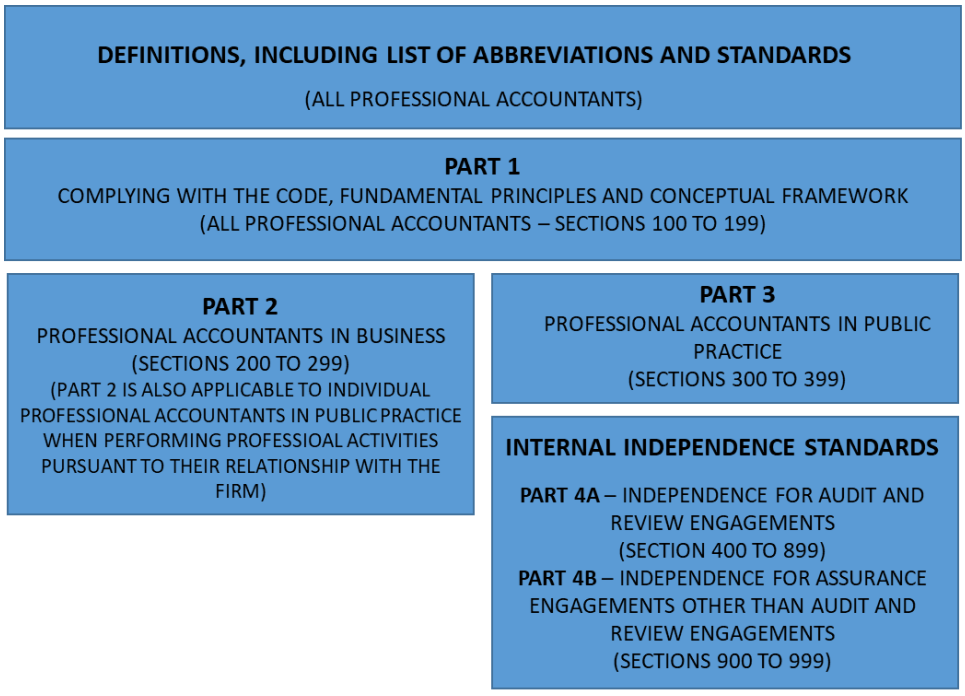

Figure 6: The layout of the SAICA COPC after the 2018 restructuring (SAICA, 2018a:12)

The illustrations above show that the extent of the SAICA COPC does not differ considerably before and after the restructuring. Registered auditors are classified as professional

accountants in public practice and therefore need to adhere to Part 1[9], Part 3 and Part 4 of the Code. Part 2 is only applicable to professional accountants in business, as can be seen from Figure 5.

The part of the SAICA COPC relevant to this chapter is contained in Part C (before restructuring) and in Part 4A (after the restructuring). Sheldahl (cited by Maree & Radloff, 2007:3) states that a professional code establishes rules of standard practice which serves as direction for dealing with certain circumstances. Part C or Part 4A of the SAICA COPC focuses on independence for audit and review engagements and describes possible threats and safeguards based on different situations. Safeguards specifically related to audit tenure will be discussed in Chapter 4.

Maree and Radloff (2007:8) concluded that professional accountants in South Africa strongly support the SAICA COPC. In their quantitative study their respondents (chartered accountants registered with SAICA) were asked to rate a shortened version of ethical principles contained in the SAICA COPC according to importance as a guiding factor towards their ethical behaviour. The respondents' answers could have varied from 1 'unimportant' to 7 'very important'.

Table 4: Means and standard deviations for the three parts of the SAICA COPC (Maree & Radloff, 2007:8)

SAICA Code	Mean[10]	Maximum score[11]	Standard deviation
Part A	67.14	77	8.27
Part B	54.77	63	7.29
Part C	25.29	28	3.12
Total	147.26	168	16.98

Table 3 shows that, on average, participants in Maree and Radloff's study scored 6.13 out of seven (147.26/168*7) for each ethical principle assessed as a guiding factor of ethical behaviour. A rating of 6.13 indicates that the participants regarded the ethical principles contained in the SAICA COPC as important guiding factors towards ethical behaviour. The fact that SAICA e-mailed the questionnaires to the participants creates a possible limitation,

[9] Part 1, 2, 3 and 4 of the SAICA Code (revised) is effective as of 15 June 2019.
[10] The mean refers to the average score the participants awarded.
[11] The maximum score refers to the score that could have been achieved if a 7 were scored for each of the 24 questions in the questionnaire.

as pointed out by the authors, because respondents may have answered the questions in a biased manner; being careful not to criticize SAICA's own code (Maree & Radloff, 2007:5). It should, however, be noted that purely agreeing with the importance of principles, like independence, contained in the code does not equate to compliance to the principles by professional accountants.

The Companies Act No. 71 of 2008 emphasises the importance of auditor independence when it states in section 90(2)(c) that a person or firm needs to be determined by the company's audit committee as being independent before they can be appointed as auditors. Section 90(2)(b) lists certain situations that would prohibit the appointment of a specific auditor. This list is mainly concerned about the familiarity threat upon auditor independence. Furthermore, section 94(8) explains that an auditor is regarded as independent of a company if:

a) The auditor does not receive any compensation except for audit work or for the rendering of other services which are allowed by the audit committee of the company;
b) The auditor's independence has not been influenced because of any prior engagement as auditor or with regard to any other work the auditor performed; and
c) The auditor acts in accordance with any other criteria relating to independence as described in the Auditing Profession Act.

The rotation requirements established by the Companies Act with the aim to also contribute towards auditor independence will be discussed in Chapter 4.

The King IV report on corporate governance for South Africa (Institute of Directors, 2016:52) lists a few indicators, in paragraph 28, that the governing body of a firm should consider in evaluating the independence of the governing body. Although this chapter focuses on the independence of auditors, it is interesting to note that the independence indicators in the King IV report on corporate governance are quite similar to the identified activities in the SAICA COPC which may create threats to independence. Both focus on remuneration policies, conflicts of interest due to familiarity or financial interest and the provision of other services by the individual to the company. In defining "independence", one of the research participants also referred to the King IV Code: *So, King actually gives us a few (in a different context), but they talk about independent non-executive directors. So, I always like to go to that paragraph for a guideline on what they define as being independent* (5:3).

2.4 The relationship between auditor independence and audit quality

DeAngelo (1981:115) suggested that a linear relationship exists between audit quality and auditor independence. It is mentioned that the **quality** of an audit is dependent on the auditor's ability to:

a) *Find* errors or fraud in the financial reports of a company, and
b) Resist client pressure and *disclos*e information in the event error or fraud is found.

One of the research participants gave a similar definition for audit quality: *Quality is the degree of excellence of something, and when we talk about audit quality on audit work performed, it would be the ability to detect a misstatement and for you to report that misstatement and request for correction* (10:5).

As mentioned above, DeAngelo (1981:116) defines auditor independence as the probability that the auditor will *report discovered* misconduct. It can be noted that part b of the factors which outline audit quality (namely to disclose information in the event of discovered error or fraud) has a definite connection with the definition of auditor independence (namely to report discovered misconduct).

The research participants agreed that a direct relationship exists between auditor independence and audit quality. The following statement was made by one of the research participants: *If the auditor is not independent, I believe the quality of the audit work would be more or less what the processes are, but when they have to report on the differences they identified, independence, when it is compromised, will definitely have an impact on whether they report these and whether it will have an impact on the audit opinion towards the end. They might have identified misstatements throughout the audit, but out of fear of being dismissed, they might in the end, negotiate with the client and say "hey, will you please fix this next year, I am going to give you a clear audit opinion"* (1:5).

One of the research participants explained that they believe audit quality consists of two elements, and that if one of them is compromised, the audit quality is compromised too. These elements are: skill (including the competence and experience of the auditor) and independence (including professional scepticism) (4:9).

Furthermore, it is stated that an auditor's opinion is of more value the greater the incentive for the auditor is to disclose the error or fraud, although it might have a negative implication for their client (DeAngelo, 1981:116). If the public is of the opinion that the auditor would not

disclose fraud or error because the auditor will rather retain a good relationship with their client's governing body, the value of the audit opinion would be zero. There is thus a direct correlation between the public's opinion on whether fraud or error would be disclosed and the perceived value of the audit opinion – refer to figure 7 below.

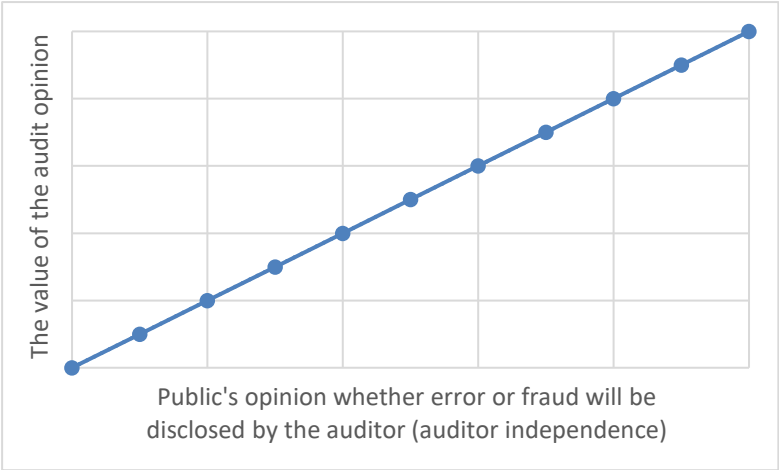

Figure 7: Illustration of the public's opinion regarding the value of an audit opinion (author's own illustration based on the discussion above)

Watts and Zimmerman (1981:7) proposed a mathematical equation to calculate the probability of the disclosure of existing fraud or error by the auditor:

$$P\left[\begin{matrix}\text{auditor}\\ \text{reports}\\ \text{breach}\end{matrix}\;\middle|\;\begin{matrix}\text{breach}\\ \text{exists}\end{matrix}\right] = P\left[\begin{matrix}\text{breach}\\ \text{exists}\end{matrix}\right] \cdot P\left[\begin{matrix}\text{auditor}\\ \text{discovers}\\ \text{a breach}\end{matrix}\;\middle|\;\begin{matrix}\text{breach}\\ \text{exists}\end{matrix}\right] \cdot P\left[\begin{matrix}\text{auditor}\\ \text{reports}\\ \text{breach}\end{matrix}\;\middle|\;\begin{matrix}\text{auditor}\\ \text{discovers}\\ \text{an existing}\\ \text{breach}\end{matrix}\right]$$

Relates to the audit risk

Relates to auditor independence

Figure 8: Mathematical equation calculating the probability of disclosure by the auditor (adapted from Watts and Zimmerman [1981:7])

As seen from the equation, the probability that an auditor will disclose an existing breach (fraud or error) is regarded as the product of three probabilities. Firstly, the probability that fraud or error will **occur**. The first probability relates in essence to the risk of material misstatement

which consists of the inherent[12] and control risk[13] and which needs to be considered in the planning phase of the audit by the auditor (Marx *et al.*, 2018:8-11). This probability depends on the company being audited. If the probability with regard to the occurrence of fraud or error is zero, an audit would be deemed unnecessary (Watts & Zimmerman, 1981:7).

The second factor is the probability that an auditor would **discover** fraud or error, provisional of the fact that fraud or error exist. This probability relates to the detection risk[14] of the auditor. Chang *et al.* (2008:1054) emphasise the importance of the determination of the detection risk since it "would not only influence the progress of audit strategies, but also significantly influence the results of the audit". Watts and Zimmerman (1981:7) suggest that the effort, skill, and competence of the auditor influence the second probability.

The third and last probability, namely the likelihood that the auditor would **report** fraud or error if found, relates to the independence of the auditor (Watts & Zimmerman, 1981:7). It can be concluded that the value of an audit depends on the competence and independence of the auditor. This correlates with the DeAngelo's (1981:116) idea regarding the equity markets' expectation of the auditor's independence to provide valuable audits as discussed earlier in this subsection.

Similar to the above statements, the majority of the research participants agreed that, if MAFR will contribute to the perception of auditor independence, MAFR will also contribute to the perception of higher audit quality. For example, one of the participants noted: *Yes, I think that's one of the main reasons for mandatory audit firm rotation is the perception of auditor independence and I think it will improve the perception of the public's view of the audit quality of the financial statements but that's not necessarily to say that it's really going to have an increase in the audit quality*… (3:6). One of the research participants however disagreed and stated: *Independence is only one aspect of quality. Anyone with proper knowledge of audit quality will know that there are many aspects to quality and that MAFR will not necessarily address quality. In my view, the uninformed, will perceive this to be a solution* (12:5).

[12] Shibano (1990:113) defines inherent risk as "the auditor's assessed probability that a material error or irregularity exists before considering the effectiveness of internal accounting controls".

[13] Shibano (1990:113) defines control risk as "the auditor's assessed probability that a material error or irregularity will not be detected by the firm's internal control system, conditional on an error or irregularity occurring".

[14] The detection risk is defined as "the probability that the audit evidence and the auditor judgement will not detect a material error or irregularity conditional on an error or irregularity occurring and the internal control system not detecting it" (Shibano, 1990:113).

Based on the literature review and the general view of research participants, the existence of a linear relationship between audit quality and auditor independence will be assumed for the remainder of this dissertation. It should, however, be noted that audit quality is influenced by both auditor independence and the auditors' capabilities (Knechel, 2016:215). This chapter deals mainly with the independence aspect, but the trade-off between knowledge and independence will be briefly discussed in the following section. Furthermore, the possible impact of MAFR on the quality of audits in South Africa will be discussed in Chapter 4 when possible problems will be deliberated on.

2.5 MAFR and auditor independence

Given the belief that auditor independence contributes to audit quality, the question with regard to MAFR is in fact whether it leads to improved auditor independence. If MAFR leads to improved independence, it can be argued that MAFR would indeed contribute to audit quality. Wallman (1996:79) emphasises that the goal of auditor independence is to ensure the reliability of financial reports; and not merely independence for the sake of independence.

A qualitative study in South Africa found that MAFR provides no guarantee towards improved auditor independence after interviewing 24 audit partners and 25 non-auditors (consisting of academics lecturing auditing, individuals managing third party capital and senior employees of the IRBA, accounting bodies or the JSE) (Ndaba *et al.*, 2021:477). The study found that individuals were sceptic about the effectiveness MAFR will have in South Africa and stated: "the regulation may be a symbolic response to a perceived decline in audit quality and auditor independence rather than an effective strategy" (Ndaba *et al.*, 2021:477). The participants believed that MAFR would not improve independence of mind directly. Instead, they criticised the IRBA for "conflating independence in appearance with independence in fact". This statement is similar to arguments raised in the past, and mentioned earlier in this chapter, that the assessment of auditor independence should be independent of the public's perception (Wallman, 1996:79; Schuetze, 1994:70). The arguments presented by Ndaba *et al.* (2021:477) were, however, challenged by the main aim of auditing financial reports namely to establish **public faith** in the reliability of a financial report. By assessing the arguments presented in this study, it became evident that the participants did not consider "independence in appearance" to be an important element of the independence of the auditor.

The research participants in the current study had similar views and agreed that MAFR might improve independence in appearance but will not have an impact on independence of mind. One research participant stated: *So, if you have informed users of financial statements that*

know what the auditor's role is, I do believe that the perception of audit quality, in their eyes will be higher as a result of mandatory audit firm rotation (11:7). Another participant made it clear that only the perception of independence will improve by saying: *I just wanted to make a note that the independence of mind will not necessarily be better, but the Independence in appearance will likely improve* (3:6).

The question arises whether independence should be regarded as a product of "independence in appearance" and "independence of mind" or rather as the sum of "independence in appearance" and "independence of mind". It can be argued that the SAICA (2020:112) did not intend for this mathematical analysis when it stated that independence comprises of both these elements. However, the point a mathematical equation makes is that, like many perceptions, the perspective of an individual can have a big influence on the perceived outcome. Knechel (2016:215) came to a similar conclusion with regard to audit quality; it was stated that "the question of whether audit quality is good or not, depends on one's viewpoint". Another study also referred to the importance of the background of a participant when the participant's stance with regard to MAFR and its effect on auditor independence is evaluated (Ewelt-Knauer *et al.*, 2013:33).

If independence is regarded as the product of "independence in appearance" and "independence of mind", both have to be positive (higher than zero) in order to conclude that MAFR indeed contributes to the independence of the auditor. In this case, MAFR would most likely not contribute to auditor independence, because prior and the current research establish the fact that most individuals are of the opinion that MAFR only contributes to the public's perception of auditor independence (independence in appearance) and not to independence of mind (Ndaba *et al.*, 2021:480). Additionally, Cameran *et al.* (2005:27) referred to an unpublished study by SDA Bocconi School of Management in 2002 that found mandatory rotation to create a positive effect on perceived independence (independence in appearance); however, the data suggested that the effect on independence of mind is negative. It is unlikely that the independence is seen as the product of "independence in appearance" and "independence of mind" because this would imply that if both elements of independence are influenced negatively, independence as a whole would still be improved, which is absurd.

If independence is regarded as the sum of "independence in appearance" and "independence of mind", only one element needs to make a positive contribution to conclude that independence is improved. Ewelt-Knauer *et al.* (2013:34) states that MAFR is considered a useful way to improve "independence in appearance". The users of financial statements support the belief that MAFR has a positive effect on audit quality due to the improved

"independence in appearance" (Ewelt-Knauer *et al.*, 2013:35). Based on the preceding arguments, it would seem that making conclusions on independence based on the improvement of one element of independence alone is not far-fetched.

2.6 A holistic view of MAFR and audit quality

It was mentioned earlier in this chapter that audit quality is influenced by both auditor independence and the auditors' capabilities (Knechel, 2016:215). In the previous section it was established that MAFR will possibly contribute to independence in appearance and thus contribute to independence as a whole. Prior research suggests that an auditor needs a few years' experience with a client in order to become acquainted with the systems and business processes of the client to deliver a quality audit (Cameron *et al.,* 2015:11). During the first few years, the possibility exists that an auditor might overlook material misstatements and limit the auditor's ability to find error or fraud. This might influence the conclusion the users of financial statements make about the effect of MAFR on audit quality.

However, the majority of the research participants believed, or hoped, that the users of the financial statements would value independence more than knowledge of the client. One of the participants said: *I would hope that there would be more users out there that would value auditor independence as the contributing factor to increased audit quality rather than knowledge of a client, because knowledge of a client you can gain and you can get to know your client and invest specific time in that, but independence is a state of mind and it's a value that each individual has. And, if you don't have that, it is definitely going to impact your audit quality negatively. And it's not something that you can learn. It's inherent to yourself. So, I would think that the users of financial statements will value auditor independence more when they judge audit quality* (11:9). Similarly, another participant noted: *I think there is an expectation from the public that if you say you are a CA, you have a basic knowledge of how to audit… Yes, there are a bit more growing pains initially, but I can't imagine you would be grossly negligent because of knowledge. And, again, if you're not knowledgeable, you'll automatically draw someone in to do it* (6:11)[15].

Only one participant noted that knowledge of a client will carry more weight when the users of the financial statements value audit quality. This participant noted*: I think the users of the financial statements and people who are in the know and understand the importance of*

[15] Translated from Afrikaans.

auditors, I think they will value the knowledge of the client more than the value of auditor independence either being in mind or in appearance (3:7).

The discussion above supports the idea of a linear relationship between audit quality and auditor independence. Although client-specific knowledge loss occurs due to MAFR, most of the research participants suspected that the users of financial statements will value the independent mindset of the new auditor more than the knowledge of the prior auditor.

2.7 Conclusion

This chapter provided context to address the first secondary research objective **{SRO1}** by providing a literature overview of the theoretical aspects underpinning auditor independence. Firstly, the definition of independence, together with the two components thereof, namely independence of mind and independence in appearance, were elaborated on. The different population groups had different opinions regarding whether one component of independence is more important than another. Most of the academics lecturing auditing believed that independence of mind is more important; while the majority (75%) of the registered auditors deemed both components to be of equal importance. It was concluded that the difference in opinion was possibly due the fact that the registered auditors are very cautious of the public's opinion (independence in appearance) because of the significant negative effect reputation damage can have on an audit firm.

The independence requirements contained in South African standards and legislations were also discussed. This includes the ISQC 1 and the new ISQM 1 and 2, ISA 220 (Revised), the SAICA COPC, the Companies Act No. 71 of 2008 and the King IV report on corporate governance. The numerous standards and legislation applicable in South Africa containing independence requirements affirm the importance of independence from a regulatory standpoint.

A direct relationship between auditor independence and audit quality was established by means of a literature review and empirical evidence. It was noted that MAFR is considered a useful way to improve "independence in appearance" and hence also improve the perception of audit quality. Lastly, it was noted that, even though MAFR will bring about a loss of client-specific knowledge that might decrease audit quality, the majority of research participants felt that the users of financial statements would value auditor independence more than their knowledge when evaluating audit quality.

CHAPTER 3: LITERATURE REVIEW: MAFR IN OTHER COUNTRIES

3.1 Introduction

In the light of several international accounting scandals, audit regulators around the world had to propose changes with the intention to enhance audit quality (Cameran *et al*., 2015:2; Hay, 2015:160). One of the famous corporate scandals, that raised a concern regarding the effectiveness of auditors, is the Enron scandal in the USA that took place at the beginning of this century, in 2001. This scandal led to the closing of the company's auditing firm, Arthur Andersen, which reduced the "big five" audit firms to the "big four". According to the Powers Report (cited by Cornford, 2003:30), the available evidence shows that Arthur Andersen failed in its professional responsibilities with reference to their audits of Enron's financial reports, because they did not bring concerns about Enron's internal contracts in connection with related-party transactions to the attention of Enron's directors, as they were obligated to do.

Similar high-profile accounting scandals include: Worldcom (USA) in 2001; Parmalat (Italy) in 2003; and Lehman Brothers (USA) in 2008. According to Harber (2016:9), these examples challenge the success of the audit profession as a means to avoid or identify fraud and error. Audit regulators reacted to the supposed lack of audit quality with extra legislation and regulations, with many believing that MAFR is perhaps the key to ensuring auditor independence and audit quality (Harber & Marx, 2020:3).

This chapter will focus on the second secondary research objective {SRO2} outlined in Chapter 1 and will begin by describing the developments regarding MAFR in key international jurisdictions. With reference to an illustration of MAFR in Italy drafted by Corbella *et al.* (2015:48), similar tables have been drafted by the author for each country under review to visually represent the developments in legislation of that country. Thereafter, a brief analysis of advantages associated with MAFR, specifically with reference to the international jurisdictions that were reviewed, and evidence gather from the empirical study, will be presented. The understanding of the international implementation of MAFR will create a platform from which the potential negative consequences that MAFR might have in South Africa can be formulated; this will be discussed in Chapter 4.

3.2 History of MAFR in other countries

As clearly illustrated in Table 1, included in Chapter 1 (refer section 1.1), a few countries have or are currently in the process of implementing MAFR. Cameran *et al*. (2015:3), however, suggest that this trend might increase in the future because of the EU's decision to adopt MAFR. Cameran *et al.* (2015:3) also states that up-to-date mandatory partner rotation seems to have been accepted easier and is thus far more commonly applied internationally. This is probably because the International Federation of Accountants (IFAC), of which more than 170 professional accountancy organisations across 130 countries are members, have put in place the requirement of mandatory partner rotation. This requirement will be discussed later. Audit partner rotation refers to the rotation of key audit partners, including the audit engagement partner, within the same audit firm after a specified period. Thus, the audit firm remains the same, but the key audit partners rotate. MAFR on the other hand refers to the rotation of the audit firms themselves. As a result, after the audit firm rotation period, a different audit firm is appointed (SAICA, 2016:4).

According to Fonteine *et al*. (cited by Harber & Marx, 2019:118) the EU adopted MAFR in 2014, while the United States of America (U.S.), after repeatedly considering MAFR over the last two decades, decided against it. This clearly illustrates the international divide on the issue. In this chapter, emphasis will be placed on the application or lack thereof in the EU, the U.S., Italy, Canada, Spain, South Korea, Singapore, Costa Rica and Nigeria. Canada and Italy introduced MAFR much earlier than other countries; Spain and South Korea reversed MAFR shortly after introducing it; while Singapore "temporarily suspended" MAFR in 2008. The Costa Rica case is quite interesting because they introduced MAFR in 2005, ejected it in 2007 and re-implemented it in 2010 (Cameran *et al.*, 2015:4). The case of Nigeria, the largest economy in Africa, might on the other hand provide an African perspective on MAFR. The selection of countries for analysis therefore contributes to the richness of the current study.

It is important to take into consideration that the regulatory or professional bodies in all the selected countries are members of IFAC. The IFAC aims to establish strong and sustainable economies and through these economies contribute to the wealth of society (IFAC, 2019). Furthermore, the IFAC facilitates the development and execution of international auditing standards through the International Auditing and Assurance Standards Board (IAASB). The IAASB issues the International Standards on Auditing (ISAs) which are to be applied in the audit of financial information. IFAC also supports the development and implementation of high-quality ethical standards for public accountants, via its support of the International Ethics Standards Board for Accountants (IESBA). The IESBA is "an independent standard-setting

body" that develops an international appropriate Code of Ethics for Professional Accountants (IESBA Code). Some jurisdictions, however, have requirements that vary from this Code; in such instances, whichever requirements are more stringent, must be complied with (IESBA, 2006:5).

The IESBA Code does not set any requirements regarding MAFR, however reference to mandatory rotation of key audit personnel is included. Although the IESBA Code of 2006 (effective from June 2006) referred to the rotation of engagement partners of listed companies, some degree of flexibility in the timing of the rotation existed (IESBA, 2006:62). The 2009 IESBA Code (effective from 1 January 2011), which applied to audit personnel of PIEs, however stated that an individual may not be a key audit partner for more than seven consecutive years; and that a cooling-off period of two years shall apply after an individual served for more than seven years (IESBA, 2009:58). After a few years without big changes to the rotation rule, the 2018 IESBA Code (largely effective for audit engagements of financial reports for periods starting on or after 15 June 2019) includes extra provisions in establishing the cooling-off period (IESBA, 2018:161). Cooling-off periods are provided in paragraphs R540.11[16] to R540.19 of the SAICA Code and range from two to five years depending on an individual's roles during their time-on period. For simplicity's sake, this literature review is written with the view that the individual acted as an engagement partner, thus requiring the more stringent five-year cooling-off period. It should however be noted that paragraph R540.19 contains a transitional provision[17] – it states that "where a legislative body has established a cooling-off period for an engagement partner of less than five consecutive years, the higher of that period or three years may be substituted for the cooling-off period of five consecutive years … provided that the time-on period does not exceed seven years" (SAICA, 2018a:148).

Table 5: Legislation regarding mandatory audit partner rotation by the IESBA

Time	Relevant provisions
2006-2011	• Audit partner rotation was mentioned, but flexibility in the timing of the rotation existed.
2011-2019	• **Audit partners should be replaced after seven years, with a two-year cooling-off period.**

[16]Section 540 falls under Part 4A of the SAICA Code and thus needs to be adhered to by accountants in public practice, e.g., auditors.

[17] "Paragraph 540.19 shall have effect only for audits for periods beginning prior to 15 December 2023. This will facilitate the transition to the required cooling-off period of five consecutive years for engagement partners in jurisdictions where the legislative body has specified a cooling-off period of less than five consecutive years" (SAICA 2018a:202).

2019-current	• Audit partners should be replaced after seven years, **with a cooling-off period depending on the role the individual had during the audit:** • **Engagement partner: five years (with a transitional provision of three years until 2023);** • **Engagement quality control reviewer: three years;** • **Key audit partner: two years.**

* Changes in legislation are noted in **bold** font.

3.2.1 The U.S.

i Audit regulators and laws

The Securities Exchange Act of 1934 was introduced in order to instil the public's trust in the capital markets after the stock market crashed in 1929. This act created the SEC (U.S. Securities and Exchange Commission) whose mission entailed to guard investors against certain economic risks through maintaining fair, orderly, and effective markets (SEC, s.a.). After the major cases of fraud, like the collapse of Enron in 2001, regulators took action to lessen the concerns relating to auditor independence through the establishment of the 2002 Sarbanes-Oxley (SOX) Act. The SOX act created the PCAOB (Public Company Accounting Oversight Board), "a non-profit corporation established … to oversee the audits of public companies" (PCAOB, 2021).[18]

ii Auditor rotation rules

In 1978, partner rotation was introduced as a requirement for audits of public companies by the American Institute of Certified Public Accountants (AICPA)[19]. This requirement obligated lead audit partners to rotate after serving seven years on an audit engagement of SEC registrants[20]. Before the partner could return, a two-year cooling-off period was required (Laurion *et al.*, 2017:209). Section 203 of the SOX Act of 2002 shortened the period of audit partner rotation to five years, thus reducing the tenure by two years. Furthermore, the SEC approved rules in 2003 which required a five-year cooling-off period for both lead and concurring partners. Laurion *et al.* (2017:209) summarise the current U.S. legislation by stating

[18] Cohn (2020) reports that the White House's budget blueprint proposes consolidating the functions and responsibilities of the PCAOB into the SEC starting in 2022.

[19] The AICPA is the national professional organisation of Certified Public Accountants in die U.S. (AICPA, s.a.).

[20] A SEC registrant is a firm incorporated in the United States that is listed and trades its securities in the United States (Clyde *et al.*, 2009:22).

that the standards require lead audit partners to “rotate off an audit engagement for an SEC registrant after five years and then sit out for another five years before returning to the audit engagement”.

Section 207 of the SOX Act of 2002 required a study by the Controller General of the United States to gather information about and review the possible effects of requiring MAFR. The General Accounting Office (GAO) reported their findings in 2003 and stated that it believed that MAFR may not be the best solution to improve auditor independence taking into account the additional financial costs and the loss of client knowledge (GAO, 2003:2).

The topic once again made its appearance when the financial crisis between 2007 and 2009 created doubt about the credibility of audited financial reports (Kim *et al.*, 2015:1089). The PCAOB suggested in 2011 that MAFR would have been the most efficient way to establish a higher level of professional scepticism. Cameran *et al.* (2015:5) notes, however, that the U.S. Congress ruled against the possibility of MAFR two years later, in July 2013.

Chasan (2014) reports that the PCAOB eventually reported, almost three years after suggesting the idea of MAFR, that “we don’t have an active project or work going on within the board to move forward on a term limit for auditors”. Therefore, to conclude the discussion on the U.S., it seems that the current decision is not to impose MAFR, probably to be revised again after a next accounting scandal.

Table 6: Legislation regarding MAFR in the U.S.

Time	Relevant provisions
1978-2002	• Audit partners should be replaced after seven years, with a two-year cooling-off period.
2002-2003	• **Audit partners should be replaced after five years,** with a two-year cooling-off period. • **SOX Act of 2002 required a study of MAFR.**
2003-2011	• Audit partners should be replaced after five years**, with a five-year cooling-off period.** • **The GAO stated their findings on MAFR by concluding that it believes that MAFR may not be the best way to support auditor independence.**
2011-2013	• Audit partners should be replaced after five years, with a five-year cooling-off period. • **The PCAOB again suggested MAFR.**

2013- present	• Audit partners should be replaced after five years, with a five-year cooling-off period. • **The U.S. congress ruled against the suggested MAFR.**

* Changes in legislation are noted in **bold** font.

3.2.2 The European Union

i Audit regulators and laws

The European Union (EU) is a unique economic and political union, comprising of 27 countries (EU, 2020). The predecessor of the European Union was established after the Second World War with the aim of ending wars between neighbours. In achieving this goal, the first step seemed to be to establish economic cooperation because it was reasoned that countries trading with one another will become economically interdependent and thus less likely to engage in conflict. In 1957, the Treaty of Rome created the European Economic Community (EEC) increasing economic cooperation between countries. This economic union evolved over time into an organisation covering a wide range of policy areas. This evolution is also reflected in the change of the name from the EEC to the EU in 1993 (EU, 2020).

While the Treaty of Rome mentioned the importance of creating a unified company law, it did not contain specific reference to the co-ordination of accounting and auditing in the member states. This harmonisation was later established through the Company Law Directives (Humphrey *et al*., 2011:433).

According to the EU (2020) the current audit rules consist of:

- an amending[21] directive (Directive 2014/56/EU) setting out a framework for statutory audits, strengthening public oversight of the audit profession and improving cooperation between authorities in the union;
- a regulation (Regulation No 537/2014) stipulating the requirements for statutory audits of PIEs.

The new EU legislation on statutory audit, Directive 2014/56/EU and Regulation 537/2014, established the Committee of European Auditing Oversight Bodies (CEAOB). The objective of

[21] The previous directive was Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

the CEAOB is to support public audit oversight; replacing the European Group of Auditors' Oversight Bodies (EGAOB). The rules aim to provide more useful information to users of financial statements by requiring more comprehensive audit reports (Lee, 2016:5).

ii Auditor rotation rules

Directive 2006/43/EC mandated audit partner rotation after seven years in PIEs with a cooling-off period of two years (Cameran *et al.*, 2015:7). Member countries were given two years to implement the directive and were allowed to impose more stringent requirements in case they find it necessary. Regulation 537/2014 however introduced a three-year cooling-off period that would apply to periods starting on or after 17 June 2016 (KPMG, 2019:12).

After the 2007-2009 financial crisis, the European Commission (E.C.)[22] issued a green paper with the title: *Audit policy: lessons from the crisis* (Cameran *et al.*, 2015:8). Following up on the 2010 green paper, the E.C. issued a few statutory suggestions with regard to the role of the auditor and auditor independence in 2011. One of the suggestions by the E.C. was to introduce MAFR after every six to nine years with the aim to enhance auditor independence (Ewelt-Knauer *et al.*, 2012:5). Ewelt-Knauer *et al.* (2012:5) further states that the European Parliament proposed MAFR after 25 years in September 2012. This proposal was, however, opposed by Germany and Spain, which led to the discussion of a rotation period of 21 years by the European Parliament.

Directive 2014/56/EU and Regulation 537/2014 introduced a new legislative audit framework, with the aim to enhance the quality of audit reports. According to Cameran *et al*. (2015:8), the audit firm tenure for PIEs will be limited to 10 years. In the case of joint audits, the same audit firm may be reappointed for another 14 years and in the case of a public tender the same audit firm may be reappointed for another 10 years. In 'exceptional circumstances' the PIE may request an extension to reappoint the same audit firm after the maximum period for another two years. It is however expected that such an extension will be fairly uncommon (KPMG, 2016:2). Thus, these regulations resulted in a "10+14+2-year" rule in the case of a joint audit; or a "10+10+2-year" rule in the case where a single firm provides the audit service, and the audit was subject to a public tender after ten years. After the expiry of these periods, a cooling-off period of 4 years will be in force (GrantThornton, 2016:2). The seven-year partner rotation remains mandatory, and both the firm and partner rotation period can be shortened by Member

[22] The E.C. improves the general interest of the union through initiating and effectuating legislation, policies and the EU budget (EU, 2020).

States (KPMG, 2016:1). These requirements came into force on 17 June 2016, but member states were allowed to implement the MAFR rule earlier (between 17 June 2014 – 17 June 2016).

The EU created transitioning rules to support the implementation of MAFR. These transition rules are based on the tenure of the existing auditor on 16 June 2014 and can be seen in the figure below.

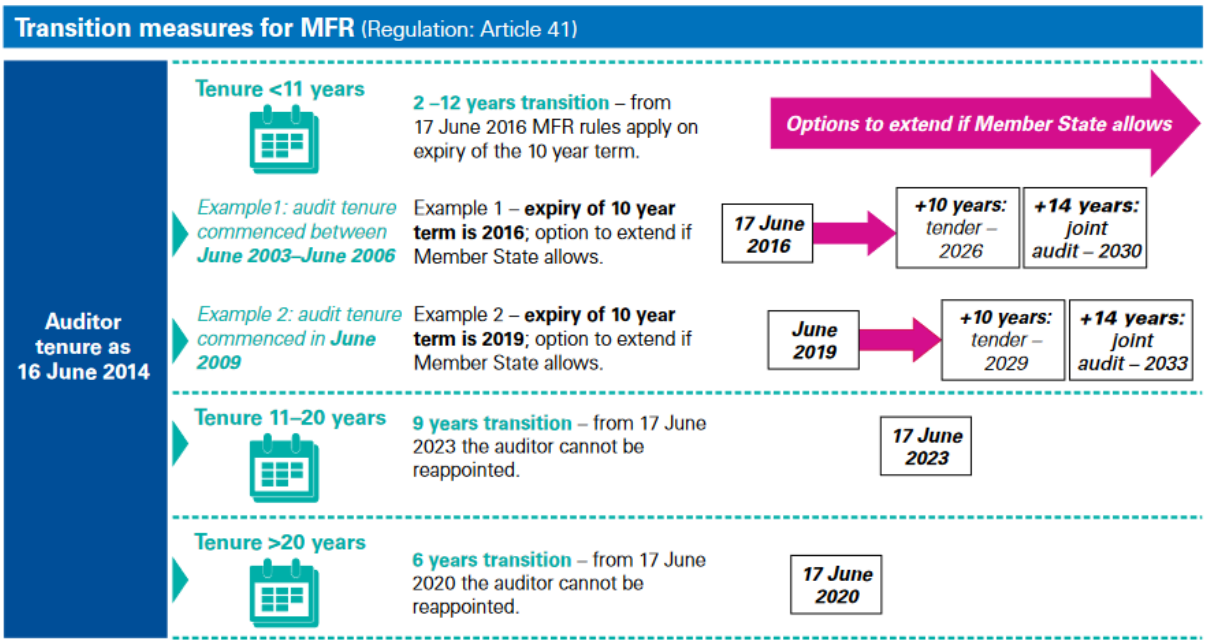

Figure 9: MAFR transitioning rules in the EU (illustrated by KPMG [2016:3]).

The figure above suggests that the only firms who would probably have rotated auditors because of the MAFR rule before 2021 would be firms whose auditors exceeded a 20-year tenure as at 16 June 2014. In 2023, the next group of PIEs (whose audit tenure were between 11-20 years on 16 June 2014) will be required to rotate auditors. This transitioning rule, which supports the implementation of MAFR in phases, would probably create less disruption in the first few years of implementation.

Table 7: Legislation regarding MAFR in the E.U.

Time	Relevant provisions
2006-2014	• Audit partners should be replaced after seven years, with a two-year cooling-off period; or more stringent in case a member state finds it necessary.
2014-2016	• **MAFR was introduced** (voluntary adoption between 2014-2016): "10+14+2-year" rule, with a four-year cooling-off period, in case of a joint audit; "10+10+2-year" rule, with a four-year cooling-off period, in case a single firm conducts the audit; Member states may shorten the tenure of the audit term. • Audit partners should be replaced after seven years, with a two-year cooling-off period; or more stringent in case a member state finds it necessary.
2016- present	• MAFR **automatically** applied from 17 June 2016: "10+14+2-year" rule, with a four-year cooling-off period, in case of a joint audit; "10+10+2-year" rule, with a four-year cooling-off period, in case a single firm conducts the audit; Member states may shorten the tenure of the audit term. • Audit partners should be replaced after seven years, **with a three-year cooling-off period**; or more stringent in case a member state finds it necessary.

* Changes in legislation are noted in **bold** font.

3.2.3 Italy

i Audit regulators and laws

Italy, a member state of the EU, is subject to the directives and regulations issued by the European Commission (IFAC, 2019). The IFAC (2019) states that the regulatory framework for accountants in Italy is mainly established through the Legislative Decree No. 139/05, Decree No. 39/2010, and Decree No. 135/2016. These legislations also set out the duties of organisations liable for regulating the accountancy profession, consisting of the *Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili* (CNDCEC) [National Council of Chartered Accountants and Accounting Experts], the Ministry of Economy and Finance (MEF), and the *Commissione Nazionale per le Società et la Borsa* (CONSOB) [National Commission for Companies and the Stock Exchange]. Vozzella *et al*. (2014:7) notes that the CONSOB is

the public authority liable for regulating security markets and thus the audits of PIEs; while the MEF is responsible for establishing a quality review framework for audits of non-public interest entities.

ii Auditor rotation rules

Italy was one of the first countries to adopt MAFR by legislating mandatory audit firm rotation in 1975. The first regulation on MAFR, which was in force until 1997, established an audit firm tenure of three years that could be extended for two additional three-year terms, thus creating a "3+3+3-year" rule. After nine years, a cooling-off period of five years was required (Corbella *et al.*, 2015:48). Corbella *et al.* (2015:48) further state that after 1997, the MAFR rule was partly modified. This modification did not explicitly indicate the length of the cooling-off period. Because of the vagueness in the new legislation, firms generally interpreted it as a three-year cooling-off term.

In 2005, the legislation changed in response to the financial scandals of Cirio and Parmalat. According to the *Testo Unico della Finanza* [Consolidated Finance Act] (as cited by Corbella *et al.*, 2015:48), the modified law extended the MAFR term from three to six years and decreased the number of audit firm term renewals from three to two, creating a "6+6-year" rule and thus extending the maximum tenure from nine to twelve years. Corbella *et al.* (2015:49) concluded that the increase in maximum tenure, which was intended to improve audit quality, demonstrates the Italian authorities' belief that longer tenured audit firms provide higher quality audits. Furthermore, the amended legislation explicitly established a three-year cooling-off period. This modification also regulated audit partner rotation in Italy for the first time, requiring audit partner rotation after six years together with a three-year cooling-off period.

In 2006, the legislation was changed once again and extended the MAFR tenure from six to nine years; renewable only after a three-year cooling-off period, with no changes regarding audit partner rotation (Corbella *et al.*, 2015:49). The last modification (as of the present date) became effective in 2010, extending the audit partner tenure from six to seven years. The MAFR requirements remain the same.

Table 8: Legislation regarding MAFR in Italy as illustrated by Corbella *et al*. (2015:48)

Time	Relevant provisions
1975-1997	• MAFR: "3+3+3-year" rule; with a five-year cooling-off period.
1998-2004	• MAFR: "3+3+3-year" rule; **with no explicitly stated cooling-off period (often interpreted as a three-year cooling off period).**

2005	• **MAFR: "6+6-year" rule; with a three-year cooling-off period.** • **Audit partners should be replaced after six years, with a three-year cooling-off period.**
2006-2009	• **MAFR: "9-year" rule; with a three-year cooling-off period.** • Audit partners should be replaced after six years, with a three-year cooling-off period.
2010- present	• MAFR: "9-year" rule; with a three-year cooling-off period • **Audit partners should be replaced after seven years,** with a three-year cooling-off period.

* Changes in legislation are noted in **bold** font.

Italy forms part of the EU, but because their "9-year" MAFR rule is more stringent than the EU's "10+10+2-year" rule, Italy is allowed to apply this rule. Their current audit partner rotation rule is in line with the required seven years' time-on and three years' cooling-off period established by the IESBA.

3.2.4 Canada

i Audit regulators and laws

The Canada Business Corporation Act and the provincial Business Corporations Act established the financial reporting framework in Canada. These acts create statutory audit requirements for companies (IFAC, 2019). Canada's accountancy profession is regulated by the provincial bodies of the Chartered Professional Accountants (CPAs) and the Canadian Public Accountability Board (CPAB). The Canadian Securities Administrators require auditors to be registered with the CPAB. The CPAB promotes audit quality through regulation, audit assessments and communication with stakeholders in order to establish confidence in the integrity of financial reporting (CPAB, 2020).

ii Auditor rotation rules

In Canada, mandatory audit firm rotation for financial institutions was introduced shortly after the Home Bank failure in 1923, and therefore much earlier than in other countries (Cameran *et al.*, 2015:4). The Bank Act originally required that a bank should be audited by two firms. The same two firms may however not perform more than two consecutive audits. As a result, one of the firms had to rotate off the audit for a cooling-off period of two years. The GAO (2003:88) further states that the use of two firms were on its own considered to be a useful

safeguard. The rotation element of the system was thought to create an additional safeguard, ensuring that financial reports were regularly reviewed by auditors with a fresh perspective.

Despite the existence of the dual auditor system, two local banks failed in 1985 (GAO, 2003:88). An inquiry into the failures suggested that the Office of the Inspector General of Banks (renamed to the Office of the Superintendent of Financial Institutions (OSFI)), relied too heavily on the reports of the external auditors. A form of direct examination of the loan portfolios of banks were recommended.

In 1991, the revised Bank Act abandoned the MAFR requirement together with the requirement of a dual audit (GAO, 2003:88). According to Canadian officials, the reasons for the abandonment were based on the opinion that a cost-benefit analysis do not support the requirements and it was noted that Canada seemed to be one of very few countries imposing such a system at that stage (GAO, 2003:88).

Mandatory rotation of audit partners for all public companies, together with a new framework that would establish independent oversight of auditors of public companies, was considered by Canada's securities regulator in July 2003. Canada introduced a SOX-like audit partner rotation requirement in 2004 requiring audit partners to rotate after five years, with a cooling-off period of five years. This policy was adjusted in 2010 to require the rotation of audit partners only after seven years, while maintaining a cooling-off period of five years (Daugherty *et al.*, 2013:35).

According to CPAB (as cited by Fontaine *et al.*, 2016:488) the CPAB and CPAs collaborated on a project to formulate ideas on how audit quality could be enhanced by providing remedies to perceived problems in 2013. The CPAB (2013:35) report concluded the following with regard to MAFR:

a) The mandatory rotation of audit firms or mandatory retendering of the audit would not contribute to the enhancement of audit quality.
b) Having audit committees perform a comprehensive review of their audit firm at least every five years, resulting in a recommendation to retain or replace the audit firm, is the preferred approach to address any institutional familiarity threats potentially created by audit firm tenure.
c) A report summarising the results, findings and conclusions of the comprehensive review should be included in an entity's public disclosures in the year in which the comprehensive review is carried out.

Thus, currently there are no Canadian requirements for MAFR; but mandatory rotation of audit partners after a seven-year period together with a five-year cooling-off period has been in place since 2010.

Table 9: Legislation regarding MAFR in Canada

Time	Relevant provisions
1923-1991	• MAFR: "9+3-year" rule for financial institutions regulated by the Bank Act, with a two-year cooling-off period.
1991-2004	• **Only one audit firm was needed to perform an audit for financial institutions and MAFR was abandoned.**
2004-2010	• **Audit partners should be replaced after five years, with a five-year cooling-off period.**
2010- present	• **Audit partner replaced after seven years,** with a five-year cooling-off period.

* Changes in legislation are noted in **bold** font.

3.2.5 Spain

i Audit regulators and laws

Like Italy, Spain is also a member state of the EU and subject to the directives and regulations issued by the European Commission (IFAC, 2019). Auditing was regulated for the first time in Spain by the Auditing Act 19/1988 which contained some of the audit rules from the Directive 84/253/CEE of the European Commission. This law contained key aspects of auditor independence and established a public oversight body for the audit profession, namely the *Instituto de Contabilidad y Auditoría de Cuentas* (ICAC) [Institute of Accounting and Auditing] (Alarcón, 2016:11). Since then, with the goal to recover confidence in their audit profession after a few incidences of audit failures, audit improvements were implemented under the Auditing Act 44/2002 (de las Heras *et al*., 2012:523). Law 44/2002 introduced auditor rotation for organisations, but due to a lack of consensus about optimal rotation periods, several amendments (such as Law 16/2007, which was later modified by Law 34/2007) were made. Law 12/2010 was introduced to make provision for Directive 2006/43/CE, amending several aspects of the existing legislation (Alarcón, 2016:11).[23]

[23] It was difficult to determine exactly how the act was amended, as the amendments to the law is not communicated in a logical manner. This is illustrated in the quotation from the introduction of Law 22/2015 as found on the website of the ICAC: "The fifth additional provision of Law 16/2007, of 4 July,

Spain's current auditing requirements are included in Law 22/2015. The main aim of this legislation is to adapt the country's internal legislation to the changes incorporated in Directive 2014/56/EU and Regulation No 537/2014 introduced by the European Parliament as discussed earlier.

ii Auditor rotation rules

According to Carrera *et al.* (2007:672), the MAFR policy was incorporated in the Spanish Audit Law in 1988. The rotation policy stated that the auditors will be appointed for an initial period of not less than three years, but not more than nine years. Thereafter the audit firm could, however, be reappointed for a maximum period of three additional years after the completion of the first period. This gave rise to a "9+3-year" rule with a minimum initial period of three years, which were only renewable after a three-year cooling-off period (Ruiz-Barbadillo *et al.*, 2014:5). However, this stipulation was removed in 1995. As mentioned above, the rotation requirement applied for the first time to audit engagements which was started in 1988, therefore the first mandatory rotation of audit firms would have taken place in 1997 (1988+9). The regulation was, however, abolished in 1995 before it could have taken effect. Consequently, Carrera *et al.* (2007:672) believes that, instead of using the scenario in Spain as an example of where MAFR did not work (which is the "traditional" viewpoint portrayed by the international accounting profession), MAFR in Spain should be more accurately regarded as a policy that was never given a chance to work.

Law 44/2002 introduced audit partner rotation to PIEs after a seven-year period, together with a cooling-off period of seven years. The seven-year tenure requirement for the lead audit partner was upheld by the modification of the Audit Law in 2010 (Garcia-Blandon & Argiles, 2015:84).

To make provisions for Directive 2014/56/EU and Regulation No 537/2014, introduced by the European Parliament, Spain's current auditing requirements as set in Law 22/2015, published on 21 July 2015, provides for MAFR every ten years. The initial ten-year tenure may however be extended with an additional four years when there is a joint audit. In contrast to the EU regulations, Spain does not allow the extension of the initial tenure after a tender, thus creating

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on the reform and adaptation of commercial legislation on the basis of European Union regulations to harmonize it with international law, as amended in turn **by the fourth final provision of Law 34/2007, of 15 November, on air quality and the protection of the atmosphere**, amended the Law 19/1988, of 12 July, on Auditing with regard to the periods of engagement of auditors, to allow the engagement to be renewed for successive periods of up to three years following the end of the initial period."

a “10+4-year” rule in the case of a joint audit or a “10 year” rule in any other circumstance. No reference is made to a cooling off period for MAFR, thus it is believed that the cooling off period will be similar to the 4-year period introduced by the EU. With regard to key audit partner rotation, Spain goes beyond the EU baseline and provides a rotation period of five years together with a three-year cooling-off period. The majority of the provisions of the Spanish Law applied from 17 June 2016 (Mazars, 2016:3). Spain did not specify additional requirements regarding the transition period, thus, it will most likely correlate with the transition rules introduced by the EU (Mazars, 2016:7).

Table 10: Legislation regarding MAFR in Spain

Time	Relevant provisions
1988-1995	• MAFR: “9+3” year rule, with a minimum initial period of three years and a three-year cooling-off period.
1995-2002	• **No legislation with regard to auditor rotation**
2002-2016	• **Audit partners should be replaced after seven years, with a seven-year cooling-off period.**
2016- present	• **Audit partners should be replaced after five years, with a three-year cooling-off period.** • **MAFR was reintroduced**: **“10+4-year” rule, with a four-year cooling-off period, in case there is a joint audit** **“10-year” rule with a four-year cooling-off period, in other circumstances.**

* Changes in legislation are noted in **bold** font.

3.2.6 South Korea

i Audit regulators and laws

In Korea[24] the Korean Commercial Act sets the framework for financial reporting (IFAC, 2019). The Act on External Audit of Stock Companies requires most public interest companies to have their financial statements audited. Listed companies are also required to submit an external auditor’s review report semi-annually. The Act on External Audit of Stock Companies authorised the Financial Service Commission (FSC) to set auditing standards in Korea. The FSC designated the responsibility to oversee and regulate financial companies to the Financial Supervisory Services (FSS) (Jee-Hee, 2020). Furthermore, the FSC entrusted the Korean

[24] “Korea” refers to South Korea (Republic of Korea) throughout this dissertation.

Institute of Certified Public Accountants (KICPA) with the responsibility to develop the Korean Standards on Auditing (KSA) based on the newest ISAs. The KICPA is also responsible for setting ethical requirements Certified Public Accountants must comply with. Korea adopted the 2005 IESBA Code but have not yet adopted the new 2018 IESBA Code (IFAC, 2019).

ii Auditor rotation rules

The FSS suggested an accounting reform bill in 2003. The motivation for the new bill was a combination between the Asian financial crisis in 1997, accounting scandals[25], and the debate the Sarbanes-Oxley Act created (Kwon *et al.,* 2014:168). This bill required MAFR for listed companies after an audit engagement of six years (Kwon *et al.,* 2014:168). No mention of cooling-off periods could be found. The aim with the MAFR rule was to improve audit quality in order to redeem trust in the external auditing service after incidences of auditing errors (Choi *et al*., 2017b:6). This rule became effective in January of 2006 but was abolished after five years in December 2010. The rule was mainly abolished because of pressure from businesses "due to the additional cost of double regulation[26]" (Choi *et al*., 2017b:7).

Regarding audit partner rotation, Korea mandated audit partner rotation after five years in 1997, together with the requirement that auditors should be retained for three-years (Choi *et al*., 2017b:6). In response to the Asian financial crises and the accounting scandals of Kia and Korean Air, the rotation period was changed to a three-year rule in 2001.

Table 11: Legislation regarding MAFR in South Korea

Time	Relevant provisions
1997-2001	• Audit partners should be replaced after five years; auditors should be retained for three-years.
2001-2006	• **Audit partners should be replaced after three years; auditors should be retained for three-years.**
2006-2010	• Audit partners should be replaced after three years; auditors should be retained for three-years. • **MAFR: "6 year" rule.**
2010- present	• Audit partners should be replaced after three years; auditors should be retained for three-years. • **MAFR: abolished.**

[25] The FSC stated in 2003 that "one out of three domestic firms was committing accounting fraud" (Choi *et al.*, 2017b:6)

[26] This "double regulation" refers to the MAFR rule which was in place alongside the partner rotation rule during the period 2006-2010.

* Changes in legislation are noted in **bold** font.

3.2.7 Singapore

i Audit regulators and laws

The Singapore Companies Act sets the framework for financial reporting. This act requires most companies to have their financial statements audited (IFAC, 2019). The Auditing and Assurance Standards Committee (AASC) of the Institute of Singapore Chartered Accountants (ISCA) is responsible for setting auditing standards. Auditing is performed according to the Singapore Standards on Auditing (SSA) which is in essence the ISAs with minor modifications to reflect the requirements of Singapore. The ISCA also issues the *ISCA Ethics Pronouncement 100 Code of Professional Conduct and Ethics* (the ISCA Code) which members of the institute are required to adhere to (IFAC, 2019). The Accounting and Corporate Regulatory Authority (ACRA) was introduced in 2004 as a statutory board with the objective to regulate business entities, public accountants and commercial service providers.

The Monetary Authority of Singapore (MAS) is Singapore's central bank. The MAS encourages economic growth through the formulation of appropriate monetary policies and the observation of emerging trends and possible weaknesses (MAS, 2019).

ii Auditor rotation rules

MAFR was introduced in 2001 with the goal to enhance the quality of external audits of financial institutions, and to avoid over-reliance on a single audit firm undertaking the audits of a majority of the local banks (MAS 2016:4). MAS Notice 615 prohibited banks in Singapore to appoint the same audit firm for more than five consecutive years without written authorisation from the MAS (MAS 2016:4). No mention of cooling-off periods is made.

The requirement for MAFR for banks was provisionally suspended in October 2008. During the financial crisis, banks were already giving a substantial amount of time and resources towards increased alertness. The MAS believed that the local banks could benefit from audit continuity during the crisis through minimising any disruption that could arise when appointing a new audit firm (MAS, 2016:4).

In 2016, the MAS (2016:4) proposed the discontinuance of MAFR by replacing it with the implementation of a re-tendering requirement. After considering the feedback, the MAS (2018:1) amended MAS Notice 615, requiring mandatory audit re-tendering that needs to be

conducted by local banks every ten years instead of MAFR. The implementation date depends on the number of consecutive years the existing auditor had been appointed for as of 31 December 2017. In the case where the same auditor had been appointed for more than 10 consecutive financial years, the requirement shall apply to the reappointment of the bank's auditor from the financial year ending 31 December 2020. In any other case the requirement shall apply from the financial year ending 31 December 2022.

With regard to audit partner rotation, the current Singapore Exchange Securities Trading Limited (SGX-ST) Listing Manual, Rule 713 requires the lead audit partner of listed companies to rotate after five years; with a cooling-off period of two years (Cheng, 2016). This rule was first introduced in 1996 (SGX, 2002:17).

In August 2018, the ISCA Code was revised to incorporate the changes to the requirements on long association of key audit partners issued by the IESBA. These changes were effective for assurance engagements of financial statements for periods starting on or after 15 December 2018. As part of the changes, the cooling-off period for engagement partners of PIEs increased from two years to five years while the time-on period remained seven years. A transitional provision is also included as part of the changes to help with the switch towards a cooling-off period of five years for engagement partners (ISCA, 2019). The transitional provision is included in paragraph 290.163 of the ISCA Code. It states that where a cooling-off period of less than five years was in place, the higher of that period or three years may be exchanged for the cooling-off period of five years. This provision will be in place for audits of financial statements for periods starting prior to 15 December 2023. Thus, under the transitional provision, the time-on and cooling-off periods for engagement partners of PIEs are seven years and, at a minimum, three years respectively.

The SGX-ST Listing Manual requires, as noted above, that the lead audit partner of a listed company must rotate off the audit after five consecutive years but may return after a break of two years. Until the SGX changes its listing policies, engagement partners that are auditing listed companies must comply with the more stringent rotation requirements contained in the ACRA Code and the SGX-ST Listing Manual. Thus, the time-on period for engagement partners on audits of listed companies will be five years; with the cooling-off period being a minimum of three years (taking the transitional provision into account) for the audits of financial statements for periods beginning prior to 15 December 2023. For audits of periods beginning on or after 15 December 2023, the transitional provision would not apply; hence the cooling-off period would be increased to five years (ISCA, 2019).

Table 12: Legislation regarding MAFR in Singapore

Time	Relevant provisions
1996-2001	• Audit partners should be replaced after five years, with a two-year cooling-off period.
2001-2008	• Audit partners should be replaced after five years, with a two-year cooling-off period. • **MAFR was reintroduced in die banking industry: "5-year" rule.**
2008-2018	• Audit partners should be replaced after five years, with a two-year cooling-off period. • **MAFR in the banking industry was temporarily suspended.**
2018-2023	• Audit partners should be replaced after five years, **with a minimum three-year cooling-off period**. • **MAFR is discontinued.** • **Audit re-tendering every ten years was introduced in the banking industry (applying to financial years ending on 31 December 2020 or 2022 based on the length or die audit engagement as described above).**
2023-…	• Audit partners should be replaced after five years, **with a five-year cooling-off period**. • Audit re-tendering every ten years for banks.

* Changes in legislation are noted in **bold** font.

3.2.8 Costa Rica

i Audit regulators and laws

The Commercial Code Law No. 3284 of 1964 established the basic framework for accounting and auditing. The *Colegio de Contadores Públicos de Costa Rica* (CCPA), and the National Supervisory Council for the Financial System (CONASSIF) are both responsible for setting the accounting and auditing standards (IFAC, 2019). Since 2005, the auditing standards are basically the ISAs translated into Spanish without any modification. Auditors providing services to regulated entities are required to be members of the CCPA and to be registered with the Stock Market Supervisory Authority (SUGEVAL) (IFAC, 2019).

ii Auditor rotation rules

As noted thus far, many countries hold different views on MAFR. In the case of Costa Rica, the uncertainty regarding the implementation of MAFR is clearly illustrated by their frequent change in policy. Unfortunately, there is a shortage of available literature explaining the reasons for these frequent changes. The exact requirements which the alterations put in place are also difficult to come by. Nevertheless, MAFR was introduced in 2005, appealed in 2006, removed in 2007 and re-implemented in 2010 (Cameran *et al.,* 2015:4; Ewelt-Knauer *et al.,* 2012:3). Ewelt-Knauer *et al.* (2012:3) also reports that Costa Rica's Commercial Code Law does not make any provisions for audit partner rotation. Costa Rica is, however, a member of the IFAC and therefore the partner rotation requirements established by the IESBA need to be adhered to.

Table 13: Legislation regarding MAFR in Costa Rica

Time	Relevant provisions
2005-2008	• MAFR was introduced.
2008-2010	• **MAFR was removed.**
2010-2011	• **MAFR was re-implemented.**
2011-2019	• **Audit partners should be replaced after seven years, with a two-year cooling-off period.**
2019-current	• Audit partners should be replaced after seven years, **with a cooling-off period depending on the role the individual played during the audit:** • **Engagement partner: five years (with a transitional provision of three years until 2023)** • **Engagement quality control reviewer: three years** • **Key audit partner: two years**

* Changes in legislation are noted in **bold** font.

3.2.9 Nigeria

i Audit regulators and laws

According to Adenola (cited by Okoye *et al.,* 2015:107), the Nigerian Accounting Standards Board (NASB) was established to stipulate accounting standards in Nigeria. The boards' aim is to enhance the comparability of financial reports of public listed companies. The Financial Reporting Council of Nigeria Act (FRC Act) of 2011, however, changed the NASB to the Financial Reporting Council of Nigeria (FRC) (IFAC, 2019).

The Companies and Allied Matters Act of 1990 (CAMA) and its amendments is Nigeria's primary legislation that creates regulations for accounting and auditing. The FRC Act grants the FRC power to develop auditing standards and to ensure uniformity between the standards issued and the auditing pronouncements of the IAASB. The FRC is also responsible for issuing a Code of Ethics for auditors of PIEs in Nigeria (IFAC, 2019).

ii Auditor rotation rules

In 2006, the Central Bank of Nigeria (CBN) introduced mandatory rotation for auditors of banks following the consolidation of the banking industry in Nigeria (Okoye *et al*., 2015:108). The CBN Code of Corporate Governance for Banks specifies that the tenure of auditors of a bank shall not exceed ten years where after a cooling-off period of ten years shall exist (CBN, 2010).

The CAMA provides numerous provisions for auditing practices and auditor independence in Nigeria. However, Salawo (2017:111) states that it should be noted that the CAMA does not provide requirements for joint audits or the rotation of auditors. In compliance with the IESBA regulation, the audit partner of a PIE needs to rotate every seven years, with a minimum cooling-off period of three years (five years from 2023 when the transitional provision expires, as explained earlier).

Table 14: Legislation regarding MAFR in Nigeria

Time	Relevant provisions
2006-2011	• MAFR was introduced for banks: "10 year" rule; with a ten year cooling-off period.
2011-2019	• **Audit partners should be replaced after seven years, with a two-year cooling-off period.** • MAFR for banks: "10 year" rule; with a ten-year cooling-off period.
2019-current	• Audit partners should be replaced after seven years, **with a cooling-off period depending on the role the individual played during the audit:** • **Engagement partner: five years (with a transitional provision of a minimum of three years until 2023)** • **Engagement quality control reviewer: three years** • **Key audit partner: two years** • MAFR for banks: "10 year" rule; with a ten-year cooling-off period.

* Changes in legislation are noted in **bold** font.

3.3 Advantages associated with MAFR

As illustrated by the different approaches that countries took regarding MAFR, one can conclude that uncertainty exists about the cost-benefit of this rule. Cameron *et al.* (2015:9) notes that, from a theoretical viewpoint, the rule could have both advantages and disadvantages. In the next section, a few of the major advantages identified in prior studies will be discussed briefly. These advantages will be supplemented by the opinions of the 12 participants of the current study. The disadvantages will be discussed in Chapter 4 with the aim to identify possible problems South Africa might face in light of this new rule. The advantages of MAFR mostly relate to improved audit quality since the main reason for considering this rule is to recover investors' trust in the audit function after the financial scandals in recent years.

3.3.1 Increasing auditor independence

The positive impact of MAFR on auditor independence (especially 'independence in appearance') was also discussed in Chapter 2. Nonetheless, in a study conducted by Daniels and Booker (2011:81), it was found that loan officers noticed that the existence of a MAFR policy enhances the perceptions of auditor independence. A familiarity threat arises when a professional accountant has a long or close relationship with a client; this can cause the professional accountant to be too sympathetic or accepting of the client's work, and also have an effect on the appearance of independence.

Four of the research participants agreed that the improvement of the perception of auditor independence is one of the main advantages of MAFR. One participant explained: *It is definitely necessary to improve independence and especially independence in appearance. So, over the past few years, obviously there's been a few hits towards the South African auditing profession… It's not necessarily due to the fault of the auditing firms, but the perception is there. So, independence in appearance, unfortunately is a big theme in South Africa at the moment. So, I think it (MAFR) will help. It will help to a certain degree* (5:27). Another research participant supported this idea and noted: *I think there are some stakeholder groups that are going to be comforted by the fact that there is audit firm rotation* (4:15). Consistent with the conclusion in Chapter 2, one of the advantages associated with MAFR in prior research and during the empirical evidence gathered in the current research, is independence in appearance.

3.3.2 Increase in competition and audit quality

The European Commission (cited by Ewelt-Knauer *et al.*, 2012:31) states that the effect MAFR has on market competition is often regarded as an advantage. The concentration of suppliers in the audit market is "a permanent, worldwide phenomenon" (Velte & Stiglbauer, 2012:156). Harber and Marx (2019:119) illustrate this progressive concentration by mentioning the movement from the 'Big 8' to the 'Big 5' to the current 'Big 4' audit firms. According to Mamat (cited by Ewelt-Knauer *et al.*, 2012:31) MAFR might offer smaller audit firms the opportunity to expand. Similarly, the MAS (2016:4) states that the MAFR policy in Singapore "has been successful in reducing the concentration of local bank audits in a single firm and has also encouraged the building up of banking audit expertise in the audit industry".

Six of the 12 research participants in the current study also identified an increase in competition and a decrease in the audit market concentration as one of the benefits of the new regulation. One participant noted: *It (MAFR) would have an economic value in the sense that I think it will give the smaller or the medium audit firms a fighting chance to also win some of the big listed companies* (1:11). One of the participants went a step further and concluded that, because of the decrease in concentration, "*the trainees I think will also be exposed to more industries or different industries. They (the trainees) wouldn't be so specialised. I think with MAFR, since the firms need to rotate, that will also expose their trainees to a broader spectrum and better exposure for the trainees at the firms… And I think it'll also in the long run for example improve our (Assessment of Professional Competence) APC*[27] *results* (2:12). Improved APC results will help to address the shortage of chartered accountants and consequently registered auditors, which will be elaborated on in Chapter 4.

One participant recognised the transformation objective of the IRBA as an advantage which could be achieved in a less concentrated audit market and stated: *It (MAFR) is forcing audit firms to recognise that government believes they're not transforming fast enough* (4:18). The transformation objective of the IRBA will also be discussed in Chapter 4.

Lastly, three participants concluded that MAFR will help to improve audit quality since it will bring about "*new pairs of eyes thinking about things differently, coming in and outgoing firms being very careful because they don't want a restatement to a new firm*" (9:1). One of the participants also mentioned a positive result brought about by the continuous tendering for

[27] The APC is the second (and final) qualifying exam which a candidate needs to pass in order to be eligible to register as a Chartered Accountant (SA) (SAICA, 2022).

new clients in a MAFR regulative system*: I do think it helps the firms up their technical skills in some respect. Because they now have to sell themselves again from scratch... They have to go through a process, and they have to assess themselves, evaluate themselves and see how they fare against the market. So that whole process, I do think will help the firms… to make sure that if they say they have these technical capabilities that they do make sure they have them for the clients* (3.8). The self-evaluation process before, during and after the tender process will also possibly contribute to improved audit quality.

3.4 Conclusion

The supposed lack of audit quality is an international phenomenon and led to the introduction of extra legislations by regulators around the world. This chapter contributed to the creation of a foundation regarding the practical implementation of MAFR and similar rules in countries around the world and consequently addressed the second secondary research objective {SRO2}. Knowledge about similar regulations in other countries sets the tone against which decisions in South Africa can be reflected.

In this chapter, the controversy about the effectiveness of MAFR was confirmed by the diverse approaches different countries took to address audit quality. It was noted that, although the UK adopted MAFR in 2014, the U.S. decided against MAFR after continuous considerations. It was noted that audit partner rotation is far more commonly applied than MAFR. A reason for the wide acceptance of partner rotation is likely due to the requirement the IFAC establish regarding partner rotations.

In order to visualise the development of MAFR legislation in different countries, tables have been drafted outlining the implementation of new regulations in the various jurisdictions. The legislation requirements in the EU, the U.S., Italy, Canada, Spain, South Korea, Singapore, Costa Rica and Nigeria were reflected on. Although the U.S. adopted audit partner rotation earlier than the rest of the countries (in 1978); Canada and Italy introduced MAFR even earlier (in 1923 and 1975 respectively). Thus, it can be argued that MAFR was seen as a solution to audit quality even before partner rotation was established. Spain and South Korea reversed MAFR less than 10 years after introducing it; while Singapore “temporarily suspended” MAFR in 2008 and discontinued the regulation in 2018. The Costa Rica case is quite interesting since MAFR was introduced in 2005, ejected it in 2007 and re-implemented it in 2010. Nigeria introduced MAFR to their banking industry in 2006 and are still implementing a 10-year rule.

It was also noted that the EU created transitioning rules to support the implementation of MAFR. These transition rules are based on the tenure of the existing auditor on a specific date (16 June 2014). Transition rules would probably create less disruption in the first few years of implementation of a new regulation and provides a recommendation for further studies.

Lastly, the benefits of the new regulation were discussed. The increase in auditor independence was found to be one of the main advantages of MAFR. The results of the empirical study supported the literature in this regard as the research participants agreed that the improvement of the perception of auditor independence is one of the main benefits of MAFR. The second core benefit identified relates to competition and audit quality. It is stated MAFR will likely contribute to an increase in competition amongst audit firms and in the process decrease audit market concentration. The understanding of the international implementation of MAFR together with the discussion of major advantages sets a background for Chapter 4 in which the potential negative consequences MAFR might have in South Africa will be formulated.

CHAPTER 4: POTENTIAL NEGATIVE CONSEQUENCES IN SOUTH AFRICA

4.1 Introduction

Prior to the implementation of MAFR, the IRBA issued a consultation paper on 25 October 2016 in which it asked interested and affected parties to submit their inputs (IRBA, 2016:1). In a study conducted by Harber (2018:139) a few of the responses were reviewed. From the responses that were reviewed it was concluded that based on the statements made by the managing partners of the Big Four firms, "the Big Four firms are strongly against the implementation of MAFR" (Harber, 2018:150). Furthermore, it was found that all the responses that were reviewed (responses of amongst others the IFAC, JSE, SAICA, and the Big Four auditing firms), raised concerns regarding the multiple objectives the IRBA articulated regarding MAFR. This chapter will start off by exploring the South African standpoint by providing a historical outline of MAFR in South Africa together with a brief analysis of the three objectives the IRBA articulated for MAFR.

Furthermore, the anticipated problems that audit firms and clients might face in the wake of the implementation of MAFR in South Africa based on the experiences in countries which introduced MAFR before South Africa will be set out. Six main problems MAFR might create was identified and is elaborated on later in this Chapter. These possible problems include:

i Decrease in audit quality
ii Switching costs
iii Limits the ability to attract and retain talent
iv Limits auditor specialisation
v Could increase audit market concentration and the market share of one firm
vi Limits the audit committee's ability to determine the best audit firm for the company

The World Bank (2004:148) states that "regulations in different markets can be assessed in two ways". The first method of assessment is based on international comparisons whereas the second method is to ask stakeholders affected by regulations. In this chapter a combination of these approaches will be used in order to anticipate the impact of MAFR in South Africa. The anticipated problems will first be justified by a comparison between, amongst other things, the economy and audit profession of the foreign countries and South Africa. The possible difficulties identified by participants in resent South African research will add to the

list of problems. Lastly, empirical evidence gathered through semi-structured interviews will be compared (and possibly add) to the potential problems identified though the literature study. The aim of this chapter is to satisfy the third secondary research objective {SRO3} by concluding on the potential negative consequences the implementation of MAFR might have in South Africa.

4.2 History of MAFR in South Africa

4.2.1 Audit regulators and laws

South Africa has numerous pieces of legislation which govern financial reporting requirements. As discussed in Chapter 1, section 3 of the Auditing Profession Act 26 of 2005 established the Independent Regulatory Board for Auditors (IRBA). The IRBA is a statutory body with the aim to provide public protection. Section 4 of this act sets out the general functions of the IRBA. The IRBA is inter alia responsible for promoting the integrity of the audit profession; protecting the public in their connections with Registered auditors; prescribing standards of professional competence and ethics of registered auditors; encouraging education in connection with the auditing profession; and prescribing auditing standards. IFAC (2019) reports that the IRBA has adopted the ISAs that are published by the IAASB. Furthermore, the Banks Act of 1990 specifies financial reporting and auditing requirements for banks (IFAC, 2019).

The Companies Act 71 of 2008, creates financial reporting requirements for profit and non-profit companies. In terms of Section seven of the *Companies Act No. 71* (2008) one of the purposes of this act is to “promote the development of the South African economy by encouraging transparency and high standards of corporate governance”. Part C of this act specifically deals with audit requirements for companies.

Listed companies also has to adhere to financial reporting requirements set by the stock exchange they are listed on, for example the JSE (IFAC, 2019). Further disclosure requirements for listed companies are set by the Financial Markets Act of 2012. This act establishes certain disclosure requirements for listed companies associated with the company’s compliance to standards of corporate governance. The corporate governance standards are captured in the King IV Report on Corporate Governance for South Africa (IFAC, 2019).

4.2.2 Auditor rotation rules

The Companies Act of 1926, which was built on the foundations which were put in place in England, was the first company legislation in South Africa (DTI, 2003:4). This act contained no requirements for auditor or audit firm rotation. The Companies Act of 1973 replaced the Companies Act of 1926 and remained in force until 31 April 2011. Originally the new act also made no reference to auditor or audit firm rotation, but Section 30 of the Corporate Laws Amendment Act, no. 24 of 2006 stated that the following section was introduced in the Companies Act of 1973, after section 274:

> **"Rotation of auditors.**
> **274A.** (1) The same individual may not serve as the auditor or designated auditor of a widely held company for more than five consecutive financial years.
> (2) Where an individual has served as the auditor or designated auditor of a widely held company for two or more consecutive financial years and then ceases to be the auditor or designated auditor, the individual may not be appointed again as the auditor or designated auditor of that company until after the expiry of at least two further financial years."

The above amendment established that audit partners need to be replaced after five years, with a two-year cooling-off period. This rule also relates to the presumed independence of an auditor.

Section 92 of the Companies Act 71 of 2008, which was effective from 1 May 2011, included the same requirements as set out in Section 274A of the previous Act. Section 92 however added that, "if a company has appointed two or more persons as joint auditors, the company must manage the rotation required in this section in such a manner that all of the joint auditors do not relinquish office in the same year".

In addition to the Companies Act, the SAICA Code of Professional Conduct (COPC) sets out principles of ethics for professional accountants. The layout of the SAICA COPC was discussed in Chapter 2 together with auditor independence; this chapter will however focus specifically on independence requirements that relates to audit tenure. As mentioned in Chapter 2, SAICA is a member of the IFAC and adapted the IESBA Code which is an ethical code issued by the IFAC in collaboration with the IESBA (IFAC, 2019). Therefore, the mandatory partner rotation requirements require an auditor not to act as key audit partner for a period of more than seven cumulative years with a cooling-off period dependent on the role

the auditor exercised. As was mentioned in Chapter 3, the cooling-off periods are provided in paragraphs R540.11 to R540.19 and range from two to five years depending on an individual's role. Paragraph R540.19[28], which contain the transitioning provision, notes that where a "regulatory body has established a cooling-off period for an engagement partner of less than five consecutive years, the higher of that period or three years may be substituted for the cooling-off period of five consecutive years … provided that the time-on period does not exceed seven years" (SAICA, 2018a:148).

Thus, if the above-mentioned acts are read together, the current position in South Africa on audit partner rotation is as follows: An audit partner will be replaced after five years with a two- or three-year cooling-off period due to the transitioning provision. The three-year cooling-off period will be implemented in the following circumstances:

a) If the individual served as the engagement partner for four or more cumulative years (R540.11 and R540.14);
b) If the individual was responsible for the engagement quality review for four or more cumulative years (R540.12 and R540.15); or
c) If the individual served in a combination of engagement partner and engagement quality control review roles for four or more cumulative years and has been the engagement partner for three or more years (R540.16).

Any other circumstance requires a two-year cooling-off period.

With regard to MAFR, the IRBA board resolved at its meeting in July 2016 that the appropriate measure to improve the independence of auditors would be MAFR (IRBA, 2017:2). This rule, which will take effect for financial years commencing on or after 1 April 2023, put forward the following requirements as captured by Agulhas (2017:1), and mentioned in Chapter 1:

1. An audit firm shall not serve as the appointed auditor of a public interest entity for more than 10 consecutive years.
2. Thereafter, the audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years.

[28] "Paragraph 540.19 shall have effect only for audits for periods beginning prior to 15 December 2023. This will facilitate the transition to the required cooling-off period of five consecutive years for engagement partners in jurisdictions where the legislative body has specified a cooling-off period of less than five consecutive years" (SAICA 2018a:202). In South Africa the Companies Act requires a cooling-off period of three years, thus less than five years which indicates that the transitional provision will apply.

Prior to the establishment of the MAFR rule in 2016 the IRBA issued board notice 138 of 2015 in the Government Gazette Nr 39475 of 4 December 2015 with the intention to strengthen auditor independence. This notice made it compulsory for audit reports on the annual financial statements of PIEs to disclose the number of periods that the audit firm has been the external auditor of the entity. This rule applied to audit reports issued for periods ending on or after 31 December 2015.

Table 15: Legislation regarding MAFR in South Africa

Time	Relevant provisions
2006-2015	• Audit partner replaced after five years, with a two-year cooling-off period.
2015-2019	• Audit partner replaced after five years, with a two-year cooling-off period. • **Mandatory disclosure of the number of years which an audit firm has been the auditor of the entity in audit reports.**
2019-2023	• Audit partner replaced after five years, **with a two- or three-year cooling-off period**.
2023- …	• Audit partner replaced after five years, **with a cooling-off period between two and five years.** • **MAFR: "10-year" rule; with a five-year cooling-off period.**

* Changes in legislation are noted in **bold** font.

4.3 Objectives of MAFR in South Africa

Before discussing the disadvantages of MAFR, it is important to establish the goals IRBA has with this new rule. In this section the objectives which the IRBA communicated will be discussed briefly because in the end the success of this rule will be measured against its ability to achieve these objectives.

As noted in Chapter 1, the IRBA articulated three objectives, namely:

- Primary: To strengthen auditor independence with the aim to improve audit quality;
- Secondary: To address the concentration of the audit market; and
- Secondary: To promote transformation in the audit profession (IRBA, 2017:5).

The next few paragraphs will elaborate on each of these objectives.

4.3.1 Strengthen auditor independence

The IRBA (cited by Harber & Marx, 2020:2) considers the main reason for corporate failure to be misconduct by management, together with insufficient auditor independence. It is believed that audit quality is compromised because of impaired auditor independence and consequently inadequate professional scepticism by auditors. The IRBA fears that auditors have become too familiar in their relationship with clients, especially larger exchange-listed companies (IRBA, 2017:19). Thus, the IRBA introduced MAFR with the hope to strengthen the believed to be weakened auditor independence to ultimately enhance audit quality. The IRBA rationalised this familiarity fear with examples of these close relationships. The examples were provided in a table that identified JSE listed entities who have audit tenures exceeding 50 years in the 2016 financial year (IRBA, 2017:6). This table is provided and was expanded by the author to also include the audit tenure disclosed in the 2020 annual financial statements of the respective companies, below.

Table 16: JSE listed entities with long audit tenures in 2016 (IRBA, 2017:6, adapted)

JSE listed company	Audit firm 2016	Audit tenure 2016	Audit firm 2020	Audit tenure 2020
Murray & Roberts	Deloitte	114 years	PwC	1 year
Naspers Limited	PwC	101 years	PwC	105 years
Barloworld Limited	Deloitte	98 years	EY, SNG-GT & S Sithebe	1 year
AECI Limited	KPMG	91 years	Deloitte	3 years
Santam Limited	PwC	87 years	PwC	92 years
Woolworths Holdings Limited	EY	84 years	EY	88 years
Sappi Limited	Deloitte	80 years	KPMG	4 years
Tongaat Hulett Limited	Deloitte	78 years	Deloitte	82 years
Oceana Group	Deloitte	74 years	Deloitte	77 years[29]
Anglo Gold Ashanti	EY	73 years[30]	EY	77 years
Distell Group Limited	PwC	71 years	PwC	75 years
Pioneer Foods	PwC	69 years	Delisted 2020	Delisted 2020
Crookes Brothers Limited	Deloitte	68 years	Deloitte	72 years
Remgro Limited	PwC	68 years	PwC	72 years

[29] In both 2018 and 2019 Deloitte disclosed an audit tenure period of 76 years.
[30] IRBA reported a tenure of 72 years, although the annual financial statements reported a tenure of 73 years in 2016.

York Timber Holdings	KPMG	67 years	PwC	2 years
Harmony Gold	PwC	66 years	PwC	70 years
Hulamin Limited	PwC	66 years	EY	3 years
ELB Group Limited	KPMG	64 years	BDO	1 year
Quantum Foods Holdings	PwC	53 years	PwC	58 years[31]
Standard Bank Group	KPMG and PwC	54 years[32]	KPMG and PwC	58 years
Trans Hex Group Limited	PwC	51 years	Delisted 2019	Delisted 2019

The above table shows that a few of the JSE listed companies (those whose last column is filled with green) who had long tenures in 2016 rotated auditors in recent years. In order to comply with the retrospective application of the MAFR rule, mentioned in Chapter 1, a few PIEs already started to appoint new auditors prior to the effective date of the MAFR rule; this can also be observed in the sample JSE listed companies recorded in the table above. Nagy (2021) reported that 43% of JSE listed companies[33] voluntarily rotated auditors since 2017; 40% of these companies reported MAFR to be the reason for the rotation. Thus, it can be estimated that approximately 17% (40% times 43%) of the JSE listed companies opted for early implementation of MAFR up and until 2021. On 1 April 2019, it was stated that "almost double the normal rotations that happened before MAFR" occurred after the announcement of the rule in 2017 (Chauke, 2019). The early adoption of this rule together with rotations that took place for other purposes will cause fewer PIEs to be impacted by the effective date in 2023.

Nagy (2021) states that the "continuous and steady early adoption of MAFR by companies, indicates that audit committees are paying greater attention to the independence of their auditors". Opponents of MAFR may argue that the early adoption merely indicate that companies are attempting to reduce uncertainties mandatory auditor rotations might create in 2023. The findings of Ndaba (2021:469) supports this idea when the participants agreed that South African auditors already display the required independence and that MAFR provides no guarantee to strengthen auditor independence. Nagy (2021) mentions that April 2023 was

[31] The audit tenure disclosure in the independent auditor report of 2016 and 2017 is not perfectly in line with the tenure periods provided from 2018 onwards.
[32] IRBA reported a tenure of 53 years, although the annual financial statements reported a tenure of 54 years in 2016.
[33] Nagy (2021) referred to the companies listed on the main board of the JSE and did not consider companies listed on the Alternative Exchange (AltX).

chosen by the IRBA as the implementation date amongst other things to provide auditors and PIEs time to prepare for MAFR. This confirms that early adoption cannot only be seen as enhanced attention given to independence by audit committees, but that planning, and precaution are probably more accurate reasons for early adoption.

4.3.2 Addressing audit market concentration

Bleibtreu and Stefani (2018:2) mentioned that the highly concentrated audit market is frowned upon by regulators. Regulators, like the IRBA, are concerned about the risk that the loss of an auditing firm would have on their country's economy (Harber & Marx, 2019:5). The loss of an auditing firm would impact the availability of auditors and the stability of the financial market if the audit market is highly concentrated (Bleibtreu & Stefani, 2018:2). Furthermore, the belief exists that audit quality could be compromised in oligopolistic markets (markets with limited competition) because of the limited choices clients have due to limited competition (Bleibtreu & Stefani, 2018:2). The audit market concentration is an international phenomenon believed to be caused by "economies of scale" and "prior mergers of audit companies" (Velte & Stiglbauer, 2012:156). Choi *et al.* (2017a:1) mentioned that the increase in regulations for listed companies contributed to the withdrawal of smaller audit firms from the audit market of listed companies. The increasing demand for high-quality and complex audits gave rise to the Big 4[34] audit firms in the market and made it difficult for new audit firms to enter the audit market (Wesson, 2021:3).

The audit market concentration is usually measured by the concentration ratio (CR) (Wesson, 2020:4). According to Velte and Stiglbauer (2012:149) an oligopoly is considered to exist when three or less audit firms have a combined market share beyond 50% or if five or less audit firms have a combined market share exceeding 66.6%. Wesson (2020:5) reports that in 2016 the number of JSE-listed companies whose audit reports were signed off by South African engagement partners and were audited by the Big 4 exceeded 90% and made out 94% of the total audit fees spent by companies listed on the JSE. This shows that an oligopoly is present in the South African economy.

According to the IRBA (cited by Harber & Marx, 2019:2) MAFR would be able to decrease the audit market concentration and hedge against possible problems a highly concentrated audit market creates. For example, the IRBA intends to create a more competitive environment by providing additional opportunities through MAFR for smaller audit firms to tender for the audits

[34] KPMG, Deloitte, PwC and EY.

of PIEs and also aims to lower the risk which a loss of one auditing firm would have on the South African economy (Harber & Marx, 2019:5).

4.3.3 Promote transformation in the audit profession

Black economic participation is continuously emphasized in South Africa. This is evident from the introduction of the Broad-Based Black Economic Empowerment Act which was effective from 2004 (Acemoglu *et al.*, 2007:22). The Broad-Based Black Economic Empowerment (B-BBEE) programme provides a framework to support the transformation of the South African economy. The IRBA emphasised the need for transformation by pointing out that, of the 4283 registered auditors in South Africa, 74.8% are white and only 10.5% are black (IRBA, 2017:10). Furthermore, the IRBA states that MAFR will likely contribute towards addressing the racial imbalance within the audit profession. Thus, it is believed that MAFR will contribute towards addressing the racial imbalance within the audit profession. The IRBA (cited by Harber & Marx, 2019:5) however also acknowledge that MAFR by itself will not accomplish all the transformation targets required in the country but believes that it can help through the creation of capacity. Thus, it is believed that MAFR will contribute towards addressing the racial imbalance within the audit profession.

Harber (2018:278) found through a quantitative study that both Big Four partners and non-Big Four partners believe that MAFR will not improve transformation in the audit profession. In fact, the partners are of the opinion that MAFR will rather hinder the progression towards transformation targets of their firms. Harber (2018:279) states that “internal firm commitments and policies are the best means to improve black participation in the economy”. The results of the aforementioned study suggest that MAFR might incumber the transformation of the audit profession due to the possible reduction of audit firms’ ability to invest in existing transformation goals (Harber 2018:288). Wesson (2020:11) suggested that the transformation objectives in the audit market should rather be addressed “by considering the total audit market (and not focusing only on JSE-listed companies) to provide opportunities to small and medium-size audit firms as well as to promote the consolidation of smaller audit firms into larger mid-tier audit firms”.

4.4 Anticipated problems in South Africa

In order to identify suggested solutions to the problems the implementation of MAFR might cause, the possible problems first need to be identified. These possible problems will be identified based on other countries’ experience, prior South African research and the empirical evidence gathered during this study. In the case of problems anticipated due to the experience

of other countries, these problems will be justified by a comparison between, amongst others, the economy and audit profession of the foreign countries and those in South Africa.

i Decrease in audit quality

A possible decrease in audit quality is very concerning. In Chapter 2, audit quality was described as being dependent on the auditor's ability to *find* errors or fraud in the financial reports of a company, and to *disclos*e information in the event error or fraud is found. In the following paragraphs, possible problems caused by MAFR which influence an auditor's ability to find and/or disclose misstatements will be discussed.

Loss of client-specific knowledge

The MAFR rule creates a daunting concern that the loss of client-specific knowledge might influence audit quality negatively. Cameron *et al.* (2015:11) explained that an auditor needs a specific amount of time before the accounting systems and internal controls of their client become familiar to them. This is particularly true in case of larger, more complex clients, like PIEs (Bratten *et al.*, 2019:297). During this "learning curve" the possibility exists that an auditor might overlook material mistakes in the first few years of the engagement. The loss of client specific knowledge could limit the auditor's ability to find error or fraud and consequently decrease audit quality.

The GAO (2003:18) conducted a survey in the United States on this matter. In this survey they asked accounting firms and public companies questions about factors that they believe are important in detecting material misstatements. Among others, knowledge of the client's operations was indicated as a factor. The GAO further states that 79% of the public companies supposed that "the risk of an audit failure is higher in the early years of audit tenure". This study pointed out that the perception exists that a loss of client specific knowledge will decrease an auditor's ability to detect error or fraud.

Harber and Maroun (2020:861) conducted a similar study in South Africa and found that the perceptions in South Africa agreed to the those in the United States. During their study a few of the stakeholders' response letters which the IRBA received between October 2016 and January 2017 were inspected. The respondents were concerned about the loss of client-specific knowledge and expertise the new rule might cause and the negative effect which this might have on audit quality. Loss of client-specific knowledge was also identified as a major theme during the interviews the researchers conducted with 14 audit partners (Harber & Maroun, 2020:877). The audit partners emphasised the likely adverse effect MAFR might have

on the auditor's "ability to gain sufficiently detailed understanding of clients". One participant stated quite strongly that, although MAFR might improve the perception of independence, it promotes incompetence because of the loss of institutional knowledge.

The twelve research participants in the current study had similar concerns and identified the loss of client specific knowledge as one of the greatest negative consequences brought about by MAFR. One of the research participants noted: *One of the biggest consequences would be that risk of material misstatements. I think initially the audit opinion that is issued might not be as informed as let's say an audit firm that has been auditing this client for a few years* (1:12). The biggest concern the participants had was based on the cost implications related to additional time which has to be invested during the first few years to get a proper understanding of the business processes. One of the participants stated*: loss of knowledge in specialised areas will lead to a decrease in the quality of the audit* (12:9). Furthermore, another participant was concerned about the opportunity for fraud that could be created and which the client might act on during the first few years of an audit engagement, and stated: *I've seen in cases that, in various case studies, that when firms, when entities or businesses change their audit firms, it's very likely from certain case studies that fraud is committed or perpetrated in that first year when they rotated or the second year. So, I think the businesses, the entities, they know this, and they are using that to their benefit* (2:13). This idea is confirmed with prior research which concluded that "fraud is more likely … when there has been a recent auditor change" (Roden *et al.,* 2016:80).

Discretionary accruals as indicator of audit quality

According to Firth *et al.* (cited by Stix, 2019:18), the success (or shortcomings) of MAFR will differ between regions. Choi *et al* (2017a:13) stated that "countries with weaker legal environments generally demand lower quality audits", the reason being that there is lower pressure to comply with higher quality audits. Stix (2019:18) did a study on the effect of the newly implemented MAFR rule in the EU and created the hypothesis that MAFR might increase audit quality in EU member states with less-developed legal systems because of their believed to be lower quality audits. This hypothesis was altered into another theory, namely that MAFR will not increase the (believed to be high) level of audit quality in highly regulated member states (Stix, 2019:18). Instead, it was predicted that MAFR would decrease the audit quality in highly regulated member states because of the extra effort audit firms would encounter to adapt to the new rule (Stix, 2019:18). The empirical results however rejected the hypothesis and showed that MAFR had a slightly negative effect on audit quality of member states with low-developed legal systems (Stix, 2019:31). The results also indicated that no

significant relationship existed between audit quality and MAFR in highly regulated member states.

In the study of Stix (2019:9), audit quality was measured using the Modified Jones Model[35]. This accrual-based model measures discretionary accruals, estimated as "the actual amount of accruals minus the predicted amount of accruals" (Stix, 2019:20). Discretionary accruals are accruals which are not dependant on economic factors and are thus more susceptible to influence by management (IGI Global, 2021). If the values of discretionary accruals prove to be lower after the introduction of MAFR, it might indicate better quality accruals, and in effect also higher audit quality. Higher audit quality can be presumed if discretionary accruals are lower because it shows that an auditor probably found discrepancies which management then corrected and in effect lessened the gap between actual accruals and the predicted accruals.

Member states with higher or lower legal environments were distinguished based on a "combined index of investor protection and law enforcement" (Stix, 2019:24). The combined indexes of the member states were compared to the EU average of that index. If the index of a member state was higher than the EU average, that member state was regarded as highly regulated. The indexes were retrieved from the World Bank's worldwide governance indicators and consisted out of the "rule of law" and "regulatory quality" series (Stix, 2019:24). The "rule of law" consists out of the public's perception regarding the confidence participants in the economy have in the rules of the county. It also considers the quality of law enforcement and the occurrence of crime (World Bank, 2021b). The "regulatory quality", on the other hand, articulates the public's perception regarding the ability of the government to create and implement policies to promote the private sector's development (World Bank, 2021a).

In order to identify South Africa as either a higher or lower regulated legal environment, the same index can be used:

[35] The Modified Jones Model is the most used method to identify possible earnings management (Chen, 2010:59).

Table 17: Comparison between the EU average and South African legal environments for 2018 based on the World Bank's governance indicators

Country	Rule of law: Estimate	Rule of law: Percentile rank	Regulatory quality: Estimate	Regulatory quality: Percentile rank
EU average[36]	1.07	81.93	1.15	82.62
South Africa	-0.1 ↓	51 ↓	0.1 ↓	60.6 ↓

"Estimates" refers to the country's score on the combined indicator. This score identifies the "units of standard normal distribution, ranging from -2.5 to 2.5" (World Bank, 2021a), while the "percentile rank" refers to a country's rank among all countries included in the combined indicator. A score of 0 corresponds to the lowest rank with 100 being the highest rank. The year 2018 was used to identify South Africa as a higher or lower regulated legal environment because it was the last year used in the research conducted by Stix (2019:25) and thus the most recent available figure.

Table 17 shows that, based on the measurement used in the prior research, South Africa would be seen as a lower regulated country because both South Africa's rule of law and regulatory quality are lower than the EU average. In 2018, the South African "rule of law: estimate" was -0.1 while the EU average estimate was 1.07. Furthermore, the "regulatory quality: estimate" of South Africa in 2018 was 0.1 while the EU average estimate was 1.15. The percentile ranking of South Africa correlates with the estimate and is lower than the average ranking of the EU for both governance indicators measured. Consequently, it can be expected based on the findings by Stix (2019:25) that MAFR will have a slightly negative effect on the audit quality of South Africa because South Africa is identified as a country with a lower developed legal system based on the indicators used in this study. This conclusion is purely driven by the finding that discretionary accruals increase in lower regulated countries (or rather countries with a lower regulation rate than the EU average). The increase in discretionary accruals is a possible indicator of earnings management and accompanying lower audit quality. Whether these findings will be true in a South African context could be an interesting study to conduct a few years after the implementation of MAFR in this country.

[36] The average of the EU was calculated by adding the indicators of the 2018 EU member states and dividing the sum of the amounts by the total number of 2018 EU member states. This calculation is included in Annexure F.

Going-concern opinions as indicator of audit quality

As discussed earlier, Spain had a "9+3 year" MAFR rule between 1988-1995. The regulation was, however, abolished before the first mandatory rotation could take place in 1997. Ruiz-Barbadillo *et al.* (2009:113) used the unique setting in Spain to study the effect a MAFR rule has on auditor behaviour. Financially stressed companies' audit reports were examined in a period in which the MAFR rule was in force (1991-1994) and in a period without a MAFR rule in place (1995-2000) to compare the auditors' reporting behaviour between these periods. This study focused on whether an auditor will disclose concerns to maintain high audit quality. The sample consisted of listed companies on the Madrid Stock Exchange but were adjusted to exclude financial service and insurance companies and companies in liquidation (Ruiz-Barbadillo *et al.,* 2009:118).

Two hypotheses were created (Ruiz-Barbadillo *et al*., 2009:117):

- H1: The tendency to give a going concern modified audit opinion to financially stressed companies is greater in the MAFR period due to the *economic dependence effect*. This hypothesis illustrates the idea that MAFR might mitigate the probable adverse impact economic dependence has on an auditor's choice to issue a qualified opinion (Ruiz-Barbadillo *et al*., 2009:120).
- H2: The tendency to give a going concern modified audit opinion to financially stressed companies is smaller in the MAFR period due to the *reputation protection effect*. This hypothesis on the other hand illustrates the idea that MAFR might challenge the likely favourable effect reputation concerns have on an auditor's choice to issue a qualified opinion (Ruiz-Barbadillo *et al*., 2009:121).

The findings by Ruiz-Barbadillo *et al*. however suggests that MAFR does not influence the likelihood for the issuing of going-concern opinions. The study rather indicates that the reputation auditors want to uphold has an advantageous effect on the likelihood to issue going-concern opinions, irrespective of whether a MAFR rule apply (Ruiz-Barbadillo *et al.*, 2009:130). Although their study does not suggest that MAFR will cause an adverse effect on audit quality, it does suggest that MAFR will have no effect on audit quality[37] because of auditors' commitment to uphold the profession's reputation in Spain.

In order to make this study applicable in a South African context, the commitment of South African auditors to sustain the profession's reputation should be compared to that of Spain's

[37] It should be noted that, in this sentence, audit quality is considered to merely be the likelihood of issuing going-concern opinions when necessary.

auditors. The World Competitive Ranking (WCR), compiled by the Institute for Management Development (IMD), provides a framework that can be used to compare certain features of different countries (IMD, 2021a). The Department of Employment and Labour (2020) explained that "the IMD's WCR is an annual report that ranks the competitiveness of 63 selected countries and is recognised internationally as the leading survey of competitiveness between nations". "Management practices" are one of the features that can be used for comparisons between countries. This feature consists of "auditing and accounting practises" (IMD, 2021b:5). Spain's "management practices" were ranked at 47th out of 63 countries in 2021 (illustrated in Figure 9), while South Africa's "management practices" were ranked at 52nd out of 63 countries in 2021 (illustrated in Figure 10).

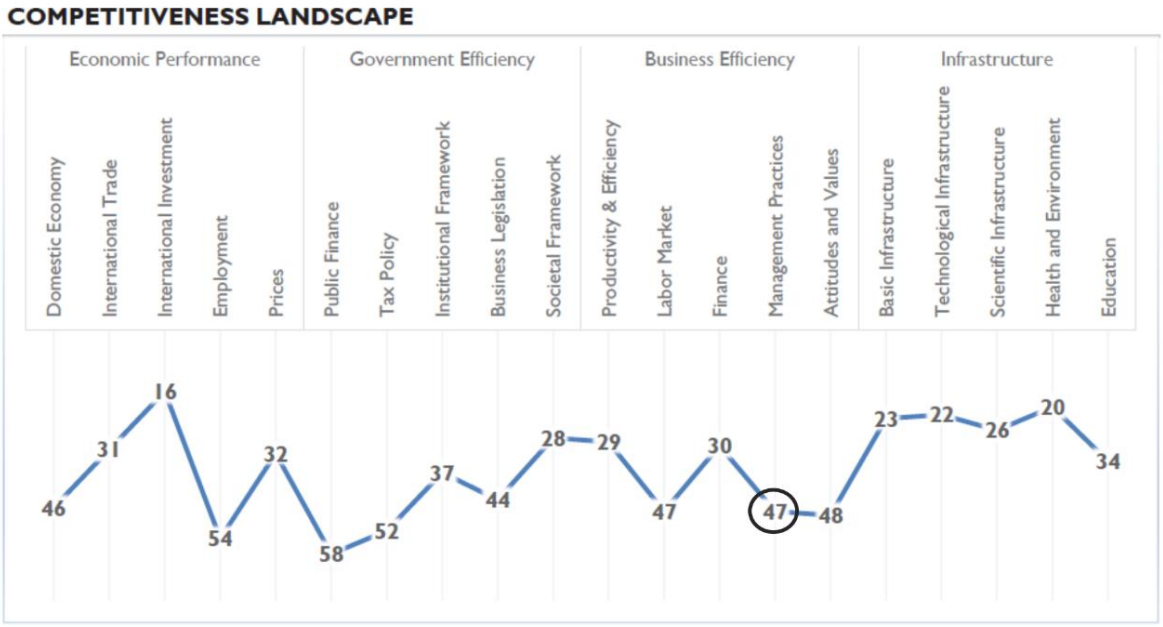

Figure 10: Spain's competitiveness landscape 2021 (illustrated by IMD [2021c:3])

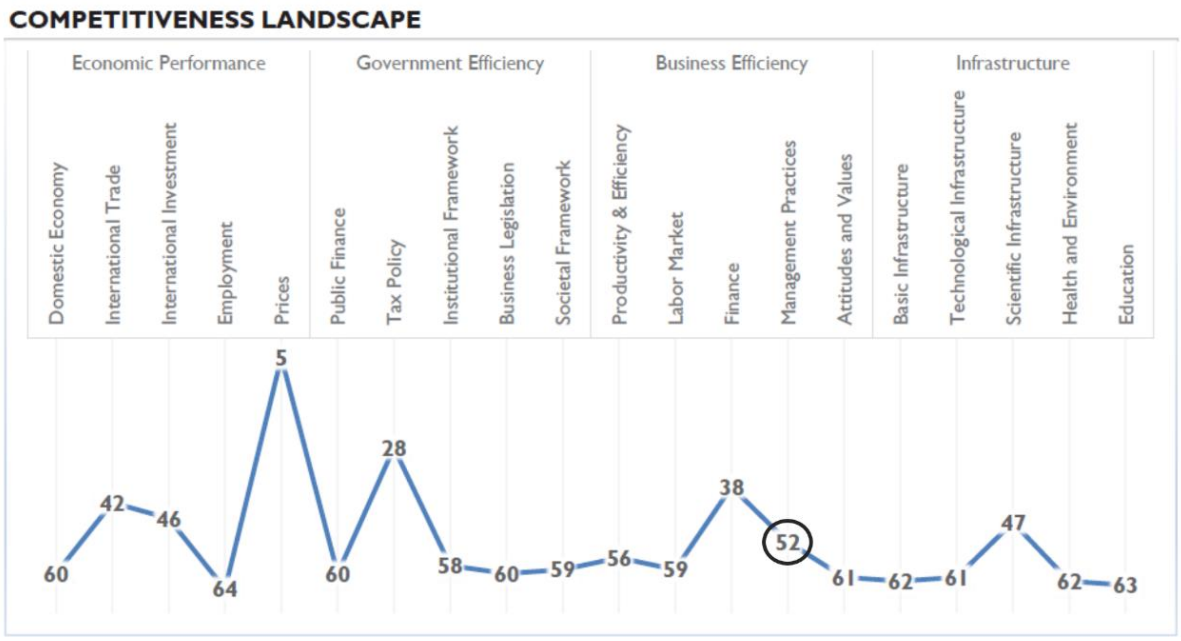

Figure 11: South Africa's competitiveness landscape 2021 (illustrated by IMD [2021d:3])

The figures above show that there was a small difference between the “management practices” ranking of Spain and South Africa in 2021. Although the “management practices” heading consists out of numerous elements, “auditing and accounting practises” also forms part of this grouping as mentioned earlier (IMD, 2021b:5). Thus, it can be concluded that the possibility exists that auditors’ reporting behaviour in South Africa might be similar to the auditors’ behaviour in Spain. Consequently, the reputation South African auditors probably want to uphold could likely have a bigger effect on the likelihood of issuing going-concern opinions in comparison to whether a MAFR rule applies. This conclusion assumes that “auditing and accounting practises” are a good indicator of auditors’ reporting behaviour, that “auditing and accounting practises” have a notable influence on “management practices” and that the 2021 auditor behaviour in Spain is consistent with the behaviour that existed from 1991-2000.

The probability that these results will be true in a South African context will only be confirmed when a similar study is conducted in South Africa. A future South African study could for instance compare the likelihood of issuing going-concern opinions in a period before the announcement of the MAFR rule in South Africa (2012-2016) to the likelihood of issuing going-concern opinions in a period after the announcement of the MAFR rule in South Africa (2017-2021). Such a study does not fall within the ambit of the current study but can be considered for future research.

Other audit quality threats identified through the empirical study

From the empirical study, two additional audit quality concerns were raised, namely divided attention of audit partners and a shortage of quality and risk management staff.

One of the research participants explained that audit quality might be compromised due to audit partners' divided attention. Audit partners will spend more time recruiting new clients and probably less time reviewing audit files. The research participant explains: *Instead of the partners spending their time now on the audit quality and on signing off the financial statements, these partners now have to go out into the market, and they need to go sell themselves (their audit firms). So, for each of those rotations, what happens is the audit firms come in and they have to do proposals. And it's not just one round of presentations and there you go. They actually need to go through rigorous processes for the bigger listed companies where they have to bring their teams, they have to introduce who's going to be on the teams, they have to get a proper understanding of the client and it takes up a lot of the partner's time. And I'm worried that these audit firms are not set up like that. I know some of the audit firms are now doing all the prepping for presentations at night because they don't have time to do it during the day. Because, they have to make time for this mandatory audit firm rotation, but they don't have enough staff. And so, there's always the risk that these firms are now going to spend too much time on selling and not enough time on the technical aspects of the audits, because they're not set up for this* (3:9).

Another concern raised by one of the registered auditors is that the quality and risk management function of the audit firm will probably experience an overwhelming workload due to the number of new clients brought about by MAFR. An increase in consultations take place with the audit teams during the first year of a new audit. The research participant stated: *Potentially also it's going to have a negative impact also on firms' quality and risk personnel, because they are going to definitely get a lot more consultations, a lot more questions if it's the first year that you are auditing a listed entity, than you would if it's the fifth year or the sixth year or whatever the case might be. So that could potentially also, is there's going to be an increased lack of capacity to address other risks within a quality and risk management department or within your quality and risk management little team that you have* (11:13). This lack of capacity might lead to a decrease in audit quality.

ii Switching costs and changes in audit fees

Switching cost refers to the cost incurred by auditors or clients due to the switching of audit firms (Fontaine *et al.*, 2016:487). It is suspected that a more frequent change in auditors will

increase costs for both the auditor and the client (GAO, 2003:27; Cameron *et al.*, 2015:11; Daugherty *et al*., 2013:30). These costs include marketing and an increase of resources during the first few years to get acquainted with the new client. Research shows contradicting evidence about who will be responsible for carrying these costs. Some research suggests that this cost will most likely be passed on to the client through audit fees; thus increasing audit fees (Kwon *et al.*, 2014:192). Contrasting this view, other research suggests that these costs will be carried by the auditor due to increased competition brought about by MAFR; which will cause audit fees to decrease (Corbella *et al*. 2015:46). Both situations, however, have detrimental effects.

Higher audit fees

Kwon *et al.* (2014:192) conducted an empirical study on audit fees and audit hours of Korean listed companies between 2000 and 2009. Consistent with the mentioned perceptions, it was found that fees in the post-regulation period of MAFR (2006-2009) were significantly higher than in the period prior to the regulation (2000-2005) (Kwon *et al.,* 2014:192). As discussed earlier, the regulators in South Korea required MAFR from 2006 up and until 2009. During this period auditors were also required to disclose audit fees as well as audit hours (Kwon *et al.*, 2014:168). These requirements created a unique setting in which the effects of MAFR could be investigated.

One of the research questions investigated in the Korean study was: “What is the impact of introducing a mandatory audit firm rotation policy on audit fees?” (Kwon *et al.*, 2014:174). It was anticipated that audit hours (and thus audit cost) would be higher in the first few years of an audit engagement to allow the auditor to become acquainted with the new client. It was also suggested that competition between audit firms might encourage low-balling[38] (Kwon *et al.*, 2014:174). The granting of an initial audit fee discount is however more probable to arise when the firm has the chance to continue as auditor of the client for a long period. If a longer audit period is expected, the initial discount can be recouped over a longer period. Petty and Cuganestan (cited by Kwon *et al.*, 2014:174) stated that MAFR will probably increase audit fees because auditors will have less time to recover the “familiarisation cost” occurred during the first few years. It should be noted that a decrease in audit fees, accompanied by an increase in audit hours, could indicate poor audit quality.

[38] Schatzberg (1990:338) describes “low balling” as an event in which auditors initially sets audit fees below their total current cost to influence clients to hire them.

The equation used to measure the effect MAFR had on audit fees in the above-mentioned research indicated that the audit fees were higher in the post-implementation period (2006-2009) (Kwon *et al.*, 2014:182). The analyses of audit hours found that MAFR changes, in the post-implementation period, had a significant audit effort increase compared to pre-2006 auditor changes (Kwon *et al.*, 2014:187). A reason for this could be the expected increase of inspections the FSS will conduct upon the initial MAFR engagement. This probably led to auditors applying more professional scepticism and consequently also more audit effort (audit hours). Furthermore, the incoming audit firm probably increased efforts in the early years of the appointment to bridge the knowledge/experience gap that existed due to unfamiliarity (Kwon *et al.*, 2014:182).

Kwon *et al.*'s study concluded that the audit quality (measured as abnormal discretionary accruals) did not significantly change in Korea due to firm rotation, but that the audit fees increased. Moreover, it was found that audit fees in the post-implementation period increased for all engagements, irrespective of whether they were continuing engagements, voluntarily auditor-rotated engagements, or mandatory-rotated engagements. Thus, the rule had a much wider effect on audit fees than merely on mandatory audit firm rotation engagements (Kwon *et al.*, 2014:192).

Another study conducted by Scott and Gist (2013:708) investigated the impact of specialisation in the audit industry and competitive pricing. That study used least square regression to test the relationship between industry specialisation and audit fees. The audit fees which Arthur Andersen's large clients (S&P 1500 companies) had to pay in 2002 after the downfall of the auditing firm in 2001, following the Enron scandal, were used as research sample (Scott & Gist, 2013). The downfall of one of the big audit firms caused a mandatory auditor change for many large clients at once (Scott & Gist, 2013:728). The hypothesis which was tested read: "There is a positive association between national industry specialisation and audit fees charged to former Andersen's largest clients, *ceteris paribus*[39]" (Scott & Gist, 2013:715). Areas of specialisation were classified by using auditing fees of the S&P 1500 companies to determine market share. The market share was calculated as "the sum of audit fees of all companies audited by an accounting firm in a given industry divided by the sum of all audit fees across all firms within the same industry" (Scott & Gist, 2013:715). The study only included audit clients who switched to one of the Big 4 firms in 2002 and who disclosed their audit fees publicly for 2001 and 2002 (Scott & Gist, 2013:718).

[39] A Latin phrase meaning; "all other things being equal" (Liberto, 2021).

It was found that the previous Arthur Andersen clients paid, on average, $582 000 more in 2002 than what they paid to Arthur Andersen in 2001. This increase in fees was larger than the average audit fee increase for clients that were not obligated to change auditors (Scott & Gist, 2013:720). One reason for this increase could have been due to the fact that previous Arthur Andersen clients chose industry specialists as new auditors. For an auditor to be regarded as an industry specialist in 2001, the auditor had to have a market share of 24%, while a market share of 30% was required in 2002. Of former Arthur Andersen clients, 45% selected an industry specialist in 2002. The reason for choosing an industry specialist is possibly rooted in the fact that experience in an industry is considered to positively influence the effectiveness and quality of an audit (Scott & Gist, 2013:727). It is implied that companies appoint industry specialists mainly to signal reporting and auditing quality to investors (Scott & Gist, 2013:730). The hypothesis was proved to be correct due to the positive relationship that was observed between industry specialisation and audit fees. Furthermore, the results showed that the Arthur Andersen clients to whom Andersen acted as an industry specialist in 2001, paid a 22.8% premium to Andersen. Similarly, the previous Andersen clients who appointed Big 4 industry specialists paid a 23.8% premium in 2002 (Scott & Gist, 2013:726). A reason for the increase in audit fee premiums paid to industry specialists could have been the loss of bargaining power former Anderson clients experienced due to the mandatory change that had to happen quickly (Scott & Gist, 2013:729). Lastly, the study concluded that, in a MAFR environment, PIEs would probably appoint a Big 4 firm when they are required to rotate auditors. This would limit the number of auditors PIEs could appoint and consequently decrease the bargaining power of clients which will lead to higher audit fees (Scott & Gist, 2013:730).

Only one research participant in the current study agreed that the switching cost will be carried by the audit client and thus lead to a higher audit fee in the first year. This research participant stated that: *So, audit fees are going to increase. We have seen this too, some firms, some large listeds in South Africa started to rotate early, a year or two ago, and everyone's experience was higher audit fees*[40] (8:21). This participant also stated that the pressure on quality in South Africa will prevent audit firms to underquote (8:23). Two other participants however noted that investors might be willing to absorb the cost if they believe that the audit quality will improve. The majority of the research participants however believed that the current South African environment will not allow for an increase in audit expenditure. One participant noted*: I think in South Africa companies are on a cost-cutting. Many companies still see audit*

[40] Translated from Afrikaans.

as a "necessary evil". I don't believe it (the audit fee) is going to get higher; I believe audit firms are also going to want to get this work, and therefore they're going to use the fees as a bargaining tool. I believe the fees will go down rather than up[41] (7:15). This notion will be elaborated on under the next section.

Lower audit fees

Contrary to the preceding discussion, the increased competition in the audit market created by MAFR might cause audit fees to decrease in the short term (Kwon *et al.*, 2014:174). EY (2011:11) shared this view, stating that audit fees might decrease in the short term after the implementation of MAFR due to fee pressures. The fee pressures will be caused by the continued competition among firms to replace the audits lost as a result of the required rotation (EY, 2011:11). An Italian study found that "the total amount of fees paid to the auditor was lower for companies audited by a Big 4 and unchanged for companies audited by a non-Big 4 audit firm" following MAFR (Corbella *et al*., 2015:46). Corbella *et al.* (2015:62) examined non-financial companies listed on the Milan Stock Exchange between 1998 and 2011. This period falls within the period MAFR regulations were present in Italy (being after 1975 when Italy implemented MAFR). Corbella *et al.* (2015:55) used multivariate regression to determine if there is a change in audit related fees or abnormal fees associated with audit firm rotation. The hypothesis of the study predicted that no relationship exists between a change in audit firm and the total/abnormal audit fees paid by the company (Corbella *et al*., 2015:51). However, the study concluded that for the companies who rotated to a Big 4 audit firm, the total audit fees paid was less in the first year after the change (Corbella *et al*., 2015:62). It seems as if Big 4 auditors discount audit fees in the first year in order to compete for new clients and thus participated in "low-balling". McGregor and Carpenter (2021:46) explains that "low-balling" in itself creates an independence issue because the auditor becomes financially invested in the company, creating a self-interest threat in order to retain the client so as to recover the investment made in the first year. Their results also showed that audit fees paid to non-Big 4 auditors mainly remained the same (Corbella *et al*., 2015:62).

A prior South African study investigated the perceptions that audit stakeholders have on the financial impact of MAFR (Harber *et al.*, 2020:215). The stakeholders included audit partners, audit committee chairs, CFOs, and equity fund managers. This quantitative study found that stakeholders believed that MAFR will increase the audit firm costs due to "setup and transition costs" and costs to prepare tenders to secure appointments. Consequently, a competitive

[41] Translated from Afrikaans.

market will cause audit fees charged to clients to rise in response to the increased costs (Harber *et al.*, 2020:226). Harber *et al.* (2020:226) however states that, if the audit market is not competitive, then a cost increase will not necessarily lead to increased audit fees. Tables 18 and 19 contain a summary of the participants' perceptions towards audit cost and fee related statements.

Table 18 indicates that the participants strongly agreed that MAFR will require more resources for auditing firms, and thus lead to higher audit cost (statement 1). The participants felt neutral (did not agree or disagree) about the statement that audit firms would pass the cost increase to their clients through higher audit fees (statement 2). Furthermore, non-audit services and new audit appointments were not deemed to offset the increased cost (statement 3 and 4).

Table 18: Perceived effect of MAFR on audit costs (drafted by Harber *et al.* [2020:224])

Statement	1 = Strongly agree 3 = Neutral 5 = Strongly disagree	Auditors Mean	AC chairs Mean
1.	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.	1.44***	1.51***
b.	Activity: Additional meetings both locally and internationally with management.	1.43***	1.59***
c.	Activity: Additional time spent on understanding the business and industry.	1.41***	1.39***
d.	Activity: Additional industry specialist involvement including technical input.	1.49***	1.49***
e.	Activity: Marketing and proposal (tendering) presentation costs.	1.43***	1.56***
f	Activity: National and international travel costs.	1.76***	2.05***
2.	Increases in costs will be passed on to companies in the way of increased audit fees.	2.50***	1.95***
3.	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.	3.36***	3.2
4.	Any financial losses incurred by the audit firm due to MAFR will be sufficiently offset by new client appointments.	3.79***	3.1

One of the costs that will increase due to the MAFR regulation is tendering cost. The increase in tendering cost poses a threat that auditors might be more concerned about acquiring the client than making a profit in the early years of the engagement (Harber *et al*., 2020:219). This threat is strengthened by the financial consequences unsuccessful bids will have (Harber *et al*., 2020:229). Table 19 contains the perceived percentage of first year's audit fees an auditor will incur to tender for a PIE.

Table 19: Perceived amount of tendering fees (drafted by Harber *et al.* [2020:229])

Statement			
Auditors		**Median**	**Mean**
19.	Consider the costs incurred to tender/propose for a listed company. Approximately what percentage of the first year's audit fee would these tender/proposal costs amount to?	30%	42%

The fact that auditors consider tender cost to be on average 42% of the first year's audit fees is concerning. Based on prior research findings, audit cost is considered to be more than the prospective audit fee increase (Harber *et al.*, 2020:231).

Most of the research participants of the current study agreed with the statement that audit firms would carry the switching cost and probably participate in low-balling to secure clients. One participant noted: *There is a big risk for low-balling at this stage and it will be directly linked to audit quality… They (the auditors) are going to have to absorb it, the only question is, are we going to lose audit quality because we bring in MAFR, because eventually we will have to work faster because we are working with even less money. So the obvious thing is, if you have to do 20% more procedures, the fee must be 20% more. I think unfortunately what will happen is, the work will become more, and the fee will have a small incremental increase and I think audit quality will definitely suffer* (6:28).

Some research participants noted that the investors would probably be willing to pay an increased audit fee, but that the audit committee and the senior management would most probably not agree with this sentiment. One research participant explained: *So, if your audit fee goes up by 20%, the company doesn't even feel it, it's not even on the radar of the investors. Okay. So, that's an important note… So, yes, they (the client) can absorb it but the question is as you ask: do you believe investors are willing to pay it? Yes, I believe they are. I think they're quite happy to take on 50% more audit fees, they really are. The question is to me whether the audit committee and the senior management being the CEO and the CFO in particular, so talk about the board particularly, is the board going to allow it? I think that's where the resistance will be* (4:23). Another participant agreed with this notion and stated: *The economic environment, of course makes it a lot tougher just to get any form of audit fee out. Yeah, an audit fee is a grudge purchase, particularly for a chief executive. Now if you think about it from the perspective of a chief executive... His day-to-day is selling something. You've got a R10 million audit fee end of the year transition; he sees it as an opportunity to drive prices down. Maybe the audit fee goes from ten million to nine and a half, nine million, and he's thinking to himself: "Wow, if I can save a million rand in costs, that's the equivalent of selling X number of widgets in a year…. A good CEO will try and drive prices down. And our*

CEOs in this country are very powerful and very strong. And sometimes I think too strong relative to the board. But I do think that the control of the audit fees should be taken away from management and should be the preserve of the board. And the audit committee chair in particular, should have the sole responsibility of determining the audit fee. I mean; I think that's the issue (9:7). This participant went on and explained that clients forget about the cost of a proposal and secondly, if you win the audit there is very little precedent for clients to pay the cost of the transition. The participant explained that in the UK market, non-executive directors apply a different approach and say: *"Actually, there's a bit of risk for us in this transition. We want to make sure that our auditors have the scope to do the right amount of work to understand the client. We will pay the audit firm for the onboarding, to do the systems descriptions, to do the walkthroughs, to set up their files"* (9:7). This participant warns that if the audit profession as a whole is not able to receive the right level of economic return it will limit the ability of audit firms to attract and retain talent, which links to the next adverse effect discussed below.

iii Limits the ability to attract and retain talent

A consequence of the possible decrease in profits of audit firms due to MAFR is that audit firms might cut certain costs. One of the expenses which audit firms will probably try to limit would be expenses related to recruitment. Included in this recruitment expense is bursaries which are normally awarded to financially least privileged students. Harber and Marx (2019:5) agrees by stating that audit firms will most likely reduce the budget for "bursary programmes and other transformation initiatives". There is currently no study which examines audit firms' profits post-MAFR implementation and the relationship between recruitment expenses. In order to illustrate the potential relationship between company profit and bursaries, the integrated report of Sasol Ltd, a South African based PIE, was used.

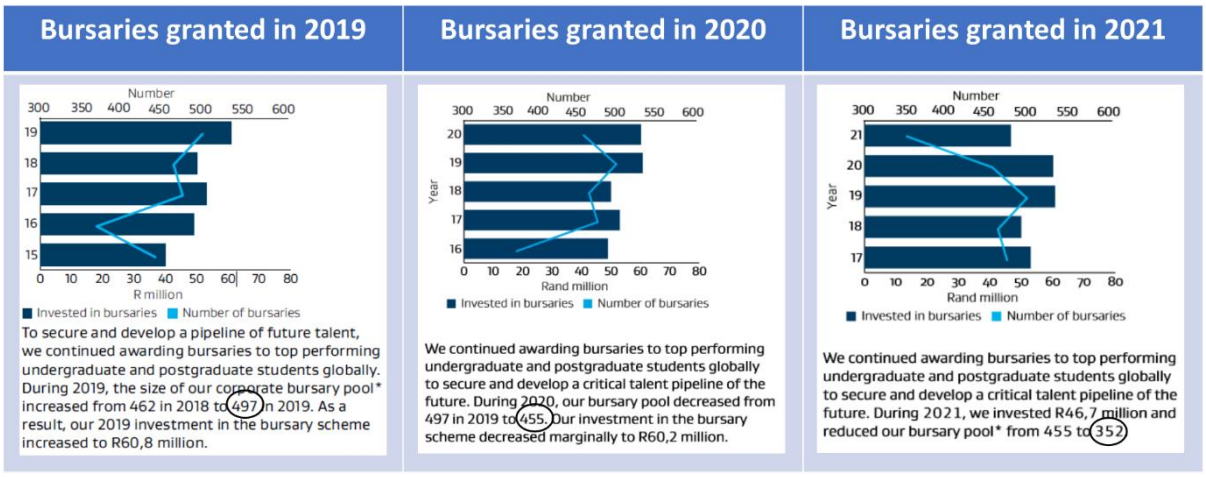

Figure 12: Sasol bursaries awarded between 2019-2021 (adapted from Sasol's integrated reports)

In 2019, Sasol invested R60,8 million in their bursary scheme and increased the size of their corporate bursary scheme to 497 students while reporting a profit of R6,074 million (Sasol, 2019:94). Sasol (2020:89) however reported a loss of R91,272 million in 2020 because of the economic impact of Covid-19 and the low oil prices. This loss impacted their bursary scheme negatively causing the size of the scheme to decrease to 455 and the investment to decline to R60,2 million. The bursary scheme felt an even bigger negative impact in 2021, although Sasol was able to restore their profit to R10,532 million in this period (Sasol, 2021:45). In 2021, only R46,7 million was invested in the bursary scheme and the size of the pool decreased to 352 students.

South African auditors share in this sentiment when they expressed their opinion that "as the profession becomes 'poorer', less investment will be available for bursaries, training, transformation initiatives, and talent retention through competitive remuneration offerings" (Harber *et al.,* 2020:223). This response suggests that, instead of contributing to the transformation objective, MAFR might instead hinder audit firms to achieve their transformation targets. Harber and Marx (2019:14) reported that audit partners strongly felt that "existing and/or improved efforts within the audit firms themselves" will support race diversity in the audit market better than MAFR. The lasting impact a decrease in profit in one year could have on bursary schemes, as Sasol disclosed, should also be kept in mind. It should however be noted that the R91,272 million loss Sasol made in 2020 is unprecedented and highly unlikely for any audit firm.

The research participants in the current study also noted that the expense audit firms will cut first when their profit decrease is training and development, recruitment including bursary schemes, staff expenditure, rent and partner bonuses. The research participants also raised concerns regarding the implications a less profitable and more regulated audit industry will have on talent retention. One of the auditing lecturers noted: *And, I think it's going to have serious implications for talent retention within public practice, within audit firms. I think Chartered Accountants like myself and the vast majority of us just want to leave audit and go into corporate or some other sector, certainly don't want to stay in audit. And this is going to exaggerate, because there is more regulation, more cost, and more risk placed on auditors* (4:17). Another research participant noted that some of the smartest individuals are drawn to the audit profession due to the remuneration. If there is a downward trend in remuneration, some of the strongest candidates might choose another career path which will decrease quality over the years (7:16).

iv Limits auditor specialisation

Another possible problem created by the increase in uncertainty for audit firms due to mandatory changes in clients is that audit firms will be unable to plan effectively (Ewelt-Knauer *et al.*, 2013:30). Consequently, the unknown audit capacity complicates the process of recruiting and allocating talented employees with specialised knowledge effectively. Specialisation is often used as a representation of auditor expertise and is gained through training and experience from auditing companies in a specific industry (Elder *et al*., 2015:77). According to BDO Seidman (cited by Lu & Sivaramakrishnan, 2010:5) MAFR might discourage the acquisition of specialisation because of audit firms' inability to target specific market segments because of routine rotations. Knechel *et al.* (2007:20) states that: "specialized knowledge in an industry has a direct effect on an auditor's ability to assess audit risks, detect errors and misstatements, and improve earnings quality". Thus, auditor specialisation can be seen as an important element necessary for quality audits.

Knechel *et al.* (2007:20) studied the effect the switching of auditors with different levels of industry expertise had on abnormal returns of SEC registered companies. Abnormal returns are defined as unexpected profits (or losses) generated by a security (CFI, 2021). In essence, abnormal returns indicate market participants' reaction to, in this case, the switching of auditors. They found that a switch between Big 4 audit firms where the successor auditor is an industry specialist[42] gave effect to substantial positive abnormal returns. However, substantial negative abnormal returns were experienced when the predecessor was an industry specialist, but the successor not (Knechel *et al.*, 2007:19). Furthermore, the biggest negative abnormal returns occurred when a company switched from a specialist Big 4 auditor to a non-Big 4 auditor. The highest positive abnormal returns occurred when a switch was made from a non-Big 4 auditor to a Big 4 auditor who was not a specialist (Knechel *et al.*, 2007:19).

Table 20: Summary of the findings of Knechel *et al*. (2007:40)

Predecessor	Successor	Market reaction
Big 4 non specialist	Big 4 specialist	Significantly positive
Big 4 specialist	Big 4 non specialist	Significantly negative

[42] In order to be classified as an "industry specialist" an auditor had to have at least 30% market share based on the percentage of clients or sales in the specific industry (Knechel *et al.*, 2007:23).

The above table illustrates the important role specialisation plays in the perception of audit quality by market participants. MAFR might either prevent audit firms from investing in the acquisition of sector specific knowledge, or it may motivate firms to specialise in more than one industry, thus decreasing market share held by certain firms without affecting audit quality (Elshawarby, 2017:1). In order to acquire knowledge during the first few years of mandatory audit firm rotation, resource strains might be experienced. For example, the number of people with knowledge about a specific industry in a firm might be limited. Boone *et al.* (2000:375) described the big auditing firms as "generalists", while smaller firms are defined as "specialist firms" being able to provide personalised services. These descriptions suggest that the bigger auditing firms have another advantage since they would probably find it easier to specialise their general knowledge towards different market segments.

Unfortunately, prior studies in countries who already implemented MAFR have not examined the effect of MAFR on specialisation amongst audit firms in a post-MAFR environment, the reason probably being that specialisation is a difficult variable to measure. Market share is not a reliable measurement of specialisation, because firms with smaller market shares might have individuals who "possess high levels of industry knowledge and expertise", thus specialising in a specific industry (Knechel *et al.*, 2007:40). Consequently, the use of market share as a measure might create misleading perceptions of the level of specialisation within an audit firm.

During the current empirical study, the research participants were asked if they believe MAFR will influence auditor specialisation in South Africa. Most of the participants agreed that MAFR will have a limited effect on specialisation in South Africa since the rotation of clients which require specialised knowledge will cause audit firms to either upskill themselves in the specific industry or recruit individuals with the knowledge from other auditing firms. One of the registered auditors from a mid-tier firm noted the importance of training and stated: *I think being from a quality perspective and a training perspective is we would have to potentially do specific training for the audit team that is now on a listed entity on the JSE requirements potentially. If it is a very complex listed entity you would have to also potentially bring in a specialist or two that can either train our people up or that can form part of the audit team as an audit expert to mitigate that negative consequences* (11:15). Another participant stated that acquiring knowledge in different industries is in line with the new CA2025 competency framework of SAICA: *I think it will limit specialisation, but I actually think it is a good thing because especially now with the new CA2025 framework, how they have been encouraging the agilities, encouraged and needing to learn, unlearn and to change and just to keep up to date. Like I think that specialisation is going to be limited, and yet it's an opportunity for the*

firms to improve and to learn. And I think it is necessary, especially with where SAICA is going with the new framework, that that is encouraged (2:22).

The only concern raised by a participant was that it will be difficult to maintain individuals with specialised knowledge in a specific industry if the audit firm loses clients due to mandatory rotation which made up the largest portion of that industry. The participant explained: *There's not a huge number of audits that requires deep specialisation. But those that do are big, right? So, you got to be a specialist. …But when you're getting into banks, when you're getting into insurers, when you're getting into regulated industries or industries that are really unique. …Those types of industries, I think then the issue of special skills does become important, the retention of those specialist skills and MAFR certainly complicates securing the people, providing a career path for those people. If you were a firm that (you know in this country there's only a number of very big banks); if you were a firm that under MAFR dominated that industry, you built your practice over a long period of time with lots of banking partners understanding credit, understanding derivatives, understanding all of that. Then under MAFR, you've got a much smaller banking portfolio. What do you do with those people? Where do they go? They've built their career on it. Now you want to keep them happy till the next cycle comes around? It's hard to do* (9:11). In line with this argument another participant noted: *If rotation is routine the process can be managed. The problem comes in where an industry has a limited client base (like construction at the moment) – there are only 2 listed construction companies left. Specialisation is there but will disappear with rotation unless teams follow the audit client which means the independence objective is lost* (12:6). The statement made by this participant again affirms the idea that MAFR might only contribute to the perception of independence and not actual independence of mind.

v Could increase audit market concentration and the market share of one firm

Harber and Marx (2019:1) found that MAFR in South Africa might not lower the domination of the Big 4 in the audit market and could in fact lead to an even higher concentrated market because audit committees and shareholders of PIEs might be unwilling to appoint smaller audit firms. A reason for the move from one Big-4 firm to merely another Big-4 firm is due to the geographical spread of international audit clients and the extensive global networks of the bigger firms. MAFR will also affect the smaller audit clients' market. Chetty (2019:4) explains that "the smaller market will have an increased audit firm rotation rate", meaning that the turnover rate will be faster, enabling bigger audit firms to penetrate the small audit client market. Likewise, a study in Poland (an EU member state) found that MAFR will not reduce audit market concentration since "the biggest capital groups will choose a firm from the Big 4"

regardless of the rotation regulation (Indyk, 2019:90).The Polish study examined the audit tenures and direction of changes in the period 2011 to 2017 between Big-4 and non-Big 4 firms of companies whose parent company was listed on the Warsaw Stock Exchange (Indyk, 2019:98). Indyk (2019:109) concluded that the big companies (which represented 66% of the analysed assets) who were audited by Big-4 firms merely appointed another Big 4 firm in the event of a change in audit firms.

By means of an analytical model Bleibtreu and Stefani (2019:1) found that MAFR will only decrease the audit market concentration if the market share of non-Big 4 audit firms were "significantly large" before the implementation of the regulation. If the market share of non-Big 4 audit firms was however small prior to the implementation of MAFR, the implementation of the regulation will further increase the market concentration (Bleibtreu & Stefani, 2019:1). Consequently, the outcome of MAFR depends significantly on the market structure prior to the implementation of the regulation and will differ between countries with different market structures (Bleibtreu & Stefani, 2019:31).

As noted earlier, in 2016, 90% of JSE-listed companies whose audit reports were signed off by South African engagement partners were audited by the Big 4 audit firms (Wesson, 2020:5). Kamolane and Odendaal (2021:90) investigated the South African audit market concentration among listed entities classified according to industries[43] for 2013, 2016 and 2019. It was found that a concentrated market exists in all the industries and that five of the industries were dominated by PwC while Deloitte dominated one of the industries (Kamolane & Odendaal, 2021:90). Table 22 contains a summary of these findings:

[43] The industries were based on the industry classification list for JSE-listed companies acquired from the JSE (Kamolane & Odendaal, 2021:82).

Table 21: Number of companies audited by Big 4 and non-Big 4 firms per industry (Illustrated by Kamolane and Odendaal [2021:84])

Industries	2013		2016		2019	
	Companies	Audited by Big 4 / non-Big 4 firms	Companies	Audited by Big 4 / non-Big 4 firms	Companies	Audited by Big 4 / non-Big 4 firms
Basic Materials	27	24	31	28	32	24
		3		3		8
Financials	56	39	81	58	94	63
		17		23		31
Industrials	48	26	52	27	49	28
		22		25		21
Consumer Goods and Services	40	32	46	37	58	47
		8		9		11
Telecommunications and Technology	20	12	21	14	22	12
		8		7		10
Healthcare	6	4	8	5	8	6
		2		3		2
Total	**197**		**239**		**263**	

The table above indicates the number of listed companies, per industry, that is audited by the Big 4 and non-Big 4 firms respectively. The table shows that in 2013, 70% of the companies in these industries were audited by Big 4 audit firms, in 2018, 71% and in 2019, 68%. The findings of Bleibtreu and Stefani (2019:31) suggest that the implementation of MAFR in South Africa will increase rather than decrease the audit market concentration. The market share of non-Big 4 audit firms in South Africa are currently too small for MAFR to have a positive impact on the high market concentration in South Africa.

The empirical evidence of the current study also indicates that MAFR will not likely improve the market concentration in South Africa. Most of the participants believed that the mid-tier audit firms do not have the technical skills, resources, or the knowledge to audit big, listed companies. Thus, listed entities will just rotate between the Big 4 firms. One participant noted: *I think in any case your bigger clients prefer to go to your bigger audit firms and also the ISAs say if you don't have sufficient resources then you should not undertake the audit of a specific client* (1:27). Furthermore, some of the participants noted that the perception of quality that is linked to the Big 4 audit firms will discourage the change to a non-Big 4 auditor due to the accompanying risk. One participant stated: *So, eventually, I don't know if we will necessarily get to a point where we expand to other audit firms in any case, because there is a risk from the management that we might lose the trust of our shareholders* (6:35). Another participant agreed and said: *At the end of the day the clients and the audit committee of the client picks the external auditor. And they, I can guarantee you, are going to feel that the other Big 4 firms are more competent to audit them. Because like I said previously, these are listed entities. These are public interest entities. And to incentivise an audit committee of a listed entity to pick a non-Big 4 audit firm, how are you going to do that? I don't think it's going to go there.*

So, I think this whole market concentration objective of MAFR, I think they're going to miss the boat there (5:24).

One participant however noted that BDO and SNG-Grant Thornton have expanded rapidly in South Africa over the last few years, possibly to compete against the Big 4 for PIEs. The participant noted that: *Do I think that it's (MAFR) going to be effective in decreasing concentration? Yes, in the bottom half, the smaller half of the JSE listed companies, and in some of the private companies or non-listed companies. But on the larger end of the JSE, say the top 100, the top 80 or the top 50 on the JSE, I don't think so. I think that they're going to stay within the Big 4 and like I said it's going to be a game of musical chairs around the Big 4* (4:29).

One of the registered auditors concluded that, even if clients move to mid-tier audit firms, the individuals that form part of the audit market will not change. The mid-tier firm will recruit specialists from the market since they do not have the time to train and develop their own specialists. The participant stated: *We have seen this with mid-tier firms that have already started getting work based on MAFR. They are buying into that specialisation. Not buildable, it takes too long to build it up. If you want to grow a tree, you should have started growing it 20 years ago. And in an audit specialisation it is too expensive to grow a tree for 20 years. And that specialisation is bought in… What's going to happen is, PWC's people are just going to move over to, let's say the guys that come in are SNG. So, half of PWC's 5000 people will just go to SNG. So, SNG is going to be the new name within the Big 4. And PWC is going to be the fifth one. But the concentration did not change. So, it's that old story of "moving the deck chairs on the titanic". MAFR cannot stop concentration in South Africa. Our market is simply too small. We are just going to get a migration of people* (8:28).

It should also be noted that Francis *et al.* (2013:350) concluded that the dominance of the Big 4 audit firms does not harm audit quality, but that the concentration within the Big 4 is found to be a problem. This suggests that regulators should rather be concerned about the dominance of an individual Big 4 firm in order to improve audit quality. Wesson (2020:8) did research on the market concentration within the Big 4 in South Africa between 2010 and 2018. It was found that in 2018, PwC had "a market share of 25% of JSE audit clients and a share of 53% in the assets and market capitalisation of the market". Consequently, PwC met the criteria of a monopoly position[44] in the South African market. PwC's market share increased

[44] A monopoly is present when one audit firm has a market share above 33.33% (Velte & Stiglbauer, 2012:149).

over the period (2010-2018) and suggested that PwC was appointed by larger JSE clients between 2015 and 2018. As mentioned earlier, the audit firm rotations after 2017 could be seen as early implementation of MAFR. This points out that MAFR might increase the market share of one firm and consequently increase the risk of poorer quality audits as discussed by Francis *et al.* (2013:350). Kamolane and Odendaal (2021:90) confirms PwC's high market share by noting that PwC significantly increased its dominance in five of the six industries listed on the JSE between 2016 and 2019, as noted above.

The research participants had mixed views regarding MAFR's influence on the dominance of a specific Big 4 audit firm. Some of the research participants believed that MAFR will not worsen or improve the dominance of a specific big-four audit firm. On the other hand, other research participants believed that MAFR will help to ease out dominance between the Big 4 audit firms. One participant explained: *I think that will be a bit of an equalizer… So now, when they have to move away from PwC, they're not all going to go to KPMG or EY or Deloitte. They might go to different ones. So, I think within the Big 4, there might be a bit better distribution, but you don't know. I mean, the other thing is after ten years, are they just going to go back to the PwC or wherever they came from. And then it just goes back. For ten years, you're going to have this swap around. Or for like ten years it might be a bit more diversified. And then the next ten years, it just goes back to what it was* (5:25). Another participant had a similar view and noted: *So, what's going to happen in my opinion, it's just a case, it's just logically, it's just rational. If all the clients of the Big 4 have to take their audits to the market, or at least a majority of them that are required to under the regulation, that is going to have the impact of evening out the spread of the larger companies amongst the Big 4. So, you're going to see the three of the Big 4, the Deloitte, EY and KPMG, increase their market share relative to PwC. That's what I think is going to happen. But it's very important to note, I believe that's only going to happen with the larger multinational listed companies on the JSE. Like I said, when you come to the smaller (I don't know where the cut-off line will be), but the smaller of the JSE listed companies, I do think there will be a general all round deconcentration of the market, because I think BDO and SNG-Grant Thornton are going to be a contender for appointment, for that part of the market* (4:30). Consequently, it is difficult to predict the effect MAFR will have on the dominance of a specific Big 4 audit firm.

Lastly, the likely causes of the global phenomenon of a highly concentrated audit market will be discussed briefly. The success of a regulation addressing the concentrated market can be measured against the regulations' ability to address one or more of the root causes of this problem. Causes for the high concentration in the audit market includes: (1) the globalisation of companies and economies of scale; (2) the reputation or brand power of the Big 4; (3) the

complexity of accounting standards; (4) industry-specific skills; and (5) infrastructure (Mališ & Brozović, 2015:340; Kamolane & Odendaal, 2021:79). These features create barriers to medium-sized audit firms to enter the market. It should be noted that MAFR will not be able to directly address any of these barriers. Consequently, and in line with prior studies discussed above, it will be highly unlikely for the MAFR regulation to decrease audit market concentration in South Africa.

vi Limits the audit committee's ability to determine the best audit firm for the company

In order to conclude on the effect MAFR will have on an audit committee's ability to determine the best suited audit firm, the factors used to select an auditor first need to be examined. Olowookere (2018:153) determined through surveys and the use of the "logistic regression model" the factors which serve as determinants in choosing an external auditor in the Nigeria Deposit Money Banks. As discussed earlier, Nigeria introduced mandatory audit firm rotation for banks in 2006 and mandates the rotation of external audit firms after 10 years. The data used in the study was collected after 2015 and therefore consists of data collected in a post-MAFR period (Olowookere, 2018:158). Olowookere (2018:158) found that the most important factors influencing the choice of external auditors are:

- the status of the auditor (whether it is a Big 4 audit firm or not);
- the technical accounting skills; and
- the long-term relationship with the current auditor.

Another study in Nigeria analysed the determinates used by "listed Global Brand[45] companies" in choosing external auditors (Inua & Urhoghide, 2018:47). Inua and Urhoghide (2018:47) also found that companies with a larger asset base are more prone to selecting Big 4 audit firms as auditors, but their study concluded that a higher audit fee will discourage a company to select a Big 4 firm. Consequently, the audit fee is listed as a fourth determinant.

In South Africa the same factors will likely be the major determinants in deciding which external auditors should be used. Both South Africa and Nigeria are relative economic powerhouses in the African continent. Both countries are listed as developing countries in 2022 with their Human Development Index (HDI) being below 0.8. A wide range of aspects is used in the calculation of a country's HDI including "economic growth, life expectancy, health, education, and quality of life" (World Population Review, 2022).

[45] Global brand companies are defined as having "the characteristics of exporting their products and services outside the shores of Nigeria" (Inua & Urhoghide, 2018:43).

When thinking about the listed determinants, MAFR will probably impact three of the four determinants. Firstly, the technical accounting skills of the auditor might be impacted if for example, the company is highly complex in nature and specialised knowledge is limited to their current auditor. Kamolane and Odendaal (2021:90) articulates this problem by stating that “the dominance of individual Big 4 audit firms in certain industries pose a significant challenge to the implementation of MAFR and risk of disruption in the audit market due to the increasing number of initial audits, where firms would not have gained the necessary client knowledge”. As discussed earlier, a lack of knowledge by the auditor will pose a threat to audit quality. Another determinant which will be influenced by MAFR is the long-term relationship with the current auditor; this is clear since the MAFR regulation requires regular rotation of auditors. Comfort rather than quality is influenced by affecting this determinant. Lastly, the debatable fee increase or decrease due to the new regulation might cause companies to choose audit firms with lower audit fees, but who also delivers lower audit quality. This risk however exists regardless of MAFR.

Only the loss of “technical accounting skills” and a possible fee increase will likely cause a limitation on the audit committees’ ability to choose the best audit firm for their company. This opinion is supported by the review done by Ewelt-Knauer *et al.* (2013:30) which states that two of the Big 4 firms noted that MAFR limits the choice of audit firms and consequently force companies to choose external auditors with less industry experience and specialisation as their existing auditors (PwC, 2011; Ernst & Young, 2011).

Furthermore, McGregor and Carpenter (2021:33) tested the impact the new regulation might have on the ability of directors from companies to discharge their statutory duties in accordance with the Companies Act. It should be noted that in terms of Section 90 of the Companies Act of South Africa (2008) the audit committee (consisting of directors with “adequate knowledge and experience”) is responsible for nominating an auditor which the shareholders need to approve at the annual general meeting. Section 76 of the Companies Act of South Africa defines the “standards of directors conduct”. These standards state that directors should act “in the best interest of the company”. McGregor and Carpenter (2021:35) found that MAFR could cause directors to act in a manner that is not in the best interest of the company. This could be due the fact that the appointment of new auditors could lead to a higher amount of time being spend by the company to explain the business process to the new auditor and consequently also the acceptance of higher audit fees. McGregor and Carpenter (2021:37) however concluded that these reasons do not in itself create valid grounds for a breach of statutory duties. Instead, if directors fail to abide by the MAFR requirement they would breach Section 94 of the Companies Act of South Africa which

requires the audit committee to nominate an auditor who is independent of the company being audited (McGregor & Carpenter, 2021:37). McGregor and Carpenter (2021:38) however also made mention of Section 29 of the Companies Act of South Africa namely that "financial statements prepared by a company must not be false or misleading". It is believed that an independent auditor who deliver audits of a high quality will help directors of a company to produce financial statements according to reporting standards (McGregor & Carpenter, 2021:38). If the MAFR regulation influences audit quality, directors might be unable to rely on the auditor's opinion and may consequently fail to comply with Section 29 of the Companies Act of South Africa. Thus, the MAFR regulation will cause directors to breach their fiduciary duties, and not act in the best interest of the company, if they do not comply with the MAFR requirements or if they provide financial statements that are false or misleading (McGregor & Carpenter, 2021:48).

Most of the research participants did not deem MAFR as a regulation which would limit the audit committee's ability to select the best audit firm for the company. However, three research participants in the current study felt that the South African audit market is not large enough to enable audit committees to select the best suited audit firm for the company in a MAFR environment. One of the participants noted: *The audit committee has very strict measures and a great responsibility. So, they have to make sure they trust the auditor, that the auditor is the best one at the best fee, because at the end of the day they are going to be held responsible for this appointment (or partly responsible). So, definitely it ties your hands. If you believed that holding auditor was the best auditor, and now you are forced to walk away from him, you may now also be forced to choose your second or third best choice simply because of the legislation... It felt to me that your audit committees are going to have a difficult task to appoint auditors with whom they feel 100% comfortable in some cases*[46] (7:25). One of the other research participants noted that: *A large number of individuals on audit committees resigned because of this because they said, "how am I going to fulfill my fiduciary responsibility to do the best for the company if you don't give me the tools to select the best firm for the company i.e., to appoint whom I want to appoint"* (8:33).

4.5 Conclusion

This chapter satisfied the third secondary research objective {SRO3} by discussing the potential negative consequences the implementation of MAFR might have in South Africa. Firstly, a historical outline of auditor rotation rules in South Africa was given and it was noted

[46] Translated from Afrikaans.

that prior to 2023, only audit partner rotation requirements existed. Thereafter, an analysis was made of the three objectives the IRBA articulated for MAFR. Primarily the IRBA believes that MAFR will improve auditor independence and consequently also audit quality. The long audit tenures displayed by some of the JSE listed companies, creates a familiarity fear the IRBA wants to address with MAFR. The secondary goals, namely addressing the concentration of the audit market and promoting transformation in the audit profession are based on the belief that audit quality could be compromised in markets with limited competition due to the limited choices. It was found that an oligopoly is present in the South African audit market. The IRBA believes that MAFR will create additional opportunities for smaller audit firms to tender for audits and consequently contribute to a more competitive environment. Partners of audit firms are of the opinion that MAFR will not contribute towards addressing the racial imbalance within the audit profession and believe that this problem will be addressed better through internal firm policies. This outline of the purpose of the new regulation creates a benchmark against which the possible effect of MAFR can be measured.

Secondly, the anticipated problems that audit firms and clients might face in the wake of the implementation of MAFR in South Africa were deliberated on. Much of this was based on the experiences in countries which introduced MAFR before South Africa. Six main problems that MAFR might create were identified, namely: i) Decrease in audit quality, ii) High switching costs, iii) Limits the ability to attract and retain talent, iv) Limits auditor specialisation, v) Could increase audit market concentration and the market share of one firm and, vi) Limits the audit committee's ability to determine the best audit firm for the company.

A possible decrease in audit quality is very concerning. The MAFR rule creates a concern that the loss of client-specific knowledge might influence audit quality negatively since it could limit the auditor's ability to find error or fraud. Research participants in the current study identified the loss of client specific knowledge as one of the greatest negative consequences brought about by MAFR. Furthermore, two additional audit quality concerns were raised through the empirical study, namely divided attention of audit partners and a shortage of quality and risk management staff.

The literature study revealed that audit fees in some countries were significantly higher after the introduction MAFR. This was caused by the increased audit hours needed during the first few years of an audit engagement in order to gain an understanding of the clients' business processes. On the other hand, the occurrence of low-balling might increase if audit firms grant initial audit fee discount in order to secure a client. The research participants of this study believe that audit firms in South Africa will carry the switching cost and probably participate in

low-balling to secure clients. Low-balling however creates independence issues due to auditors becoming financially invested in the client, which creates a self-interest threat in order to retain the client to recover the loss made in the first year. The research participants in the current study also noted that the expenses audit firms will cut first when their profit decrease is training and development, recruitment including bursary schemes, staff expenditure, rent and partner bonuses. The research participants also raised concerns regarding the implications a less profitable and more regulated audit industry will have on talent retention. It was stated that chartered accountants will probably leave the auditing sector and that it will become difficult to per sway smart individuals to adopt a career in the auditing profession if there is a downward trend in remuneration.

Furthermore, MAFR can complicate the allocation of talented employees with specialized knowledge due to the increase in uncertainty audit firms might experience due to mandatory changes in clients. However, most of the current study's research participants believes that MAFR will have a limited effect on specialisation in South Africa. They trust that the rotation of clients which require specialised knowledge will cause audit firms to either upskill themselves in the specific industry or recruit individuals with the knowledge from other auditing firms.

A prior study found that MAFR will only decrease the audit market concentration if the market share of non-Big 4 audit firms were "significantly large" before the implementation of the regulation. The research participants of the current study do not deem the non-Big 4 audit firms to have the technical skills, resources, or the knowledge to currently audit big, listed companies. Thus, it is expected that listed entities will merely rotate between the Big 4 firms and that MAFR will not improve the market concentration in South Africa. In the next chapter possible pro-active measures to reduce the potential negative consequences will be discussed.

CHAPTER 5: SUGGESTED SOLUTIONS TO PROSPECTIVE PROBLEMS

5.1 Introduction

In this chapter the primary research objective {PRO}, namely, to determine what pro-active measures could reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa, will be addressed. Solutions will be formulated based on the anticipated problems in order to set out pro-active measures to limit the potential negative impact of MAFR in South Africa. These solutions will be based on measures that other countries introduced and on the empirical evidence that was collected through interviews with the research participants. The identified solutions will be used in Chapter 6 to outline whether the identified measures will likely reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa.

Suggesting solutions to the complex and integrated anticipated problems are multifaced and will probably differ between countries. Harber *et al.* (2020:231) agrees in his statement that "the IFAC recognises that the most effective approach to regulation will vary between jurisdictions and there is no 'one single approach' to be applied". Thus, no 'one single solution' will prevent the possible negative impact of the MAFR regulation. A few suggested solutions for each possible problem will be discussed below. These solutions are presented under the headings of the six identified problems as was discussed earlier in Chapter 4.

5.2 Suggested solutions

i Decrease in audit quality

In Chapter 4 the probable decreasing audit quality was found to be mainly caused by the loss of client specific knowledge. Thus, this section will firstly focus on solutions to mitigate the loss of client specific knowledge and thereafter on more general considerations.

Loss of client specific knowledge

Chetty (2019:72) listed some suggested changes which might mitigate the loss of knowledge problem. With reference to the interviews held during this study and prior research, these changes will be deliberated on below:

Firstly, it is important to upskill the audit trainees, together with the clients' junior and middle management with problem solving competencies (Chetty, 2019:72). The rationale for this is that these employees are the fieldworkers who will be managing the challenges on a day-to-day basis and therefore they need to be equipped with problem solving and decision-making skills (Chetty, 2019:72). None of the research participants in this study referred to the upskilling of employees on problem solving competencies as a solution to this problem. This could be due to the fact that the CA2025 competency framework, which is implemented from 1 January 2022, already aims to develop the problem-solving skills of trainees and includes this skill as part of the decision-making acumen (SAICA, 2021:7).

Secondly, effective knowledge sharing between the new and predecessor audit firms are also seen as a solution (Chetty, 2019:72; Harber & Marx, 2020:17). An audit file transfer system or a 'shadow' system where the incoming firm could be incorporated in the audit of the client during the last year before the rotation takes effect, was mentioned as ideas (Harber & Marx, 2020:17).

The research participants in the current study had differing views about the feasibility of an audit file transfer solution. The majority of the participants agreed that an audit file transfer between the predecessor and successor audit firms will be feasible but stated that it will create risk implications which will likely cause the predecessor auditor to be reluctant to the idea. A participant stated: *I think that's the starting point, I think the file transfer is something that has to happen anyway. Because, I think there is automatic knowledge in audit papers. So, I think it will help to improve the quality of the audit. So, for me, that's almost the first thing that has to happen, there has to be a standard working paper transfer*[47] (6:26). Only one of the registered auditors believed that an audit file transfer system will not be feasible and stated: *Yes, audit file transfer will never work, it's regulatory actually prohibited, and stupid. Our firm will not transfer files. It's actually proprietary, your audit file is proprietary information. Not only your methodology, but how you arrived at the answer of the audit is also actually proprietary* (8:19)[48]. The opposition from this registered auditor could be due to the stringent rules the IRBA has regarding the access of audit working papers and the risk associated with the transfer of the information.

According to the IRBA (2018b:9), audit working papers are the sole property of the audit firm. The IRBA (2018b:11) also states that if a client grants written consent, the predecessor auditor

[47] Translated from Afrikaans
[48] Translated from Afrikaans.

may provide working papers to the successor auditor; care should, however, be given to only make information available that is “strictly necessary”. This “strictly necessary” information could include working papers required to test the opening balances as required by ISA 510 (IRBA, 2018b:13). The IRBA (2018b:15) also identified the risk of sharing working papers with third parties and notes that: “A successor auditor might claim compensation from the predecessor auditor for expressing an incorrect auditor’s opinion on the financial statements, in circumstances where the successor auditor relied on the working papers of the predecessor auditor for purposes of planning the initial audit engagement”.

The participants, especially the registered auditors, were of the opinion that a shadow system is a feasible solution. The concerns raised mainly focused on the cost involved and the boundaries that should be set. Regarding the cost implication, one of the participants noted: *Sure, the shadowing can become feasible, but, I mean, who’s going to carry the cost of the shadowing, it can become expensive. If we have employees on an audit, without getting a return on it? So, unless the audit firm believes that it will save them time in the future and then ultimately save them money by having a shadowing employee on an audit, then that could work. But then the other question: will the predecessor auditor want to share the knowledge and experience that they have built up for so many years with a competitor?* (10:13). Another participant noted the importance of having boundaries in place during the period you are shadowing: *As an incoming auditor, I would be very cautious of getting too close because you actually haven't done an audit yet. You've just observed. So, you don't really know, and the danger is you get too close and then the client says “but actually, you were here”, the following year when you do it on your own, you really get into the detail, you pick up an issue and the client says “but you shadowed last year, so why is it an issue now?”. Well, you hadn't done an audit, you were just shadowing. So, I do think the shadow system can go some way. And I think it’s less around the detailed knowledge, it's more around understanding the rhythm and the process of how the client works, how the audit committee works, the interactions. Yeah, just building up a high-level knowledge. But you got to be very careful as to how far you push it in that shadow year, what your role is in the shadow year* (9:4). If auditing firms or clients are willing to invest and set proper boundaries, a shadow system can be seen as a solution to mitigate against the loss of audit specific knowledge caused by MAFR. One of the registered auditors in the sample was part of a shadowing system as the existing auditor and noted: *It works to transfer knowledge and experience. It actually helps more just to convey street smarts*[49] (8:17).

[49] Translated from Afrikaans.

Based on the interviews held, most of the participants agreed that knowledge sharing will not happen without regulatory intervention. One participant stated: *No, I don't think they (the audit firms) will (be willing to share their audit file and their knowledge of the client with a new auditor). I think that there is such liability exposure for the audit firms that they would be highly reluctant. And that's why it would need to be a regulation. I can tell you the audit firms also don't want to put the number of years that they've been auditing their client on the auditor's report. It's called the tenure rule, but you know it's there, and it is there because the IRBA passed a regulation that required it. So, a lot of things can be regulated by the IRBA* (4:22). Therefore, in agreement with the notion Chetty (2019:72) made, the IRBA will have to establish minimum information sharing requirements. Another research participant noted that currently there are very limited requirements in terms of what a predecessor auditor needs to provide to the new auditor when there is a change in auditors. Consequently, the participant suggested that the current requirements should be extended to potentially a few meetings and working through the audit strategy memorandum. The participant also noted that the predecessor needs to be compensated for the extra hours needed (1:17). Chetty (2019:72) concludes that regulation will ensure that the quality and quantity of information shared are the same across all audit firms, thus ensuring a level playing field.

As a third potential solution, a joint audit[50] in the last few years before rotation will ensure that the new audit firm is familiar with the audit risk of their new client by the time they are the sole auditors (Chetty, 2019:73). By having multiple audit firms involved in the audit process, audit issues can be viewed from various perspectives, reviewed more thoroughly, and will be subjected to each audit firm's quality control mechanisms, thus increasing audit quality (Institute of Chartered Accountants in England and Wales, 2019). A few of the research participants of this study also mentioned joint audits as a solution. One of the research participants stated: *If a joint audit is done correctly, audit quality will increase. Obviously, it's not for everyone because it's more expensive... But, a joint audit is definitely something that I believe can improve audit quality* (7:23).

As mentioned by the research participant, joint audits will have financial implications but will partially replace the initially higher audit cost that are often experienced in the first few years (Hay, 2015; IFAC, 2020). These costs are mainly due to the extra time necessary to become acquainted with the new client. Furthermore, it might be time-consuming and difficult to develop a joint audit approach, particularly if there are substantial differences in the audit

[50] During a joint audit, an entity is audited by two (or more) auditors, but one joint opinion is produced (IFAC, 2020).

methodologies utilised by the two firms (ACCA, 2007). Furthermore, the development of a joint approach could be challenging because South African audit firms have limited joint audit experience outside the banking sector (IRBA, 2020a). To encourage and improve joint audits, the IRBA developed a guide for registered auditors on joint audits (IRBA, 2020b). According to Hay (2015), there are limited evidence which explores the effectiveness of joint audits. One of the registered auditor participants was pessimistic about the effectiveness of a joint audit and noted: *The audit fee is going to be at least double in that year… I think you're going to fall over each other in it. I don't think that that would be a solution. I think there's just too many people at the party* (9:5). Further research is required in this area to determine the costs and effectiveness thereof in South Africa. After the implementation of the MAFR rule, a few companies are now subject to joint audits of which some even involved the incorporation of small-to-medium sized firms (IRBA, 2020a). Nagy (2021) noted that three companies who rotated auditors in recent years, appointed black-owned audit firms alongside one of the Big 4 firms in joint audit arrangements. The IRBA (2020a) noted that joint audit arrangements were developed between EY, PwC, and a medium-sized audit firm, SNG-GT. Two listed entities' audits were also won through a joint pairing between Thawt Incorporated and Crowe JHB, two small-to-medium sized audit firms in South Africa (IRBA, 2020a). These arrangements are believed to create opportunities for smaller audit firms to gain exposure and skills to audit PIEs. The IRBA encourages these arrangements to address the transformation and market concentration objective which will be elaborated on later in this chapter (Nagy, 2021).

Lastly, a few other suggestions to mitigate the loss of client specific knowledge were mentioned by the research participants of the current study, namely: recruiting individuals with knowledge of the client; and the supply of non-assurance services during the cooling-off period.

The recruitment of knowledgeable individuals in order to gain the necessary client specific knowledge, might be a solution but is frowned upon in practise. One of the research participants noted: *There are some companies in our country that is just too technical and just too big, and it takes years to understand them. And the audit firms, I think will definitely go that route and try to get some of the previous team members of the other audit firm onto their teams. And that it will save them a lot of time and effort. So, the moment you lose (a client), you lose out a lot, because you lose out on fees and your staff. And you're already tendering for other positions with the current staffing that you have* (3:12). Another research participant agreed to this notion and named the recruitment of knowledgeable individuals as a solution: *There has been this discussions around potentially creating these audit teams that will move from one firm to another, just leaving the partner behind and potentially move as senior*

manager, manager and say three third years or whatever and move where the audit is moving… that potentially might create animosity and increase competition between the firms. But that is a, I would say, a very good way of doing it. What you need to just then be very mindful of is that, that specialised team doesn't now, you know, inflate their salaries purely just, because you are sort of buying them to be able to get the client specific knowledge (11:17). As noted by the participant, this solution has cost implications since individuals with the knowledge would want to be remunerated for their move between the firms.

One of the lecturer participants noted that providing non-assurance services during the cooling-off period can mitigate the loss of client specific knowledge later on in the MAFR process when the predecessor auditor is able to be elected again. The participant stated: *Maybe they (the predecessor auditor) can also do more consulting rather than just the audit. Because if they have such specific client knowledge, maybe they could offer these services on a consulting side rather than on the audit, but obviously not both* (2:16).

The participants agreed that irrespective of the above mitigating factors, additional time will be needed in the first few years of a new audit to get acquainted with the client. One of the participants summarised this idea as follows: *I think one needs to realise that as a firm in the first year, you need to take a little bit of an investment cost. In terms of, you know, having to invest more time upfront before you actually can start billing the client* (11:16). The potential increase in audit fees due to the increased time auditors will spend was discussed in Chapter 4.

General considerations

In Chapter 4 the divided attention of audit partners due to time spent to continuously tender for clients and a possible shortage of quality and risk management staff was also mentioned as likely problems. The research participants of this study however consider these problems to merely be growing pains which will solve themselves in the longer run. One of the research participants noted: *This is something that will come with time, and as they get used to the new process…Some firms already implemented the rotations earlier and a lot of their rotations also happened as a result of the negative publicity that some audit firms got in the market… So hopefully, because of that, they realise that they really need to incorporate this into their firms and incorporate this into their structures and that it's not just business as usual like in the past. And, if they do that and if they implement another level within the firms, for someone who's doing the selling and someone else who's doing your technical bits on their audit. Then they can make a success of it, but until they get to that, going to where you actually have the*

different levels and someone who's signing and someone who's selling, they are going to struggle. If you're just giving all of that work to one person (3:10).

Establishing the optimal tenure length (the optimal length of an audit contract) will be important in establishing quality audits. Brooks *et al.* (2017:3) concluded that a 24-year tenure period is suitable for countries with a high investor protection level, and a 14-year tenure period is suitable for countries with a low level of investor protection. The reason for the different tenure periods between countries with high or low investor protection is based on the presumption that auditors will "prolong their independence when a country's legal liability requirements are stronger" (Brooks *et al*., 2017:3). Indyk (2019:96) made the assumption following the prior study, that a five-year tenure period may cause audit quality to decrease. Because the IRBA established a maximum tenure period of 10 years, the level of investor protection in South Africa is irrelevant. The conclusion that can be made is that a longer (10 year), rather than a shorter tenure period will provide higher quality audits in South Africa. A longer tenure period will probably also be encouraged by the switching cost involved with the rotation of auditors. This issue will be discussed in the next subsection.

Ilyasova (2015:92) conducted a study in the U.S. where it is suggested that this problem is possibly overemphasised. It is found that the length of audit tenure had a negative relationship towards audit effort (Ilyasova, 2015:91). This finding suggests that "in the later stage of tenure, auditors are less likely to enhance client-specific knowledge and more likely to be pressured by the client/firms than in the early stage of tenure". The value of client specific knowledge is believed to lessen over time, because less attention is paid to this knowledge due to lower audit effort during longer tenure periods. Consequently, it can be argued that the client-specific knowledge that is lost when a new auditor is appointed, would in any case not have received the necessary attention during the longer tenure periods of the previous auditor. A study conducted on companies listed on the Stock Exchange of Singapore between 1986 to 1995 (before MAFR was introduced in Singapore), confirmed this statement by identifying factors which contribute to a change in auditors (Woo & Koh, 2001:133). Woo and Koh (2001:142) found that "audit opinion, auditor quality, management changes, income manipulation opportunities, leverage, complexity and firm growth" usually influence the decision to change auditors. As seen from the list, one of the drivers behind auditor rotation has always been to increase audit quality, thus establishing a direct, rather than an indirect relationship between audit quality and auditor rotation.

ii Switching costs and accompanied changes in audit fees

The switching costs is an issue which cannot be prevented but should instead be managed. An empirical study conducted by Sharma *et al*. (2017:147) found that the widely accepted rotation of audit **partners** is also associated with significantly higher audit fees. Harber *et al.* (2020:219), however, states that the anticipated cost of audit **firm** rotation is expected to be higher than the cost related to audit partner rotations. The higher cost is due to tendering cost which is an additional expense that needs to be accounted for under the audit firm rotation system (Harber *et al.,* 2020:219). The question, as mentioned in Chapter 4 is: Will the audit firms or the audit clients carry the increased cost? The answer to this question will determine whether an increase or decrease in audit fees can be expected. The contrasting views, together with the negative effects associated with each option, was discussed in Chapter 4.

Harber and Marx (2020:17) suggested that one way in which switching cost could be managed is by means of a guideline document for audit fees the IRBA could provide to preserve audit quality in a more competitive market. More than 80% of the registered auditors who were research participants in the current study supported the idea of a guideline document, while 50% of the academics lecturing auditing encouraged such guidance.

The registered auditors in support of the idea explained: *But it must not just be a guideline, there must also be certain requirements in there that you have to follow, and it must be linked to the costs as well as the hours. Because if you don't get the IRBA to force this onto audit firms, you are always going to sit with low balling, you are always going to sit with too low audit fees that people go in with, especially now where we are tendering for the listed entities and then the quality of the audits are going to suffer. It's the quality of the audits that's going to suffer. It will have nothing to do with independence. It's going to be about the quality of the audits, because the lower your audit fees are, the quicker you have to work, the lesser people you're going to use on your audits, the less specialists you're going to use, and you're going to just say we have to make this deadline come hell or high water. And the only thing that suffers is quality then. You know, that's what I know from 20 years of experience* (11:26). The main purpose of a guideline document would be to create a supporting mechanism to auditors to explain a higher fee and thus discourage low-balling.

The concerns raised by the participants focussed mainly on the difficulty of establishing an accurate guideline document applicable to the wide range of industries in South Africa. Some participants elaborated on methods the IRBA could use to calculate a benchmark. The suggestions were as follows:

- Provide guidance about the hours that should be spent; this would be more practical if the auditor had to disclose the number of hours worked on the audit together with the number of years they have been the auditor (2:21).
- The revenue of the client; this is not seen as the best way to calculate a guideline since the revenue of a complex client might for example be low during a certain year (3:17).
- Provide a percentage range within the previous firm's fees (making provision for the additional cost for a first-time audit) (2:21).

One of the participants had another idea, namely, that the audit fee should not be included as part of the statement of profit or loss, but rather be included in the statement of changes in equity where the dividends to shareholders are included; the reason being that an audit is a transaction with the shareholders and that accounting it similarly would prevent client management from negotiating unreasonably low audit fees in order to improve the companies' profit. This research participant explained: *I don't think that audit fees should actually be recorded in the income statement. I think audit fees should go in the financial statements where dividends go. It's a transaction with shareholders… Because it's not a reflection on the performance of the company. It's a relationship with the equity holders of the business that appoint them... Then what you do is, you take management out of the equation completely for the payment of the fee. The audit fee is a board decision where it belongs* (9:7).

iii Limits the ability to attract and retain talent

The MAFR regulation will not cause audit work to become less; instead, more hours will be required to understand a new client (Kwon *et al.*, 2014:174). Therefore, the demand for talented professionals will still exist. The research participants believed that the frequent rotation of specialised clients will possibly also lead to the rotation of employees with specialised skills between audit firms due to their knowledge becoming more valuable to the new audit firm in comparison to their previous employer's.

The probable increase in audit cost might cause audit firms to save on certain costs to achieve their performance goals (Harber *et al.,* 2020:223). The research participants agreed that training and development, recruitment including bursary schemes, staff expenditure, rent and partner bonuses will probably be cut. One participant however noted that as a CA you have CPD (Continuing Professional Development) compliance requirements, thus training and development might be reduced, but it cannot be cut entirely (5:19). The cost that audit firms cut cannot be regulated, but if the IRBA provides a guideline document for audit firms which will decrease low-balling opportunities as discussed above, these cost cuttings may not be necessary.

It is generally believed that the audit profession has become over-regulated and that this cause qualified professionals to pursue other possibilities where the risk better matches the reward (Aruñada, 2004:635; NCOP, 2020). The introduction of the new MAFR cannot be seen as the reason for over regulation but is merely a consequence of an already over regulated industry. If MAFR improves the reputation of the audit industry, through improving the perception of auditor independence, it might even help attract talent.

iv Limits auditor specialisation

Elder *et al.* (2015:76) made the comment that the appointment of a specialised audit firm will limit possible adverse effects MAFR might have on audit quality. As discussed earlier, the reason for poorer quality audits in the first few years of an engagement is largely due to a lack of client and industry knowledge (Stanley & DeZoort, 2007:154). The appointment of auditors with industry experience (a level of specialisation) is believed to ensure quality audits during the first few years (Elder *et al.,* 2015:77). As discussed in Chapter 4, the research participants agreed that, although MAFR will complicate audit planning, it will not negatively affect auditor specialisation since audit firms will either upskill themselves, thus contribute to an increase in specialised knowledge in the industry, or recruit employees with specialised knowledge, thus maintain the level of specialisation in South Africa. One of the research participants noted: *We might also have to ask that question: Are we going to broaden our skills? Do we want to keep stuck in just knowing this one industry, or would we want to learn more about others as well? I think actually if you think of it in the long run, it would not be a negative thing, it would be a positive thing that our profession needs* (1:25). Companies whose audits are up for tender are expected to have formal rotation policies in place which motivates the appointment of auditors with specialised skills in the client's industry. Therefore, the conclusion can be drawn that the importance of auditor specialisation will increase rather than decrease in a MAFR environment.

v Could increase audit market concentration and the market share of one firm

In order to decrease audit market concentration, a considerable amount of capital investment will be required by the non-Big 4 audit firms (Kamolane & Odendaal, 2021:80). This capital investment should be used to develop resources and expertise, establish an international network, and in the process improve the reputation of these audit firms (Kamolane & Odendaal, 2021:80). Unfortunately, the high cost of capital, associated with the ownership structure of audit firms, cause high capital investments to be unappealing (Oxera, 2006:84). It is uncertain whether the capital investment will in fact reward the non-Big 4 firm with the tender; thus, causing a mismatch between the risk and reward (Oxera, 2006:84). Furthermore, if a

PIE tender is won by a non-Big 4 audit firm, a self-interest threat to independence may arise if the fee generated by the PIE represents a large portion of the total revenue of the firm (SAICA, 2020:124). A few research participants also expressed concerns regarding independence issues which may arise when mid-tier firms audit PIEs with large audit fees. One of the participants mentioned: *Let's say the smaller firms do get to bid for the JSE listed clients, I think their independence of mind will definitely be compromised in light of our current economic situation* (1:13).

Most of the participants believed that MAFR alone will not achieve the goal to decrease market concentration. Some research participants exchanged other ideas to decrease market capitalisation; these ideas are listed below:

- Non-Big 4 firms should raise more awareness about themselves. This will help with the recruitment of talented trainees and help establish trust amongst the audit committees and shareholders (6:36).
- The IRBA should provide training to the smaller audit firms to equip them with the necessary skills, knowledge, and resources (1:27).
- Joint audits between Big 4 and non-Big 4 audit firm should be encouraged. In this way non-Big 4 audit firms will gain experience in auditing PIEs. The research participant however noted that: *The problem what they currently do with those type of audits (joint audits) where you (a Big 4 audit firm) team up a small firm, is that a lot of the times it's just a team up in name to say that "yes we have this other firm, we're teaching them a few things", but the knowledge and the skills of those firms are sometimes so lacking and so difficult that the audit firms who team up with them have to end up doing most of the work. So, you might also find then that the Big 4 firms don't want to tender for that work, because then they end up doing more. So, it has to be somewhere in the middle where if you team up with a small firm they have to take the ultimate responsibility for that sections that they need to do, because currently in the public space where you team up with them, the big auditor has to take responsibility for the small auditor and then the small auditor doesn't always do what they are supposed to, or doesn't always know what to do because they don't have the experience. So, there's a big gap in the market to actually help but the firms (the Big 4), if they don't have incentive to do that, they're not just going to do that out of their own, because they have enough other things on their plates* (3:21).

Some research participants believed that the only way to address market concentration is through legislation. One of the participants noted: *It is extremely hard to break into the Big 4 domain because of the market perception that the Big 4 firms equals better quality audits.*

MAFR without legislated compulsory joint audits will not decrease market concentration (12:17). Another participant agreed and stated: *If they (the Big 4 firms) don't have incentive to do that (team up and upskill smaller firms) they're not just going to do that out of their own because they have enough other things on their plates* (3:21).

A few participants, however, believe that MAFR is already contributing to a decreased audit market concentration. One participant noted: *I think that (decrease in market concentration) is potentially the biggest benefit of mandatory audit firm rotation, other than the fact that it is there to increase independence. It is to level the playing fields a bit and also to allow for medium sized firms to be able to play in that field. But, based on the fact that they would need to then have the necessary and the relevant people in which to do that. So, yes, I definitely believe that a decrease in the audit market concentration is a good thing. It will up the audit quality, but only if the audit firms that now becomes part of this pool other than the Big 4 audit firms will need to really pull up their socks and make sure that they have the necessary specialists in their firms, and that they have the necessary training and development and whatever so that they can play with the big boys* (11:29).

Nagy (2021), however, does not pose the increase of audit market concentration as an issue and states that a number of smaller auditing firms in South Africa have already benefited from audit firm rotation. Examples of non-Big 4 audit firms appointed by PIEs due to the early implementation of MAFR include BDO, Crowe Thawt, Mazars, Moore Stephens, Nexia SAB&T, Ngubane and Co, RSM, SNG-GT, and PKF (Nagy, 2021).

vi Limits the audit committee's ability to determine the best audit firm for the company

As explained earlier, the MAFR rule is believed to create a problem for directors (forming part of the audit committee) who are forced to select a new acceptable auditor. Prior to the MAFR requirement, audit committees merely supported "the retention of their existing auditor by the shareholders until such time that the entity is in a better position to change the auditor" (McGregor & Carpenter, 2021:38). Based on the audit tenure years in Table 16, some firms took longer than 100 years to establish a "better position" or felt the need to change auditors. Most of the research participants believed that the auding landscape in South Africa is big enough to enable an audit committee to choose an acceptable auditor in a MAFR regulatory system. One of the registered auditors concluded: *I do think that the landscape is big enough. I don't think that any company or corporate in South Africa can say that the only firm that can do a competent job for us is the current firm that we've got. I don't think that that's the case. I'm not sure that that's an appropriate argument against MAFR. There's lots of arguments against MAFR but that's not a good one* (9:14). The only other limitation which can possibly

play a role is if another audit company is currently providing non-assurance work for the PIE which disqualify them to take over an audit. A counterargument for this problem was however provided by another research participant who stated: *There are other options in any case so I don't think it will necessarily limit their options, but I do think what it will do automatically is it will force audit committees to look at other firms as well. And I think that might be an indirect secondary goal that MAFR was trying to do. And that's all, if we can just get that thought going, that there aren't just four firms, it might help their ability to start looking at other firms as well, which could potentially add value* [51] (6:38).

Taking the preceding discussion of the six identified potential problems with MAFR into account, Table 23 that follows provides a summary of suggested solutions to these problems. The table provides a useful collation of all the identified potential solutions to address the primary research objective {PRO} of this study. These suggestions would be of value to a variety of stakeholders, including but not limited to regulators (most notably the IRBA), professional bodies, auditors, audit clients and policymakers.

[51] Translated from Afrikaans.

Table 22: Summary of suggested solutions identified to possible problems

Possible problems	Suggested solutions	Additional comments or considerations
i. Decrease in audit quality - Loss of client specific knowledge	1. Upskilling the audit trainees, together with the clients' junior and middle management with problem solving competencies.	• The CA2025 competency framework will assist in the upskilling of aspiring CAs.
	2. Effective knowledge sharing between the new and predecessor audit firms using an audit file transfer system or a 'shadow' system.	• A shadow system is deemed to be more appropriate. A guideline regarding the minimum information that needs to be shared created by the IRBA will be welcomed. This will ensure that the quality and quantity of information shared are the same across all audit firms.
	3. A joint audit in the last few years before rotation.	• The effectiveness of joint audits is not clear and the cost implications makes this solution unattractive.
	4. Recruiting individuals with knowledge of the client. 5. Supply non-assurance services during the cooling-off period.	• This solution is frowned upon in the industry. • This solution may be viable in the years following the implementation of MAFR, when the second mandatory firm rotations need to occur.
- General	Incorporate the application of MAFR into firm structures.	• The quality and risk management departments of firms will need more staff during the original implementation of rotations and an additional partner level is suggested in order to distinguish

	Establishing the optimal tenure length.	between partners signing audit opinions and partners recruiting clients. • In South Africa a longer (10 year) tenure period will provide higher quality audits.
ii. Switching costs	1. Switching cost should be managed. 2. The IRBA could consider providing a guideline document for determining audit fees. 3. A suggestion was made to consider moving "audit cost" from the Statement of Profit or Loss to the Statement of Changes in Equity.	• A guideline document will help prevent low-balling. • Since the audit is an arrangement with the shareholders and does not give information about the performance of a business, this presentation would lessen the interest of the clients' management in decreasing audit fees.
iii. Limits the ability to attract and retain talent	If the switching cost can be controlled, and the recruitment expense and staff cost does not have to be cut, MAFR should not affect the attractiveness of the auditing profession.	• MAFR might help to attract talent by improving the reputation of the audit industry.
iv. Limits auditor specialisation	MAFR will likely have a limited effect on specialisation in South Africa since the rotation of clients which require specialised knowledge will cause audit firms to either upskill themselves, thus contribute to an increase in specialised knowledge in the industry, or recruit individuals with	• Acquiring knowledge in different industries is in line with the CA2025 framework. • Companies whose audits are up for tender are expected to have formal rotation policies in place which motivates the appointment of auditors with specialised skills; this would further prevent the loss of specialisation.

	specialised knowledge, thus maintain the level of specialisation in South Africa.	
v. Could increase audit market concentration and the market share of one firm	1. Non-Big 4 firms should raise more awareness about themselves. 2. Training should be provided to the smaller audit firms to equip them with the necessary skills, knowledge, and resources. 3. Joint audits between Big 4 and non-Big 4 audit firm should be encouraged.	• Independence issues could arise when mid-tier firms audit PIEs with large audit fees. • Non-Big 4 audit firms should be managed in such a way to support the Big 4 firm during these audits. Legislation might be necessary to encourage Big 4 firms to partake in these joint audits.
vi. Limits the audit committee's ability to determine the best audit firm for the company	Most of the research participants believes that the auding landscape in South Africa is big enough to enable an audit committee to choose an acceptable auditor in a MAFR regulatory system.	• This problem will be addressed simultaneously when the audit quality and auditor specialisation issues (refer above) receive attention.

5.3 Conclusion

This chapter satisfied the primary research objective {PRO} by determining which pro-active measures could reduce the potential negative effects of MAFR. Solutions were formulated for each of the six anticipated problems discussed in Chapter 4.

In order to mitigate the problem of a loss of client specific knowledge, upskilling audit trainees and the middle management of the client with problem solving competencies was regarded as a solution. Another solution, namely establishing effective knowledge-sharing between the new and predecessor audit firms were also noted. To encourage knowledge sharing between audit firms, audit file transfers, shadow systems, and joint audits were proposed as possible solutions. However, most of the participants agreed that knowledge-sharing will not occur without regulatory intervention and that the IRBA would have to establish minimum information sharing requirements. Recruiting individuals with knowledge of the new client and supplying non-assurance services during the cooling-off period, were also proposed by research participants to limit the loss of client specific knowledge. Irrespective of the mitigating factors, additional time will be required in the first few years of a new engagement to get acquainted with the client.

The switching costs is regarded as an issue that cannot be prevented, but should be managed instead. The creation of a guideline document for audit fees by the IRBA could serve as a supporting mechanism to help auditors explain higher fees, and consequently discourage low-balling. Another suggestion is to change the accounting treatment of audit costs in the annual financial statements. This would entail moving the audit fees from the statement of profit or loss to the statement of changes in equity in order to better display the nature of the payment as a transaction between the auditor and the shareholders. This could prevent client management from negotiating unreasonably low audit fees to improve the companies' profit.

MAFR is generally assumed to have a limited effect on the ability of the audit profession to retain and attract talent, and auditor specialisation. Most of the research participants believed that MAFR will not achieve the goal to decrease market concentration on its own. To recap, the following ideas related to decreasing the audit market concentration were generated: non-Big 4 firms should raise more awareness about themselves; the IRBA should provide training to the smaller audit firms to equip them with the necessary skills, knowledge, and resources; and joint audits between Big 4 and non-Big 4 audit firms should be encouraged. Lastly, the South African audit landscape can be regarded as large enough to enable audit committees

to select an acceptable auditor regardless of the MAFR regulation. In Chapter 6, the solutions proposed in this chapter will be used, in conjunction with the possible problems, to draw conclusions regarding the prospective effectiveness of MAFR in South Africa.

CHAPTER 6: CONCLUSION AND FURTHER RESEARCH RECOMMENDATIONS

6.1 Introduction

In light of recent accounting scandals, the quality and effectiveness of audits has come under scrutiny. Accounting regulators around the world started to introduce legislation to re-establish trust in the audit function. One of the regulations introduced in multiple countries was MAFR. In South Africa, the IRBA also opted for this rule in an attempt to enhance audit quality. The MAFR introduced by the IRBA forbids audit firms to serve as appointed auditors of PIEs for more than ten consecutive years. Thereafter, the audit firm will only be eligible for reappointment as auditor after the expiry of no less than five financial years. This rule was established in 2017 by the IRBA and will be *effective* for financial years commencing on, or after, 1 April 2023 in South Africa (Agulhas, 2017:1). The adoption of the new rule was, however, opposed by different groups who argued that the rule will decrease instead of increase audit quality (Harber & Maroun, 2020:861).

This chapter will focus on the prospective effectiveness of MAFR with reference to the goals the IRBA articulated, possible problems identified and suggested solutions to the latter; thus, it will conclude on whether the identified measures is likely to reduce the potential negative effects of MAFR to a degree that justifies the implementation of MAFR in South Africa. This chapter also summarise the achievement of the research objectives. Lastly, the study will be concluded with an explanation of its limitations and recommendations will be made for future research.

6.2 Reflection on the potential effectiveness of MAFR

As discussed in Chapter 4, the IRBA articulated three objectives for MAFR. In the following paragraphs, the effectiveness of the MAFR regulation will be discussed based on the probability of the IRBA's goals being achieved, and on whether the identified measures will likely reduce the potential negative effects of MAFR.

Objective 1: Strengthen auditor independence with the aim to improve audit quality

The primary objective of MAFR is to strengthen auditor independence. In Chapter 2, it was noted that MAFR would likely improve auditors' independence in appearance, but that this regulation might not have an impact on independence of mind. After the recent accounting

scandals, the IRBA is concerned about the appearance of auditors and believes that this regulation will restore the public's opinion of the audit profession.

The advantages of MAFR was briefly discussed in Chapter 3. As part of this discussion, an increase in audit quality caused by an increase in independence was mentioned as one of the contributions of MAFR. In contrast, a decrease in audit quality that is mainly caused by a lack of client specific knowledge, was listed as one of the six potential negative consequences of this regulation. The solution to this problem, namely up-skilling audit trainees and the management of audit clients with problem solving abilities while encouraging knowledge-sharing between the predecessor and successor, could mitigate the loss of client specific knowledge. The research participants in the current study, however, emphasised the role of the IRBA in establishing knowledge-sharing protocols.

A possible decrease in audit fees due to low-balling to secure audit clients also threatens audit quality. The research participants of this study suggested that the IRBA should introduce an audit fee framework to assist auditors in determining and explaining audit fees to clients. If audit fees are not addressed, it might create recruitment problems in the auditing profession if the risks that individuals are exposed to in the profession do not match the rewards.

The research participants in this study believe that MAFR will have a limited impact on auditor specialisation. Furthermore, the research participants noted that the South African audit landscape is large enough to enable audit committees to choose appropriate auditors even if they cannot choose their current auditors due to mandatory rotations.

Objective 2: Address the concentration of the audit market (secondary goal)
Concentrated audit markets are a global phenomenon since there are only a few international auditors capable of auditing international companies. The IRBA stated that MAFR alone will not solve the issue of a highly concentrate audit market. Some of the research participants of this study noted that MAFR will help mid-tier firms to obtain a few PIEs, but that it would still have a small impact on audit market concentration.

It was noted that a monopoly within the Big 4 is deemed to negatively effect audit quality. The research participants believed that MAFR would not have an impact on the concentration within the Big 4 since clients will probably rotate between two Big 4 audit firms. Thus, after the 10-year rotation period is over, the concentration will return to the concentration before the implementation of MAFR.

Objective 3: Promote transformation in the audit profession (secondary goal)

The participation of black individuals in the South African economy, is a continuous objective of regulators throughout South Africa. The IRBA also emphasised the need for transformation in the audit profession and believes that MAFR will contribute toward addressing racial imbalances. The participants of the current study agree with participants in prior research studies by noting that internal firm policies would probably encourage transformation more than MAFR. The participants explained that MAFR might lead to cost-cutting that would limit funds for bursary schemes and would, in turn, negatively effect audit firms' transformation objectives. If the switching cost related to MAFR can be controlled, and the recruitment expenses and staff costs do not have to be cut, MAFR would not effect the attractiveness of the auditing profession.

In conclusion, besides the possible contribution toward improved independence in appearance, MAFR will likely have a limited effect on the secondary goals articulated by the regulator.

6.3 Research objectives

Table 24 provides a brief outline of how the research objectives, established in section 1.4.2. of Chapter 1, were addressed.

Table 23: How the research objectives were addressed

Research objective	How it was addressed
Primary research objective {PRO}	
Determine what pro-active measures could reduce the potential negative effects of MAFR to such a degree to support the implementation of MAFR in South Africa.	Suggested solutions to the possible problems MAFR might create in South Africa were deliberated on in Chapter 5. These solutions were formulated based on the potential negative consequences established in Chapter 4. Empirical evidence formed the basis of the suggested solutions. In Chapter 6, a conclusion was drawn on the effectiveness of MAFR in South Africa by considering the possible problems and suggested solutions thereto.

Secondary research objectives {SRO}	
1. Provide a literature overview of the theoretical aspects underpinning auditor independence.	Chapter 2 addressed this objective by deliberating on the definition of independence, independence requirements in South Africa, and the relationship between auditor independence and audit quality. The literature study was supported with empirical evidence obtained through interviews with participants.
2. Provide a historical overview of the practical implementation of MAFR in other countries.	Chapter 3 created a foundation regarding the practical implementation of MAFR. This was done by critically analysing similar regulations in the U.S., the EU, Italy, Canada, Spain, South Korea, Singapore, Costa Rica and Nigeria. A brief discussion about the advantages of MAFR set the background for Chapter 4.
3. Explore the potential negative consequences the implementation of MAFR might have in South Africa.	Chapter 4 started off with a historical outline of MAFR in South Africa. This Chapter concluded on the potential negative consequences the implementation of MAFR might have in South Africa based on evidence found in research literature and the empirical study.

6.4 Summary of contributions

This study contributes to the limited research on MAFR in South Africa. Prior South African research on this topic consisted mainly of quantitative research. This dissertation contributes to the gap in audit literature by anticipating possible problems based on the consequences MAFR had in other jurisdictions. Furthermore, suggested solutions to these problems were gathered. These solutions - to which Chapter 5 was dedicated - will give the IRBA, as well as audit firms, an idea of measures that can be put in place to mitigate the potential negative consequences of MAFR. Other countries, who are still deliberating on whether MAFR should be introduced, could also benefit from this study. This study, especially the empirical evidence, could assist these countries in better understanding how knowledgeable parties would react

to the implementation of such a regulation, and which problems should be addressed from the start. The value to regulators is therefore clear.

6.5 Limitations of the study

Consistent with all qualitative research on MAFR between June 2017 and April 2023, this study may have been impacted by bias due to respondents aiming to influence, amend, or appeal the implementation of the rule before the implementation date in April 2023. Harber and Marx (2020:18) shared in this view in concluding that, at present, empirical research on this topic in South Africa may be biased.

Because of prejudice, respondents might have had the incentive to perceive MAFR in a negative light by overstating the cost while understating the benefits. This possible bias may have benefited the identification of potential problems South Africa may face (Chapter 4), but could also have negatively affected the recognition of suggested solutions by participants (Chapter 5) – of course one can only speculate. The qualitative semi-structured interviews were, however, conducted during the last few months of 2021 and from January to May 2022, which might have mitigated possible prejudice as the interviews were held close to the implementation date. The inclusion of audit partners who already experienced MAFR before 2021 may also possibly hedge against this potential prejudice.

Another limitation of this study is that the sample size (12 individuals) is relatively small and cannot be expected to be representative of the entire population. Ilyasova (2015:102) notes that self-selection bias, meaning that participants who choose to form part of the sample might have strong opinions about MAFR, also creates limitations. This places a limitation on generalising the results to the entire population of the two participant groups. However, since this study followed a qualitative design where generalisation is not the main goal, this is acceptable.

The last limitation refers to the fact that the opinion of certain interested bodies, like investors or legislators, were not considered in this study because they did not form part of the study's participant groups. Future research studies may involve these stakeholders.

6.6 Future research recommendations

The literature on MAFR is rapidly increasing due to more countries either considering or implementing this rule to increase trust in their auditing systems. The complex nature of audit

quality, auditor independence and cost-analysis necessitates further research that enables policy makers to make calculated decisions. Future research recommendations include:

- To determine whether the potential problems predicted in this study will manifested in a South African context after the implementation of MAFR (i.e., a post-implementation study). The suggested solutions can consequently be examined to determine their effectiveness in mitigating the foreseen negative impact of MAFR. Such a study would help regulators in other jurisdictions with their decision on implementing similar rules, and allow for appropriate amendments to the rules in South Africa and other countries that already adopted MAFR.
- To elaborate on the anticipated problems firms and clients in South Africa might face in the wake of the implementation of MAFR by using empirical research.
- To use qualitative interviews with audit partners in countries already implementing MAFR to help identify problems South Africa might experience, together with possible solutions. The use of audit partners from countries who already implemented MAFR will hedge against the possible bias that might currently exist in the South African context, as they will be able to provide a more objective reflection of the consequences of MAFR.
- To investigate the opinion of audit committee members regarding possible problems MAFR might create in South Africa, as well as projected solutions to these problems.
- As demonstrated in Chapter 3, countries apply the MAFR rule differently. Some provide for a "10+10+2-year" rule, with a four-year cooling-off period (like the EU); while others provide for a "9-year" rule, with a three-year cooling-off period (like Italy). An interesting study would be to compare the audit quality of these counties prior to, and after, the adoption of MAFR in order to establish the best manner of implementing the rule.
- To ascertain whether MAFR will show an increase in discretionary accruals in a South African context, to assess the impact of the regulation on audit quality in South Africa a few years after the implementation of MAFR, would be an interesting study to conduct.
- To conduct a South African study, similar to the study conducted in Spain, that compares the likelihood of issuing going-concern opinions in a period before the announcement of the MAFR rule in South Africa (2012-2016) to the likelihood of issuing going-concern opinions in a period after the announcement of the MAFR rule (2017-2021). Such a study would provide evidence on the auditors' reporting behaviour both in periods before, and after, the announcement of MAFR.
- To compare the increase of cost associated with MAFR to prior research which determined the cost involved in the widely accepted mandatory partner rotation (Sharma *et al.*, 2017:129).

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ANNEXURE A: RECRUITMENT MATERIAL: INSTITUTIONS

Email to obtain institutional approval for participants to partake in the study

Good day

I hope that you are doing well!

I, Liné van Deventer, a student at the North-West University (NWU) m currently conducting my master's degree research and would like your institution to participate. Research ethics approval has already been obtained (ethics number: NWU-00961-21-A4). The first step in our ethics process is to obtain permission from your institution to contact an academic lecturing auditing at your institution to participate. Informed consent will also be obtained from the individual member before an interview will be conducted.

In 2017, the Independent Regulatory Board for Auditors (IRBA) issued a rule on Mandatory Audit Firm Rotation (MAFR) for public interest entities (PIEs). This rule requires that an audit firm shall not serve as the appointed auditor of a PIE for more than ten consecutive financial years (with a cooling-off period of 5 years) to avoid long relationships between the audit clients and the audit firm.

The purpose of this research is to determine what pro-active measures can be put in place to mitigate possible problems the implementation of MAFR might create in South Africa.

Information will be collected through conducting open ended semi-structured interviews with academics lecturing auditing to third years or postgraduate students in the CA stream from your institution. This information will be vital in helping to develop pro-active measures which can be put in place to mitigate possible problems caused by the implementation of MAFR in South Africa.

The duration of an interview will be approximately 30 to 45 minutes and will be conducted over an electronic platform (Zoom) in order to adhere to COVID-19 protocols. Participation will be completely voluntary, and results will be reported anonymously.

Kindly indicate whether your institution would like to participate in this study by completing the following google form: https://forms.gle/TdJaryt6KKccy6AE7

If permission is granted, I will also obtain the informed consent and permission of the individual participants from your firm/institution/office before conducting the individual interviews with them.

If you have any questions, please feel free to contact me.

Yours sincerely,
MCom student: Miss. L van Deventer (28410769@nwu.ac.za or 083 282 1044)
Study leader: Prof. N van der Merwe (Nico.VanDerMerwe@nwu.ac.za)
School of Accounting Sciences; North-West University; Potchefstroom campus

ANNEXURE B: RECRUITMENT MATERIAL: INDIVIDUALS

Email to obtain individual participants' approval to partake in the study

Dear Sir/Madam

I hope that you are very well!

I am Liné van Deventer, a student at the North-West University (NWU) and am currently conducting my master's degree research (ethics number: NWU-00961-21-A4). **The aim of my research is to outline pro-active measures to mitigate possible problems the implementation of Mandatory Audit Firm Rotation (MAFR) might create in South Africa.**

This research has a qualitative component consisting of semi-structured interviews with individuals, like yourself, who share experience relating to MAFR. Will you be so kind as to share your valuable inputs in a 30-45 minute interview?

Kindly indicate whether you would be willing to participate in this study by completing the following very short google form: https://forms.gle/Szjz3nXXc9iArPzK9 or by merely replying to this email.

After you have indicated your willingness to partake, an email containing the zoom link, consent form and interview questions will be sent to you.

The information gathered from the Google form together with future communication will stay anonymous and all information will be kept strictly confidential. You may indicate whether you would like to receive a report on the research findings after completion of the study.

If you have any questions, please feel free to contact me.

Yours sincerely,
MCom student: Ms. L van Deventer (28410769nwu@gmail.com or 083 282 1044)
Study leader: Prof. N van der Merwe (Nico.VanDerMerwe@nwu.ac.za)
School of Accounting Sciences; North-West University; Potchefstroom campus

ANNEXURE C: INFORMED CONSENT

On NWU letter head:

Tel: 083 282 1044
Email: 28410769nwu@gmail.com
Date: 18.11.2021

Mandatory Audit Firm Rotation in South Africa:
Suggested solutions to prospective problems

Consent form[52]

By signing this form, I confirm that:

1. I have read and understand the information communicated via email explaining the above research project and I had the opportunity to direct questions towards the researcher.
2. I understand that my participation is completely voluntary and that I am free to withdraw at any time without giving any reason and without any negative consequences. Furthermore, should I not wish to answer a particular question, I am free to decline.
3. I understand that my response will be kept strictly confidential.
4. I give permission to members of this study to have access to my anonymous response.
5. I understand that although my response will be recorded and used in the study, my name, and the name of the firm/institution I am associated with will not be linked to the research material and that I will not be identified in the reports that result from this research.
6. I agree to partake in the above research study.

Signature of Participant	Date
Signature of Researcher	Date

[52] This consent form was drafted from an example found on the web (SampleForms, 2021).

ANNEXURE D: LIST OF INTERVIEW QUESTIONS

Mandatory Audit Firm Rotation (MAFR): List of semi-structured interview questions

Auditor independence

1. How would you define the principle of auditor independence?
2. SAICA's code of professional conduct defines independence as independence of mind and independence in appearance; please elaborate on how you understand both these components?
3. In your experience, what relationship exists between auditor independence and audit quality?
4. In light of the possibility that MAFR will contribute to a *perception* of auditor independence, what impact would you argue will MAFR have on the *perception* of audit quality by *the users* of financial statements?
5. Consider the notion that an auditing firm's knowledge of a client is directly related to the period the firm is involved with the client. Do you think that *the users* of financial statements value auditor independence more than knowledge of a client when judging audit quality?

MAFR in other countries and the potential negative consequences in South Africa

6. What value, if any, does MAFR have in your opinion?
7. What would you claim are the greatest potential negative consequences of MAFR?
8. What, if anything, can companies and audit firms do to mitigate these negative consequences?
9. One of the major concerns identified in a study conducted by the United States General Accounting Office was that MAFR will create a loss of audit client-specific knowledge; how can audit firms mitigate this potential negative consequence?
10. In a recent study, a system of audit file transfer or a 'shadow'-system between the previous and incoming audit firms were mentioned as solutions to mitigate the loss of client-specific knowledge; do you think such systems are feasible?

11. Countries like South Korea reported significantly higher audit fees after the implementation of MAFR. To what extent do you think the current economic environment in South Africa will allow such an increase in audit fees? Please also comment on whether you believe investors will be willing to carry the cost in order to possibly improve audit quality in SA.
12. Contrary to the higher rates reported in South Korea, an empirical study in Italy concluded that rotation of audit firms was used to negotiate lower cost due to continued competition amongst them. Due to the debatable decrease in audit fees together with an increase in tender cost, prior South African research suggests that audit firms' profit would likely decrease. A decrease in profit would probably contribute to cost cuttings for audit firms. If so, which expense do you argue will audit firms cut first, and what would the impact (if any) be on the country?
13. In light of a study that suggested IRBA could provide a guideline document for audit fees (switching costs), what is your opinion on such a regulatory system with regard to audit fees?
14. Respondents to the Ewelt-Knauer *et al.* (2013) study stated that uncertainty about clients will complicate audit planning and consequently also the process of recruiting and allocating talented employees with specialised knowledge. One respondent argued that MAFR might discourage the acquisition of specialisation because of the audit firms' inability to target specific market segments due to the routine rotations. How big of an influence do you believe MAFR will have on auditor specialisation in South Africa, and if you agree that it might limit specialisation, what actions might possibly limit the negative impact?
15. Controversy exists about whether MAFR will increase or decrease the audit market concentration. A highly concentrated audit market is frowned upon by regulators due to the risk which the loss of an auditing firm would have on their country's economy and the belief exists that audit quality could be compromised in oligopolistic markets. What are your thoughts on audit market concentration and in which ways, if any, can the appointment of non-Big 4 audit firms be encouraged in a MAFR legislative system?
16. Francis *et al.* (2013:350) concluded that the dominance of the Big 4 does not harm audit quality, but that the concentration within the Big 4 is found to be a problem. What is your opinion: Will MAFR worsen or improve the dominance of a specific Big 4 audit firm, and why?
17. Opponents of MAFR argue that this legislation will limit an audit committee's ability to determine the best suited audit firm for the company. Thinking about the audit market, is the South African landscape large enough to possibly mitigate this problem? Please motivate.

ANNEXURE E: DEMOGRAPHIC INFORMATION OF PARTICIPANTS

Academics lecturing auditing			
Experience	Min	Max	Mean
Number of years acting as an audit lecturer	5	12	7.3
Gender	Male	Female	Total
Number of participants	2	4	6

Audit Partners			
Gender	Male	Female	Total
Number of participants	4	2	6
Audit firm type	Big 4	Non-Big 4	Total
Number of participants	2	4	6

ANNEXURE F: CALCULATION OF THE 2018 EU AVERAGES

Table F.i.: EU averages of the World Bank's governance indicators of 2018

EU averages 2018	Rule of law: Estimate	Rule of law: Percentile rank	Regulatory quality: Estimate	Regulatory quality: Percentile rank
Austria	1.9	97.6	1.5	91.3
Belgium	1.4	88.5	1.3	86.5
Bulgaria	0	53.4	0.6	72.6
Croatia	0.3	63	0.5	71.2
Republic of Cyprus	0.8	76	0.9	78.4
Czech Republic	1	81.7	1.3	87
Denmark	1.8	96.6	1.6	93.8
Estonia	1.2	86.5	1.6	91.8
Finland	2	100	1.8	96.2
France	1.4	88.9	1.2	84.1
Germany	1.6	91.3	1.8	95.2
Greece	0.2	66.3	0.4	59.1
Hungary	0.6	72.1	0.6	71.6
Ireland	1.5	89.4	1.6	93.3
Italy	0.2	62	0.7	75.5
Latvia	1	79.3	1.1	83.7
Lithuania	1	82.2	1.1	79.8
Luxembourg	1.8	95.7	1.8	94.7
Malta	1.1	88	1.3	82.2
Netherlands	1.8	96.2	2	99
Poland	0.4	66.8	0.9	78.8
Portugal	1.1	85.1	0.9	79.3
Romania	0.3	67.8	0.4	63.5
Slovakia	0.5	76	0.8	70.2
Slovenia	1.1	82.7	0.7	73.6
Spain	1	80.3	0.9	80.8
Swede	1.9	98.6	1.8	97.6
EU Average	1.07	81.93	1.15	82.62