Mandatory audit firm rotation in South Africa and the pushback from the audit profession?

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Introduction

It is commonly agreed that the provision of assurance services, most notably the external audit function, is an activity of public protection. In the eyes of the public, especially the investing public, but also all stakeholders of the company, the audit function provides the much-needed stamp of credibility and assurance as to the fair presentation of the company's financial reporting.

As is clearly stated in international professional and ethics standards governing auditors, the auditor must act at all times with the required independence (both independence in mind and in appearance), objectivity and professional scepticism that is required for the purposes of providing an audit opinion on the fair presentation of the company's financial statements. Auditor independence is important because it has an impact on the quality of the audit. DeAngelo, as quoted by many recent academic studies on audit quality, provides a useful definition of audit quality as the probability that the auditor will:[1]

a) uncover a breach of a statutory or regulatory requirement
b) report the breach to the appropriate parties.

If auditors do not remain independent, they might be less likely to report irregularities through the available reporting channels or insist that financial statements be prepared to their satisfaction, thus, impairing audit quality.[2] This potentially lessens the credibility of the financial reporting process. The most notable reporting channel is via the auditor's opinion and the audit report in which that opinion is contained, and therefore a lack of independence could impair the quality of the audit report provided to the public and stakeholders of the company. Other reporting channels, to provide some South African examples, would be as a whistle-blower to relevant regulatory authorities, such as the Independent Regulatory Board of Auditors (IRBA), the Financial Services Board (FSB), the Johannesburg Stock Exchange (JSE) or the tax revenue authorities (SARS).

[1] LE DeAngelo 'Auditor size and audit quality' (1981) 3:3 *Journal of Accounting and Economics* 183–199, available at <http://doi.org/10.1016/0165-4101(81)90002-1> (accessed 21 October 2016).

[2] P Carey & R Simnett 'Audit partner tenure and audit quality' (2006) 81:4 *The Accounting Review* 653–676.

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International developments

Over the years, most notably since the collapse of Enron in 2001, as well as many other corporate scandals before and since then, regulators globally have expressed concerns about auditor independence and taken actions to mitigate those concerns through increased auditor and corporate regulation. Some significant examples of these regulations, which are specifically relevant to this paper, include the 2002 Sarbanes–Oxley (SOX) Act in the United States (US) and the 2014 decision of the European Parliament to implement mandatory audit firm rotation (MAFR) on European companies. The SOX Act, also known as the 'Public Company Accounting Reform and Investor Protection Act', which is US legislation that, among many other requirements, prohibits the auditor (in a US context) from providing most non-audit services to its clients. More specifically, the SOX Act imposes a one-year 'cooling-off period' for former auditors taking employment at their previous audit clients and requires audit partners to rotate every five years. Similarly, the European Parliament in 2014 voted in favour of Directive 2014/56/EU, amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.[3] These new rules force European companies to hire new audit firms at 10- to 24-year intervals, depending on certain criteria, bringing MAFR into one of the world's most significant economic regions.[4] More specifically, public interest entities have to appoint a new firm of auditors every 10 years. However, member states have the option to extend this maximum period to 20 years (24 if there is a joint audit) provided the audit is subject to a public tendering carried out after 10 years. These new rules require European-listed companies, banks and financial institutions to appoint a new audit firm every 10 years, though this can be extended if companies put their audit contract up for bid at the decade mark or appoint another audit firm to do a joint audit. The rules also prohibit certain non-audit consulting services and cap the amount of additional fees auditors can charge their clients (to 70%). The laws are expected to apply from mid-June 2016.[5]

Improving the quality of the non-executives on the audit committees, possibly through education and promotion of King III Report principles of corporate governance (soon to be replaced by King IV), was believed to be a means of having a greater impact on auditor independence and audit quality.

It is important to note the key difference between the US and the EU regulations outlined above. The US has decided not to adopt MAFR. Instead of rotating the entire audit firm, the US regulations allow the incumbent audit firm to retain the business (and perhaps the institutional knowledge and experience gained over the years), and simply rotate the engagement partner. In the EU regulations of MAFR, however, the incumbent firm must rotate and lose the business, without the possibility of tendering for reappointment. The difference is, of course, very significant to the firm. The audit firm effectively loses the business of the audit client, regardless of whether or not the partners in the firm are suitable and capable of performing the audit. The EU has adopted this in an attempt to further mitigate the threats (particularly familiarity) to auditor independence, thereby protecting audit quality.[6]

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[3] European Commission 'Directorate-General for Financial Stability' (2015), available at <https://www.unodc.org/unodc/en/drug-trafficking/legal-framework.html> (accessed 2 May 2016).

[4] KPMG 'EU audit reform – What you need to know' (2014), available at <https://www.kpmg.com/BE/en/IssuesAndInsights/ArticlesPublications/Documents/EU-Audit-Reform-Fact-Sheet-MFR.pdf> (accessed 21 October 2016).

[5] KPMG 'EU audit reform'.

[6] KPMG 'EU audit reform'.

The South African context

South Africa has also had its fair share of corporate financial failures and scandals, perhaps most recently the demise of African Bank, but one can easily recall many others in the recent past. Many of these failures have partly been blamed on the inappropriate conduct of the auditors. The collapse of LeisureNet in 2000 is an often cited example of poor auditor behaviour stemming from a lack of independence. South African regulators, understandably, have in turn amended regulations accordingly over the past decade to improve corporate governance and auditor behaviour.

Currently, South Africa does not legislate the MAFR laws as have been implemented in the EU, but rather follows a system similar to the US, with auditor rotation (in other words, an individual audit partner) required every five years. This includes a cooling-off period of two years, as prescribed by section 92 of the Companies Act 71 of 2008. The profession in South Africa also places a large degree of reliance on the profession's ethical standards in order to internally assess (or self-assess) threats to its independence as auditor. These standards are contained in the International Standards on Auditing (ISAs), as well as the Code of Ethics for Professional Accountants issued by the International Federation of Accountants (the IFAC Code). These are internationally recognised standards for which the auditor can assess their independence from the audit client.

In South Africa, there is also regulation and guidance provided to the audit committee of public interest entities to assess the independence of the auditor. This is legislated in the South African Companies Act 71 of 2008. Guidance is also provided to audit committees in the King Report on Governance (King III), which is the South African standard on issues of corporate governance, soon to be replaced with the King IV Report. As an example, the Companies Act requires the audit committee to formally assess the independence of the auditor. However, legislation, standards and regulations of the JSE have all stopped short of requiring mandatory audit firm tendering or audit firm rotation as is now being implemented in the EU and the UK.

However, it seems as though the legislative framework is about to change. In August 2016, after a period of stakeholder consultation by the regulator, the Chief Executive Officer (CEO) of the Independent Regulatory Board for Auditors (IRBA) announced plans to implement mandatory firm rotation into legislation.[7] These measures may also include mandatory audit tendering or joint audits, and the IRBA believes that by doing so they will enhance audit quality, contributing to public and investor protection.

A common concern raised was that MAFR would have the effect of removing the need for much important discussion and decision-making by the audit committees and therefore take away their role as the ultimate 'auditor gatekeeper' and assessor of the audit function within the company.

The objective of the IRBA is 'to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes'.[8] It is believed that perhaps implementing mandatory rotation of audit firms is a means to further achieve this primary objective of public protection.

[7] H Ziady 'Mixed reaction to forced rotation of audit firms' Business Day (Johannesburg 30 August 2016), available at <http://www.bdlive.co.za/business/financial/2016/08/29/mixed-reaction-to-forced-rotation-of-audit-firms> (accessed 31 August 2016).

[8] IRBA 'IRBA strategic plan' (2016), available at <http://www.paab.co.za/dmdocuments/irba-strategic-plan-2016-to-2021-for-minister.pdf> (accessed 21 October 2016).

The IRBA have now made their intentions very clear. They intend to follow the direction of the EU and push for legislative change in favour of MAFR. However, the details of whom MAFR would apply to, whether mandatory tendering will be included in the regulations and on what prescribed rotation periods, has not yet been decided on. Due to the processes required for changing legislation, most notably in this case, the South African Companies Act 71 of 2008, we are still a couple of years off from the bill being enacted.

According to the MAFR consultation paper issued by the IRBA, as well as public comment made by the IRBA CEO, the main reasons why the board must consider further measures to strengthen auditor independence through MAFR are the following: [9]

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

A brief review of academic literature on the effects of mandatory firm rotation

The academic literature presents a fairly strong case against adopting MAFR. Of perhaps the greatest significance is findings of studies performed regarding the impact of audit tenure on audit quality and auditor independence. This is a key part of the debate because if auditor tenure does not impair independence or audit quality, then surely there is no need to pursue MAFR?

Most studies that analyse the effects of tenure on auditor independence indicate that independence is not impaired as auditor tenure increases. There are some mixed results in the literature but the majority of studies show, surprisingly to some perhaps, that the length of time a firm remains auditor of a company, is not at the detriment to its independence or the quality of its work. A study by Tepalagul and Lin (2015) consisted of a comprehensive review of academic research pertaining to auditor independence and audit quality.[10] Through a review of published articles during the period 1976–2013 in nine leading journals related to auditing, most studies concluded that long auditor tenure does not impair independence.[11] Many studies, however, do show that incoming auditors are more conservative and diligent, making greater adjustments to the financial statements than the outgoing auditors, but this in itself does not mean that the outgoing and long-standing auditors were less independent.

Very little research has been done on MAFR specifically, probably owing to the fact that very few countries have required firm rotation for any significant amounts of time that would allow credible research to be performed. However, two leading studies that have been performed in this area of MAFR, namely 1) Jackson, Moldrich and Roebuck (2008) and 2) Ruiz-Barbadillo, Gómez-Aguilar and Carrera (2009) are not in favour of pursuing MAFR.[12]

The indirect and unintended consequences of a move to mandatory firm rotation have not been studied sufficiently by academics, nor the perceptions of the various stakeholders involved in the audit process. In addition, no studies appear

[9] IRBA 'Consultation paper: Measures to strengthen auditor independence' (2015), available at <http://www.irba.co.za/news-headlines/press-releases> (accessed 21 October 2016); H Ziady 'Mixed reaction to forced rotation of audit firms'.

[10] N Tepalagul & L Lin 'Auditor independence and audit quality: A literature review' (2015) 30:1 *Journal of Accounting, Auditing & Finance* 101–121, available at <http://doi.org/10.1177/0148558X14544505> (accessed 21 October 2016).

[11] N Tepalagul & L Lin 'Auditor independence and audit quality: A literature review'.

[12] AB Jackson, M Moldrich & P Roebuck 'Mandatory audit firm rotation and audit quality' (2008) 23:5 *Managerial Auditing Journal* 420–437, available at <http://doi.org/10.1108/02686900810875271> (accessed 21 October 2016); E Ruiz-Barbadillo, N Gómez-Aguilar & N Carrera 'Does mandatory audit firm rotation enhance auditor independence? Evidence from Spain' (2009) 28:1 *Auditing: A Journal of Practice and Theory* 113–135, available at <http://doi.org/10.2308/aud.2009.28.1.113> (accessed 21 October 2016).

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to have been published in a South African context around mandatory firm rotation.

The opinions of experienced audit practitioners

In order to explore the perceptions and opinions of the South African audit practitioners regarding the proposed move towards MAFR, away from the current system of five-year partner rotation, fourteen senior and managing partners were interviewed. The opinions of these experienced industry leaders contains a key insight into the view of the auditing profession as a whole regarding the proposed changes to the auditing profession. Fourteen experienced practicing 'registered auditors' (audit partners) were interviewed from nine different audit firms across South Africa, which included representatives from the 'big four' firms as well as what are sometimes referred to as the mid-tier audit firms. In this forum, the audit partners were asked a number of open-ended questions around the issues relevant to the MAFR debate and each partner was therefore allowed to express their views on the subject.

The following is a brief description of the fourteen practitioners interviewed:

- All the audit partners were considered senior and highly experienced, ranging between seven and thirty-three years as a practicing audit partner. The average number of years as a practicing registered auditor of all interviewees is 22 years.
- Seven of the partners were either a regional or a national managing partner in the firm and therefore in key leadership and strategic roles within their respective firms. The remainder were senior partners who also held significant leadership responsibilities and portfolios within their respective firms or network of firms.
- The two largest black audit firms in South Africa, namely SizweNtsalubaGobodo Inc. and Nkonki Inc. were represented. These two firms are the largest 'black-owned' audit firms in South Africa and have grown to considerable size to rival the traditional mid-tier firms.

Table 1 shows a further description of the audit partners (participants/respondents) interviewed.

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Designation of audit partner in analysis of results	Big four, mid-tier or black-owned mid-tier firm	Position	Years as practicing audit partner
Audit partner 1	Big four	Senior partner	25
Audit partner 2	Big four	Managing partner	20
Audit partner 3	Big four	Senior partner	25
Audit partner 4	Big four	Senior partner	9
Audit partner 5	Big four	Senior partner	23
Audit partner 6	Black-owned mid-tier	Managing partner	22
Audit partner 7	Black-owned mid-tier	Managing partner	23
Audit partner 8	Black-owned mid-tier	Senior partner	29
Audit partner 9	Mid-tier	Managing partner	32
Audit partner 10	Mid-tier	Managing partner	17
Audit partner 11	Mid-tier	Senior partner	16
Audit partner 12	Mid-tier	Managing partner	33
Audit partner 13	Mid-tier	Managing partner	28
Audit partner 14	Mid-tier	Senior partner	7

Summarised results of the interviews

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

It was felt (by many partners) that mandatory rotation would artificially limit the freedom of those charged with governance to appoint the audit firm that best meets the needs of the company and its stakeholders.

There were no partners, of the fourteen interviewed, who were fully in favour of MAFR in South Africa. Nearly all (13/14) were against it on the grounds that it would not achieve improved auditor independence and that there were too many significant negative direct and indirect consequences.

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

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

The role of the audit committee

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

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

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

These views by the partners interviewed reflect a common international argument against MAFR in that auditor rotation would now be arbitrarily forced on a company, regardless of the stage or set of specific circumstances that the company finds itself in. For example, just when a company needs the experience of its long-standing auditors, for example in merger or acquisition deals, or in an operational change of direction, which would present significant audit risks, this may coincide with the need to rotate the audit firm, with the incoming audit firm at a significant disadvantage due to unfamiliarity of the client.

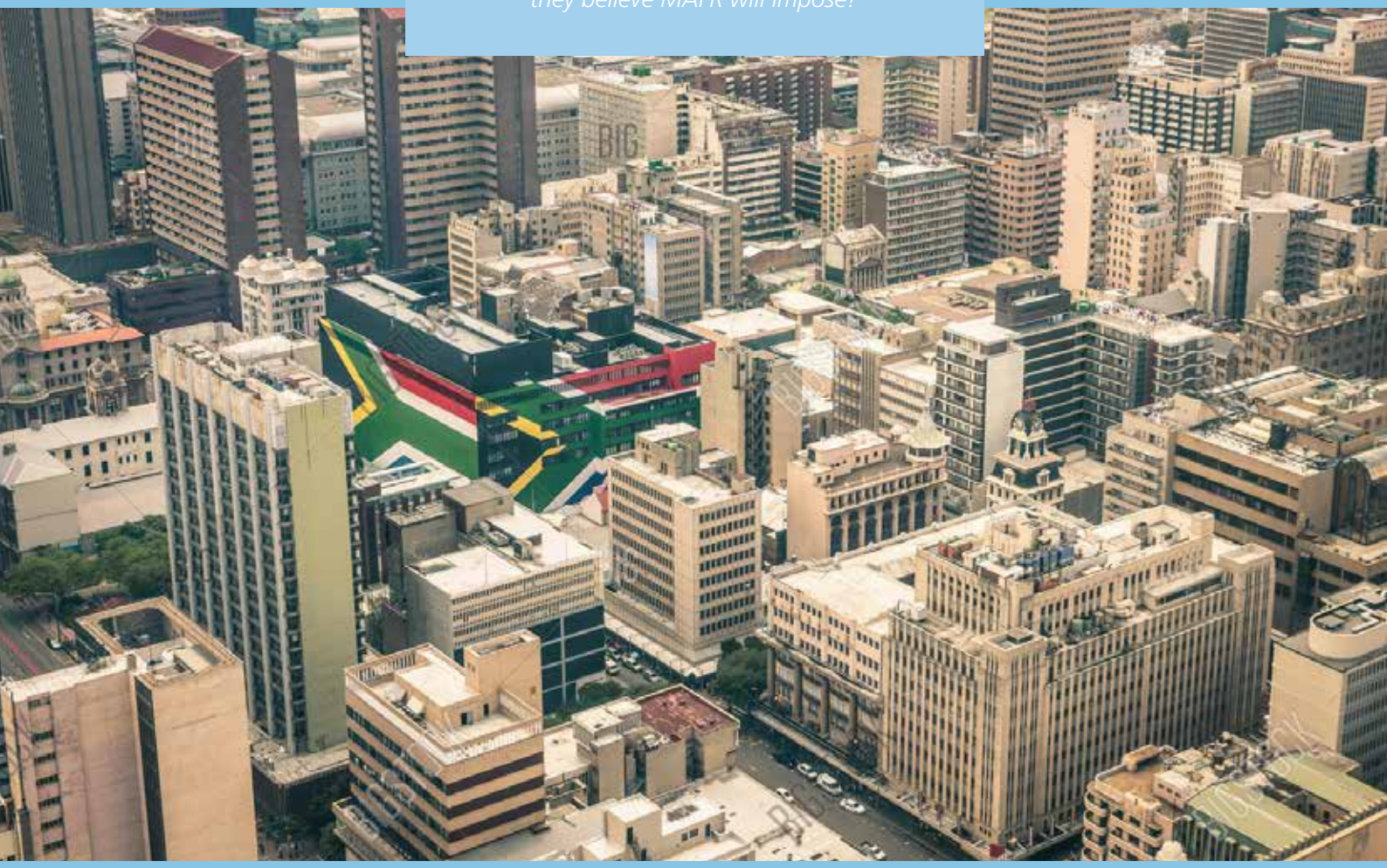
Unintended consequences

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

Loss of knowledge and experience

A primary negative consequence of MAFR that was raised was the significant loss of client-specific knowledge that would leave with the outgoing audit firm upon firm rotation. At the heart of that client and industry knowledge is an understanding of the audit risks at the client. It was the view that the auditor who has a better understanding of the audit risks will ultimately produce the best audit quality in the end product, which is the audited financial statements

Can the audit firms handle the added costs that they believe MAFR will impose?



and the audit report, not to mention the value-added report provided to management together with the audit itself. One partner made the point by stating that the loss of a client to a firm will decrease audit quality because it has the effect of 'promoting incompetence'.

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

Many of the audit partners expressed significant concern regarding the degree of tendering and costs involved that MAFR will introduce to the market.

Unmanageable costs

Many of the audit partners expressed significant concern regarding the degree of tendering and costs involved that MAFR will introduce to the market. The typical argument was that MAFR will result in many more audits going out for tender, albeit tenders whereby the incumbent auditor will not be allowed to bid for reappointment. The other firms will need to tender for the work, as they also have to deal with the fact that MAFR will require them to give up audit clients. So the effect will be the need to produce many more tender documents, together with the extensive research, pre-engagement activities and presentations that necessarily come with tendering for audit work. The cost was considered by many to be unmanageable and hugely time-consuming. In the opinion of one mid-tier audit partner, the expected effect on their firm will be the need to consider developing an entire department to dedicate their resources to producing tenders and presentations to audit committees. This person also felt that, as a mid-tier firm, these tender proposals to the larger companies would simply be turned down because of the perception by stakeholders and audit committees that the non-big four audit firms cannot or perhaps should not be auditing large listed companies. As documented under the market concentration section, many are in agreement that MAFR will simply result in a rotation of the large company audits amongst the big four firms.

Another area of cost increase will be the pressure on the auditors to increase the audit fees, thereby increasing the cost to the companies. An opinion expressed in this regard was that around the 'unfamiliarity cost', which is incurred by the incoming audit firm. And this cost is more significant the larger and the more complex the client is.

Addressing market concentration

All the audit partners expressed concern, despite their other differing opinions on other related matters, that a significant unintended consequence of forcing MAFR on South Africa would be the likelihood that the audit of large companies (particularly the listed companies) would simply rotate around the big four audit firms and therefore actually reduce competition rather than grow it.

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

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

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

Due to the problem that the incoming audit firms will need to urgently procure the skills and experience to perform the audit professionally, the firm will be tempted to offer the staff from the outgoing audit firm jobs on their audit team. This was referred to by the partner as 'cheating the system' of MAFR.

An example of this was then given with the internal audit function of a large South African state-owned entity that outsourced this function to one of the big four audit firms. What happened according to the respondent was that the audit firm then employed most of the state-owned entity's internal audit staff, with the effect that they left the company to work for the audit firm but to perform the same services as the internal audit function. Based on this example, the respondent expressed the view that MAFR would have a similar effect and that staff will move from one employer to the other yet work for the same audit client. This possibility was also expressed by other partners.

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

Transformation considerations

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

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

Again, the concerns expressed in this regard contrasted the differing objectives of improving audit quality so as to achieve sufficient public protection on the one hand, and achieving black economic empowerment

(transformation) in the profession. If regulation changes are pursued with too many objectives in mind, or with too little research and stakeholder consultation, then the unintended consequence of a loss of audit quality may result. As many partners pointed out, surely public protection through enhanced audit quality should be the only reason for changing reason in favour of MAFR? And if so, most, if not all partners interviewed, believed that MAFR was not going to achieve improved audit quality.

Of particular interest was the fact that all the non-big four partners were of the opinion that market concentration of the public interest company audits was a problem in South Africa and needed to be addressed for the good of the profession and the public. Many admitted that this was not a South African specific problem by any means; however, South Africa was in a unique position whereby transformation was also a high priority in business, across all industries in the economy. By addressing market concentration appropriately in the profession through whatever means was considered most appropriate, it would also thereby improve transformation, as it would allow the smaller black-owned emerging firms to compete in the private sector, together with the other non-big four firms. The big question that was raised numerous times was the question of whether MAFR was the best means to achieve this transformation. None of the partners, including those from black-owned firms, believed it was the best means.

[A]ll the non-big four partners were of the opinion that market concentration of the public interest company audits was a problem in South Africa and needed to be addressed for the good of the profession and the public.

Some partners suggested that either promoting transformation within the existing firms or allowing mergers with the black-owned firms was preferable to MAFR in promoting transformation. One partner who was not from one of the emerging black-owned audit firms acknowledged that although many consider mergers of these audit firms with the 'more established firms' as a solution to promoting transformation in the audit profession, it may not be wise, as the corporate cultures and management styles may not necessarily integrate well. This person went on to state that therefore joint audits may be a better solution than pursuing MAFR or simple mergers of firms. Joint audits better allow for a mentoring process and skills transfer to emerging black firms, while preserving their autonomy and growth as a separate firm in the market.

Perhaps in disagreement over the regulator's (IRBA's) thinking around transformation through growth of the emerging black-owned firms, the big four audit partners were quick to point out that their firms, and others, were transforming and this should be recognised by the regulator. One managing partner

(Audit partner 2) of a big four firm stated that their target at the moment in the near future is to reach 70% black staff and they were currently on an actual number of around 50%. This partner went on to state that other big four firms may be doing even better and that would mean that the largest 'black firms' in terms of number of staff were actually the big four firms, not the so-called 'black-owned firms'. The main point being made was that the IRBA needed to recognise these transformation achievements at the firms and therefore not focus on changing legislation to achieve transformation, especially not through MAFR.

The problem of overregulation

Lastly, all the audit partners interviewed expressed concern over the degree of regulation in the profession. In fact it is fair to say that the issue of overregulation resulted in the strongest opinions and even frustration amongst the partners. Many were particularly concerned over the public inspections reports performed by the IRBA and feared that additional regulation was damaging the ability of the practitioners to make professional judgement calls, something absolutely necessary in performing an audit, and which the International Standards of Auditing (ISA) strongly require of the auditor. The concern was simply that MAFR would be another unnecessary regulation in an already overburdened profession.

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

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

Conclusion

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

There is a strong feeling that MAFR will result in significant unintended consequences, most notably a reduction in audit quality, the very reason that the IRBA is considering MAFR. If a system of MAFR is implemented in South Africa the feeling is that this reduction in audit quality will likely come about because of a resultant decrease in competition, again being counter to the IRBA's intentions, and also because it will further reduce the appeal of younger accountants to pursue careers as audit practitioners.

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

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

In conclusion, it is fair to say that the participants interviewed are strongly against MAFR and stress its many negative consequences. Even the 'black-owned' audit firm partners are not clearly in favour of MAFR. Only one partner of the fourteen, which is one of the partners of the black-owned firms, was tentatively in favour of MAFR, providing significant qualifications and reservations.

All the other partners interviewed were against any move to change legislation currently in South Africa in favour of MAFR as they believed it would simply be detrimental to audit quality and the sustainability of the profession.

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