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Audit quality implications of regulatory change in South Africa

Abstract

Purpose

This paper explores how technical constructions of audit practice are influenced by mandatory audit firm rotation (MAFR) regulations. The paper responds to calls for additional research on how external regulation influences audit quality and supplements the predominately quantitative research dealing specifically with firm rotation and its relevance for audit quality.

Design/methodology/approach

Data are collected from South Africa which is the latest jurisdiction to adopt MAFR (from 2017). Detailed interviews with 49 participants comprising 24 audit partners and 25 non-auditors are conducted to explore how MAFR can impact audit quality. For this purpose, audit quality is defined according to a schematic developed interpretively and based on professional auditing standards and the prior research on audit quality.

Findings

There is no guarantee that MAFR will bolster auditors' independence or contribute to a more thorough audit approach. On the contrary, the effort required by incoming audit firms to gain an understanding of new clients coupled with material tendering costs is expected to decrease the profitability of audit engagements with adverse implications for audit quality. A loss of client experience and staff retention challenges may contribute further to a decline in audit quality. There may be some improvements to audit practice when an incumbent firm's work is going to be scrutinised by a new auditor but audit methodologies, including the nature and extent of testing performed, are not expected to change significantly because of MAFR. In this way, the regulation may be a symbolic response to a perceived decline in audit quality and auditor independence rather than part of an effective strategy to encourage more rigorous audit practice for the benefit of the users of financial statements.

Originality/value

The current paper provides one of the first exploratory accountants of how MAFR is expected to impact audit practice and, in turn, audit quality. The research responds to the call for more field-work studies on the mechanics of the audit process by engaging directly with practitioners instead of relying on inferential testing of broad audit quality surrogates. The study also makes an important empirical contribution by providing primary evidence on *how* external regulation influences audit practice from a seldom studied African perspective.

Keywords: Mandatory audit firm rotation; auditor independence; audit tenure; audit quality; auditing

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1. Introduction and background

In the decade following the global financial crisis of 2008/9, there has been more concern by investors, the public and regulators about the perceived ineffectiveness of auditors to ‘blow the whistle’ on corporate misconduct (Hay, 2015; The Economist, 2018a; Wilson, McNellis, & Latham, 2018). In response, government regulators have turned what was a mostly self-regulated profession into one with considerable regulatory oversight (Knechel, 2016).

Both audit regulators and the investing public have expressed scepticism concerning the quality of audits (Chester, 2018; Neate, 2019; The Economist, 2018b, 2019; The New York Times, 2014). The occurrence of corporate financial scandals has caused regulators to shine a spotlight on the independence of the auditors from their clients (Hay, 2015; Lennox, 2014). Lately there has been a trend to question audit firm tenures, as some audit firms have been engaged with clients for many decades (Horton, Tsipouridou, & Wood, 2018; IRBA, 2016; PCAOB, 2011; Roush, Church, Gregory Jenkins, McCracken, & Stanley, 2011). Long relationships between audit firms and clients have driven accusations of auditors being too accommodating of questionable accounting policies and even ‘turning a blind eye’ to irregularities and misconduct (Favere-Marchesi & Emby, 2018). Regulatory inspections of audit firms’ work in the United States (US) by the Public Company Accounting Oversight Board (PCAOB) indicate a failure to exercise the required degree of professional scepticism and to obtain appropriate audit evidence (Westermann, Cohen, & Trompeter, 2019). Similar unsatisfactory findings have been reported in South Africa by the Independent Regulatory Board for Auditors (IRBA, 2018).

Regulators are responding with more stringent rules designed to limit auditor tenure and restore both auditor independence and investor confidence (Knechel, 2016; Tepalagul & Lin, 2015; Wilson et al., 2018). Examples include the Sarbanes-Oxley Act of 2002 (SOX) in the US (which introduced stricter audit partner rotation rules) and more recently, the European Union’s (EU) decision to require mandatory audit firm rotation (MAFR) (European Commission, 2014). In June 2017, the IRBA, South African’s audit regulator, following the EU decision, issued a regulation requiring MAFR for all public-interest entities, including all companies listed on the Johannesburg Stock Exchange (JSE). Audit firms must now rotate off clients every 10 years (IRBA, 2017).

There is little research on MAFR (as opposed to voluntary firm rotation or partner rotation). What has been done tends to focus on archival studies (such as Corbella, Florio, Gotti, & Mastrolia, 2015; Mali & Lim, 2018) in the limited number of jurisdictions where the regulation has been implemented (such as the Republic of Korea or Italy). Experimental studies which construct abstract interventions to simulate audit firm rotation are also common (such as Daniels & Booker, 2011; Quick & Schmidt, 2018; Wang & Tuttle, 2009). Nevertheless, because there are so few jurisdictions in which MAFR has been enforced, “there is no clear evidence about whether it is effective” (Hay, 2015, p. 162). At the same time, the prior research is informed predominantly by positivist research paradigms; few researchers have used qualitative methods to explore the social, behavioural and decision-influencing factors which characterise the audit function (Ewelt-Knauer, Gold, & Pott, 2013; Hay, 2015). Consequently, the MAFR literature does not deal with the technical dimensions of audit practice and relevance of MAFR for the practitioner community (Ewelt-Knauer et al., 2013, p. 28). As explained more generally by Humphrey (2008, p. 193):

“The problem with so much audit research is that it does not explore audit practice *per se*, but rather fabricates such practice, studying around the edges of the “black box” of auditor decision-making or constructing experiments that cannot ever really be expected to replicate either the real pressures and career challenging or threatening scenarios that some auditors can encounter in their actual working environment”.

In this context, this paper provides one of the first exploratory accounts of the implications of MAFR for audit practice, focusing specifically on how MAFR may contribute to higher quality audits or alternately, fail to do so. Data were collected from South Africa, an ideal environment to conduct a study of this nature. South Africa has a highly advanced audit industry, capital market and systems of

corporate governance¹. Also, South Africa is most recent of a very limited number of jurisdictions to move beyond partner rotation rules and implement MAFR (Harber & Maroun, 2020; Lennox, 2014). Researchers are only beginning to investigate MAFR effects in the EU since its implementation in 2016 (see Horton, Livne, & Pettinicchio, 2020).

In 2015, the South African audit regulator (IRBA) began a consultation process after announcing its intention to follow the direction of the EU with MAFR. A consultation paper was issued in October 2016 requesting formal responses within three months (IRBA, 2016). Parliamentary hearings were then conducted in February and March 2017 (RSA, 2017a, 2017b), culminating in the announcement in June 2017 of the MAFR ruling (IRBA, 2017).

In this context, studying MAFR in South Africa makes an important contribution to the auditing literature. Firstly, this study engages directly with practitioners *currently* grappling with the introduction of MAFR. In doing so, the current paper responds to calls for additional research on potential consequences of firm rotation (Ewelt-Knauer et al., 2013; Hay, 2015). This call has also come directly from the International Federation of Accountants (IFAC), the global umbrella organization representing the accountancy profession (Choudhury, 2017). The study also addresses the need for more field-work analysis which moves beyond inferential testing of audit quality surrogates in favour of collecting primary evidence on how external audit regulations are operationalized in practice (Ewelt-Knauer et al., 2013; Hay, 2015; Christopher Humphrey, 2008). As explained by Ewelt-Knauer et al. (2013, p. 35), the views of experienced practitioners are seldom considered in research dealing with the impact of external regulation on audit quality. What is needed is a more detailed exploratory analysis of *how* specific technical constructions of audit practice are influenced by regulatory measures including MAFR. Secondly, by focusing on South Africa, this paper addresses the need for research dealing with the functioning of external regulation designed to bolster audit quality in developing economies (Humphrey, 2008). Thirdly, the current study adds to the limited body of interpretive research which deals more generally with audit practice. It makes an important empirical contribution by providing insights on audit quality and MAFR based on expert opinion to complement the predominately archival research on the topic.

Detailed, semi-structured interviews were used to collect data. Participants were purposefully selected to include audit practitioners, preparers of financial statements, users of financial statements, regulators and auditing academics. Two audit quality frameworks are employed, providing the basis for a quality schematic to explore stakeholders' perspectives on the possible implications of firm rotation for audit quality. The first (the professional framework) is based on the International Standard on Quality Control 1, '*Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*' (ISQC 1) (IFAC, 2009), developed by the International Auditing and Assurance Standards Board (IAASB). This framework was selected because it is used globally as the primary standard for audit firm quality control. The second (the academic framework) was developed using academic literature on audit quality, in this way avoiding over-reliance on a professional construction of audit quality which may be inherently biased (Power, 2003).

Together, the two quality frameworks provide a basis for exploring views on the implications of MAFR for specific aspects of audit practice and the resulting quality of audit engagements. The findings show that MAFR is likely to impact the audit industry in terms of incentives and profitability. Certain unintended effects of MAFR are confirmed, such as the threat to audit quality from the replacement of an experienced audit team with one which is less experienced in the complexities of the client's finances. Several other quality effects emerged. For example, auditors will need to devote considerable resources and time to competing for clients to replace outgoing clients (and fee revenue). This business incentive may impact their professional obligations to the detriment of quality. The senior staff time required in risk assessment and planning to bridge the unfamiliarity gap is considerable. Reduced profitability presents specific risks to audit quality. However, the increased turnover of engagements

¹ In 2015 and 2016 the World Economic Forum (WEF) ranked South Africa 1st and 3rd out of approximately 140 countries for "strength of auditing and reporting standards" and "efficacy of corporate boards" (WEF, 2016).

also presents a reputation risk as audit work and financial statements are scrutinized by new audit teams. This may have a positive effect on audit quality.

The remainder of this paper is structured as follows. Section 2 provides a brief review of MAFR research, followed by a discussion of the concept of audit quality. The audit quality frameworks used to construct the interviews and analyse the data are then developed. Thereafter, the interview methodology is described in Section 3, followed by the results in Section 4, which are thematically presented. Lastly, Section 5 offers a summary and conclusion to the paper, together with implications and practical recommendations.

2. Literature review

2.1 Mandatory audit firm rotation

The primary objective of any version of auditor rotation is to preserve auditor independence by limiting the opportunity for auditors to develop relationships with and dependency on the management teams of their clients (IESBA, 2018; Tepalagul & Lin, 2015). MAFR is the strictest version of auditor rotation rules, requiring the entire audit firm to rotate periodically. This version is less common but, with the recent adoption by the EU and South Africa, there is a developing trend in this direction. Currently, international standards recommend audit partner rotation as sufficient to safeguard auditor independence (IESBA, 2018, Section 540).

Whether MAFR is effective is contested (Casterella & Johnston, 2013; Reid & Carcello, 2017). Most notably, proponents of MAFR argue that long-standing relationships between *audit firms* (not simply individual audit partners) and clients lead to audit failures (Kwon, Lim, & Simnett, 2014; Tepalagul & Lin, 2015). Familiarity with the client impairs auditors' independence and professional scepticism, resulting in reduced audit quality (Aschauer & Quick, 2018). In contrast, opponents claim that MAFR improves investor and public perceptions of auditor independence. It does not necessarily improve independence 'in fact' (Ewelt-Knauer et al., 2013; Fontaine, Khemakhem, & Herda, 2016). Long audit firm tenures lead to valuable client- and industry-specific knowledge and expertise with positive implications for audit quality. As a result, opponents of MAFR believe that it will impair audit quality because the regulation leads to a loss of experience (Casterella & Johnston, 2013; Ewelt-Knauer et al., 2013; Kwon et al., 2014). New auditors may have 'fresh eyes' and may be perceived as more objective and independent, but they have less knowledge of their clients' businesses and industries than long-serving incumbents. The primary arguments for and against MAFR are presented in Figure 1.

Figure 1: Primary arguments for and against MAFR

There is evidence that longer partner tenures can impair auditor independence and audit quality (Ball, Tyler & Wells, 2015; Carey & Simnett, 2006). This strengthens the argument for mandating partner rotation and is consistent with international standards which recommend partner rotation for public-interest organizations (IESBA, 2018, Section 540). Yet research on the effects of audit firm tenure and independence or audit quality present mixed results (Casterella & Johnston, 2013; Tepalagul & Lin, 2015). For example, Chen, Lin and Lin (2008) and Myers, Myers and Omer (2003) find a positive association between the length of audit firm-client relationships and financial reporting quality. The finding is supported by Stefaniak, Robertson and Houston (2009), Tepalagul and Lin (2015), Bamber

and Iyer (2007) and Wang and Tuttle (2009) who argue that long-standing client relationships allow auditors to understand their clients better and apply more extensive or sophisticated assurance methods. Similarly, there is no guarantee that long audit firm tenures result in misapplication of accounting and auditing standards and a reduction in professional judgement and scepticism (Cameran, Prencipe, & Trombetta, 2016; Ewelt-Knauer et al., 2013; Mali & Lim, 2018). In contrast, some archival studies conclude in favour of firm rotation (Choi, Choi, Gul, & Lee, 2015; Corbella et al., 2015; Kim & Yi, 2009). Firm tenure may improve audit quality but beyond some point, auditor independence is compromised and audit quality declines (Brooks, Cheng, & Reichelt, 2013; Davis, Soo, & Trompeter, 2009).

Much of the prior research deals with situations where audit firms are changed for reasons other than a regulatory requirement (e.g. Blouin, Grein, & Rountree, 2007; Nagy, 2005). This is because of the scarcity of countries which have mandated firm rotation (Hay, 2015; Lennox, 2014). A review of the prior archival research highlighted only eight papers testing within jurisdictions which required firm rotation (i.e., MAFR settings primarily within Italy and the Republic of Korea). These employ audit quality surrogates, such as discretionary accruals, restatements or auditor report modifications, to indicate whether, statistically, audit quality changes on rotation. These studies present mixed findings. To illustrate, using the Italian context where MAFR has been in effect since 1975, Cameran, Francis, Marra and Pettinicchio (2015) find that quality of audited earnings declined in the first three years following rotation, suggesting that audit quality improved as audit firm tenure increased and that unfamiliar auditors are a threat to quality. This does not provide support for MAFR. Yet, Cameran et al. (2016) show that accounting conservatism, proxied by abnormal working capital accruals, increases in the last three-year period before firm rotation, implying that the outgoing audit firm anticipates scrutiny by the incoming auditor. This evidence supports MAFR. Corbella et al. (2015), also using Italian data with audit quality proxy measures related to earnings management, find that audit quality did not change upon rotation of Big 4 firms but quality improved for companies audited by non-Big 4 audit firms. This provides partial support for MAFR.

An important limitation of much of this archival research is that findings are based on changes in broad quality proxies before and after firm rotations. Important audit quality effects related to “auditor decision-making” and “the real pressures and career challenging or threatening scenarios” faced in practice by auditors (Humphrey, 2008, p. 193) cannot be understood from such quantitative designs. This is a contribution this paper intends to make. As explained by Ewelt-Knauer et al. (2013, p. 28):

“The current debate lacks a systematic and critical composition of arguments, practitioner experiences and opinions and research evidence regarding audit firm rotation effects”.

A market reaction analysis by Reid and Carcello (2017) in the US indicates that investors react negatively to events which increase the likelihood of rotation. Williams and Wilder (2016) synthesise the opinions of 15 American audit firms’ comment letters to the PCAOB. These firms expressed broad opposition to MAFR, preferring to strengthen audit committee governance of the audit function. These two perception-based studies complement the largely archival research on MAFR but stop short of explaining *how* MAFR may change specific aspects of audit practice and the resulting implications for audit quality. Indeed, to the authors’ knowledge, no papers deal directly with how auditors understand and respond to MAFR at the firm and individual engagement-level. The views of other key stakeholders such as analysts, investors and preparers have also not been considered. Hussey and Lan (2001) and Fontaine et al. (2016) are exceptions. The former conducted surveys of finance directors in the UK, finding that they were concerned with audit quality and were in favour of rotating audit firms. The latter interviewed audit committee members in Canada who felt that MAFR was unnecessary and a threat to their shareholder-granted authority to make audit firm appointment decisions. The views of auditors themselves and how MAFR impacts audit practice, have not been addressed.

The research presents mixed and inconclusive results. This is also reflected in the contradicting views on MAFR by regulators, some of whom adopted the rules (e.g., the EU and South Africa) and others, such as the US, Canada and Australia, who have repeatedly decided against MAFR in favour of more

traditional audit partner rotation rules which they believe offer a superior overall cost-benefit trade-off (Harber & Maroun, 2020; Horton et al., 2018; Roush et al., 2011). Singapore, having adopted MAFR over its banking industry, recently decided to repeal the regulation, citing inconclusive research findings and potential negative consequences relative to partner rotation rules (Choudhury, 2017). As a result, there is considerable scope for researchers to use qualitative designs to understand the technical and practical effects of MAFR and supplement quantitative research.

2.2 Conceptual Framework Development

2.2.1 Audit quality

This paper attempts to increase our understanding of the consequences and audit quality effects of MAFR. It is important to develop a framework for understanding audit quality. The seminal work of DeAngelo (1981 p. 186) provides a useful but broad definition of audit quality. Here the concept is defined as the probability that the auditor will (1) uncover a breach of statutory or regulatory requirements (particularly financial) and (2) report this breach to the appropriate parties. This definition resonates with the idea that the auditor acts as a type of whistle-blower (Maroun & Atkins, 2014; Wilson et al., 2018) and that, through a process of verification, the audit contributes to more accurate and reliable financial reporting (DeFond & Zhang, 2014).

In practice, audit quality is difficult to define and operationalize:

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

As stated by the United Kingdom (UK) regulator, “there is no single agreed definition of audit quality that can be used as a standard against which actual performance can be assessed” (FRC, 2006, p. 16). Stakeholders view audit quality from differing perspectives, depending on their role and understanding of the assurance process. Figure 2 summarises the diversity of perspectives on what constitutes audit quality. It is not intended to be exhaustive.

Figure 2: Varying possible perspectives on what constitutes 'high audit quality'

Source: Adapted from Francis (2004, 2011) and Knechel *et al.* (2013)

Users understand audit quality as the absence of material misstatements and confirmation that management misconduct has been detected and corrected (Knechel et al., 2013). From a broader societal perspective, audit quality can be inferred based on whether or not an appropriate audit opinion has been issued, with the result that material economic losses are avoided (Tepalagul & Lin, 2015). A more technical perspective considers audit quality as a function of compliance with standards and regulations allowing the auditor to collect sufficient and appropriate audit evidence (Francis, 2011; Knechel et al., 2013). To this end, the guidance provided by the standards issued by the International Auditing and Assurance Standards Board (IAASB) is relevant.

The International Standards on Auditing (ISA) do not define ‘audit quality’ directly. Rather, it is considered a product of compliance and application of the relevant standards, underpinned by ethical conduct (especially independence), professional scepticism, professional judgement, appropriate engagement leadership and a sound system of internal quality control (IAASB, 2009; IFAC, 2009). The quality control features vary according to the size, complexity and structure of audit firms (ibid) and, by virtue of their nature, are difficult to observe and measure directly. For example, many aspects of audit practice comprise proprietary information unavailable to researchers (such as engagement hours or audit work papers). Consequently, the academic research takes a different approach, focusing mainly on the outcomes of audit engagements. Commonly used proxies for inferring the level of audit quality include, for example, the levels of discretionary accruals (Kwon et al., 2014; Mali & Lim, 2018), the correlation between accruals and future profitability (Francis, 2004) and the cost of financial capital (Fernando, Abdel-Meguid, Elder, & Lubin, 2010).

2.2.2 Framework derived from professional standards

ISQC 1, read together with other applicable standards such as ISA 200 and ISA 220, outline the essential ‘elements’ or ‘features’ which contribute to ensuring that the auditors’ opinions on clients’ financial statements are appropriate (IAASB, 2014; IFAC, 2009b, 2010a, 2010b). The standards describe a process-driven framework which, when implemented appropriately by the auditor and audit firm, results in high audit quality. The components of this ‘system of quality control’ (IFAC, 2010, p. 38) are illustrated in Figure 3.

Figure 3: ISQC 1 interrelationships of audit quality components

Source: IAASB (2019, p. 7) and IFAC (2009b)

Taking a risk-based system approach to audit quality, ISQC 1 relies on three ‘key pillars’, namely, (1) ethical considerations (which include independence), (2) due diligence when accepting or continuing client relationships and (3) performance considerations (refer Figure 3). Engagement performance refers to the policies and procedures established during an audit to ensure compliance with professional standards and applicable legal and regulatory requirements. These include supervision and review of the audit by the audit partner and senior team members (IFAC, 2010). The quality of an audit firm’s governance structures, including leadership at a client- and firm-level, also play a role. Equally important is the quality of the knowledge, expertise and capacity of the engagement staff (resources).

The ultimate objective in ISQC 1 is “to establish and maintain a system of quality control” so that “reasonable assurance” can be provided on a client’s financial statements (IFAC, 2010, p. 39). Overall, the profession tends to measure audit quality from a perspective of compliance with standards and regulations and the outcome of the auditor’s report on a client’s financial statements.

2.2.3 Framework derived from the literature

The literature approaches audit quality from a variety of perspectives, not focusing exclusively on the auditor-centric approach taken by ISQC 1. Acknowledging the varying interpretations, “researchers identify the fundamental characteristics against which the quality of an audit can be discussed” (Knechel et al., 2013, p. 386)². The following *primary attributes*, derived from the literature reviews of Knechel et al. (2013, p. 386) and Francis (2011) help to define the elusive concept of ‘audit quality’:

- An audit is an economically motivated response to risk, i.e., **incentives matter**. The auditor needs to maintain **professional scepticism**.
- The output of an audit is a report but the outcome is uncertain and unobservable. There is uncertainty surrounding unobservable audit quality outcomes, i.e., **uncertainty matters**.
- Each engagement is different. The idiosyncratic nature of an audit arises because of variations in client characteristics, audit teams, timing of work and assessed risk and procedures used, i.e., **uniqueness matters**.
- The audit is a logical and systematic activity, responsive to risk, and conducted by audit practitioners i.e., **process matters**. Commitment to, and a culture of, **internal quality control matters**.
- The execution of the audit process depends on leveraging the knowledge and skills of experts, i.e., **professional judgement matters**.

The framework presented in Figure 4 integrates the above auditor and engagement attributes (namely, incentives, scepticism, uncertainty, uniqueness, process, quality control and judgement) with the four aspects of an audit (namely, input, process, output and context). These four aspects (or divisions) are commonly employed in audit quality literature to delineate different parts of an audit (Francis, 2011). This provides a useful schematic for evaluating audit quality.

² The literature reviews and discussion of audit quality by Francis (2004, 2011) and Knechel *et al.* (2013) result in a useful summary and categorisation of audit quality factors, presenting an ‘audit quality framework’ for researchers. The literature review by Tepalagul and Lin (2015), linking audit quality to auditor independence, is also particularly relevant for the application of audit quality to the audit firm and partner rotation debate.

Primary audit quality characteristics: incentives, scepticism, uncertainty, uniqueness, process, quality control and judgement

Figure 4: Framework for synthesizing and understanding research related to audit quality

Source: Constructed from the literature reviews of Francis (2011) and Knechel et al. (2013)

Many of the characteristics in Figure 4 have been tested for their impact on audit quality. For example, sound judgement increases quality (Hurt, Brown-Liburd, Earley, & Krishnamoorthy, 2013; Smith & Kida, 1991) whereas perverse incentives and pressures lower it (Blay, 2005; Farmer, Rittenberg, & Trompeter, 1987; Kathryn Kadous & Zhou, 2018). Professional scepticism and knowledge/expertise concerning the client increase audit quality (Nelson, 2009). A continual challenge, however, is that many of these cannot be measured due to their subjectivity and qualitative nature. Others cannot be observed directly as they constitute proprietary information unavailable to researchers (DeFond & Zhang, 2014; Simnett, Carson Vanstraelen, 2016). This is especially true with the inputs (for example, incentives which create a conflict of interest or degree of knowledge of the client) and the context features (for example, audit fees, engagement hours and staff remuneration). Within the audit process, audit files documenting procedures and judgements are not a matter of public record. The same is true for the specific findings from regulatory inspections which are usually published in summative form, omitting client- and auditor-sensitive details³. This makes research on audit quality particularly difficult, resulting in the majority of audit quality testing focused on publicly available data, mostly from the financial statements and the auditors' reports⁴.

In MAFR research, this challenge is illustrated in the weak audit quality proxies used within archival studies which attempt to measure audit quality changes surrounding audit firm rotation events. Most common measure of audit quality in these studies is earnings management and accounting conservatism, proxied by some form of discretionary accruals (for examples, see Casterella & Johnston, 2013). These measures are acknowledged to be a poor approximation of the complex and subjective concept of 'audit quality' (Casterella & Johnston, 2013; Knechel et al., 2013; Kwon et al., 2014). As a result, this paper addresses the need for qualitative designs to complement the findings of archival and experimental research on MAFR (Humphrey, 2008). If regulators intend to improve audit quality with MAFR rules, we need a deeper understanding on the audit quality effects of the regulation, beyond its potential to impact these quantifiable quality proxies. The concept of audit quality is difficult,

³ An exception is the inspection reports published by the US Securities and Exchange Commission (SEC) which go into some detail on firm-specific findings.

⁴ Refer to Simnett, Carson and Vanstraelen (2016) as well as DeFond and Zhang (2014) for a review of international archival auditing research employing quantifiable audit metrics. Casterella and Johnston (2013) review archival research specifically as it relates to the MAFR debate.

perhaps impossible, to define, let alone measure. Therefore, research on the topic needs to be varied in approach and design. In so doing, we are responding to calls from both academics (Ewelt-Knauer et al., 2013; Humphrey, 2008) and professionals (Choudhury, 2017; Fontaine et al., 2016) for further qualitative research on audit quality effects. This paper employs an interpretive method, utilising the dual audit quality frameworks derived (Figures 3 and 4) to explore differing practitioner perspectives on the issues central to the regulation logic.

3. Method

According to Humphrey (2008, p. 177), archival research leaves many important research questions unanswered. In particular, it does not provide “a serious consideration [of] the potential of adopting qualitative methodological approaches or ways of viewing auditing and the task/obligations of audit research that seek to engage much more closely with the social construction of audit practice”. An exploratory research design relying on detailed interviews can “enhance [the] understanding of the process of, and structures governing the provision of, auditing services” (Humphrey, 2008, p. 177). For example, detailed interviews have been used to evaluate how auditors adapt methodologies applied to financial statement audits to assurance engagements dealing with sustainability and integrated reports (Dillard, 2011; Warren Maroun, 2018; O’Dwyer, Owen, & Unerman, 2011). The method has been employed to shed light on how auditors respond to developments in financial reporting (Durocher & Gendron, 2014) and changes to auditing standards (Khalifa, Sharma, Humphrey, & Robson, 2007). Detailed interviews have also been used to examine the introduction of regulatory requirements which expand auditors’ reporting duties (Maroun & Atkins, 2014) or modify the audit profession’s governance and accountability structures (Khalifa et al., 2007; Loft, Humphrey, & Turley, 2006).

A qualitative research design does not result in reproducible data which can be subject to robustness checks and probability testing. Nevertheless, detailed interviews are more appropriate for exploring complex and seldom studied aspects of audit practice where quantitative techniques run the risk of being reductionist and overlooking important interconnections (Baxter, Boedker, & Chua, 2008; de Villiers, Dumay, & Maroun, 2019; O’Dwyer et al., 2011). This is especially true when it comes to MAFR which, to date, has only been examined by a limited number of papers relying on inferential testing of broad quality surrogates (see Casterella & Johnston, 2013; Hay, 2015).

3.1 Data collection

Data were collected using semi-structured interviews from a purposefully selected sample of audit practitioners and other experienced role-players. Despite the susceptibility of interview data to participant bias, especially that of auditors who tend to resist regulatory intervention (Malsch & Gendron, 2011), this method allows researchers to explore the social, judgemental and decision-relevant aspects of audit quality. The interview sheet included seven open-ended questions designed to explore the views of participants on the potential impact of MAFR on audit quality. Open-ended questions allow participants to express their views and avoid the researcher inadvertently leading the participants. This approach also allows the researcher to explore participants’ answers in a conversational style, facilitating in-depth insights into the links to audit quality. The result is more detailed and reliable data (Dearnley, 2005; DiCicco-Bloom & Crabtree, 2006).

Purposive sampling was employed to choose participants, based on their expertise within the South African audit profession and knowledge of issues linked to the MAFR debate. Purposive samples are most common as a form of non-probabilistic sampling, with sample size guided by the concept of ‘saturation’. Saturation “is normatively taken to imply that data collection should continue until no additional significant insight is generated and there are no more emergent patterns to be discerned” (Dai, Free, & Gendron, 2019, p. 3).

The final sample consisted of 49 participants, which is well above the median number of interviews in accounting research (26) as determined by the literature review of Dai et al. (2019). Refer to Table 1 for a summary of the individuals participating in the current study and to Appendix 1.

Table 1: Overview of participants

Position (abbreviation)	Role description	No. of participants
Audit partner ('Auditor')	Audit practitioner; senior leadership within audit firm	24
Financial manager ('Manager')	Preparer of financial statements; interacts with senior audit team members; Chief financial officer (CFO) or financial manager	6
Audit or accounting regulator ('Regulator')	Senior employee of the IRBA, professional accounting body or JSE (stock exchange)	7
Audit academic ('Academic')	Auditing lecturer from a South African university, chosen based on their knowledge of the academic literature, regulatory environment, and auditing standards	10
Analysts ('Analyst')	Senior staff from an investment company, managing third-party capital in the equity market	2

All participants were familiar with the issues central to the MAFR debate, having followed the events of the consultation process until the June 2017 ruling. Emphasis in selection was placed on experienced audit practitioners, each of whom had experience with auditing public-interest companies and with audit firm and partner rotation⁵. The participants' average experience as an audit partner was 16 years and included representation from the senior leadership of all four 'Big 4' firms plus eight of the next largest audit firm networks in South Africa⁶. Six of the audit partners acted as managing partners of their respective national audit firms. The audit partners are considered best placed to provide an insider view of the direct and indirect consequences of MAFR. All partners selected possessed personal experience with firm rotations, specifically as the incoming audit firm. The views of the non-auditors (25) were used to contrast and compare the perspectives of the auditors (24). The seniority and expertise of the participants, together with their knowledge of the MAFR debate, contribute to the validity and reliability of the findings (O'Dwyer, Owen, & Unerman, 2011).

The interviews were conducted in person and varied between 30 minutes and 90 minutes. Each interview was audio-recorded and transcribed. Unique codes were assigned to each transcript to ensure anonymity. The interviews were conducted in the cities of Cape Town, Durban, Johannesburg and Pretoria.

3.2 Data analysis

Following a similar approach to Khalifa et al. (2007) and O'Dwyer et al. (2011), the researchers focused on identifying emerging themes, principles and concepts rather than attempting to measure changes in audit quality in a positivist sense (Tashakkori & Creswell, 2007). The transcribed data were analysed thematically using an iterative process of comparison and contrasting viewpoints. Themes were identified by allocating open codes to segments of text and then sorting text segments with similar content into separate categories. The views, arguments and counter-arguments raised by the participants were structured using the two frameworks in Figures 3 and 4. This approach has been described as a 'template approach' as it involves applying a template (categories) based on prior research and theoretical perspectives (DiCicco-Bloom & Crabtree, 2006). The principal codes derived from the frameworks for audit quality are shown here in Table 2⁷:

⁵ Judgement surrounding the point of saturation is subjective and much debated in the literature (Dai et al., 2019). The researchers applied their judgement to when it occurred for the interviews of audit partners only. The views of non-auditors are included in this study to provide context, contrast, and address bias. Considering how and why views differed among the groups or types of participants was deferred for future research.

⁶ The Big 4 firms included PwC Inc.; EY Inc.; KPMG Inc.; and Deloitte Inc. Non-Big 4 firms included RSM Inc.; Nkonki Inc.; SizweNtsalubaGobodo Inc.; Grant Thornton Inc.; BDO Inc.; Mazars Inc.; Baker Tilly Greenwoods Inc.; and PKF Inc.

⁷ Note that there is overlap of activities and factors both within each framework and especially when combined. This resulted in multiple allocation of codes to sections of transcribed interview data.

Table 2: Coding description

Code ^[identifier]	Description ^[link to frameworks]
Code 1 ^[C1]	Ethical factors (technical competence and independence) ^[Figure 3]
Code 2 ^[C2]	Client engagement or continuance factors ^[Figure 3]
Code 3 ^[C3]	Engagement performance factors ^[Figure 3]
Code 4 ^[C4]	Risk management processes ^[Figure 3]
Code 5 ^[C5]	Leadership and governance factors ^[Figure 3]
Code 6 ^[C6]	Input, process, output and context factors ^[Figure 4]
Code 7 ^[C7]	Auditor and engagement attributes (namely, incentives, scepticism, uncertainty, uniqueness, process, quality control and judgement) ^[Figure 4]

The code identifiers (e.g., ^[C1]) are integrated into the results discussion (Section 4) to show the link with the audit quality attributes derived from the quality frameworks (Figures 3 and 4).

A common argument against qualitative findings is that, since statistical inference is lacking and data are often collected from direct engagement with a limited number of participants, the results are biased or anecdotal. Safeguards have been put in place to address these limitations (de Villiers et al., 2019). Firstly, as discussed in Section 2, findings are generated using audit quality frameworks drawing on the relevant professional and academic literature. This limits subjectivity and ensures that different perspectives on the interconnection between MAFR and audit quality are considered. Secondly, participants have been selected to ensure that they have the necessary experience and expertise to comment on how firm rotation can impact audit practice. While a degree of bias cannot be precluded, carefully selecting participants ensures that responses are suitably informed. Thirdly, while several audit partners have been interviewed, the researchers have also engaged other stakeholders. The objective is not to compare how views on MAFR vary among the types of participants but to avoid the results being dominated by the views of a single constituent. Finally, it must be stressed that in qualitative studies, validity and reliability are a product of generating detailed findings based on participants' opinions and cross-referenced to the prior research. This is achieved by reporting anonymised comments and highlighting how these shed light on the relationship between firm rotation and audit quality using the frameworks outlined in Section 2. The goal is not to measure quality directly but to engage with experts to explore potential audit quality effects from MAFR and, in doing so venture inside “the ‘black box’ of auditor decision-making” (Humphrey, 2008, p. 193).

4. Results and discussion

The following discussion of results refers to the codes derived from the audit quality frameworks, as shown in Table 2 (e.g., ^[C1]).

The professional obligation of auditors to maintain diligence, technical expertise and independence ^[C1] ^[C7] throughout the audit (IESBA, 2018; IFAC, 2009) was emphasized by all audit practitioners and 19 of the 25 non-auditor participants. In general, participants felt that recent scandals were exceptional cases, rather than indicative of wide-spread weaknesses in existing audits⁸. In this context, only nine of the 49 participants were in favour of MAFR. This included six regulators (which is to be expected) and three audit partners (two from the Big 4 and one from a smaller audit firm).

⁸ These include, for instance, scandals at VBS Mutual Bank, Africa Bank and Steinhoff International which involved, *inter alia*, alleged contraventions of codes of professional conduct and misapplication of the applicable accounting and auditing standards. A detailed review of these corporate failures is beyond the scope of this research.

4.1 Engagement team attributes: independence and professional competence

As discussed in Section 2.2 both ISQC 1 ^[C1] and the academic literature ^[C7] stress the importance of ethical standards for high-quality audits, with particular attention paid to auditor independence. Regulators excepted, none of the participants felt that MAFR would improve ‘independence in fact’ directly. The long-established mandatory partner rotation rule was believed a more cost-effective way for managing independence threats between senior staff at the audit firm and client. Participants’ views echo earlier research findings on stakeholder perceptions (Ewelt-Knauer et al., 2013; Fontaine et al., 2016; Reid & Carcello, 2017), as well as archival studies which did not show statistically significant improvements in audit quality proxies (Cameran et al., 2015, 2016; Kwon et al., 2014). Interviewees’ concerns that MAFR will not have a substantive impact on auditor independence are also in line with the views expressed on MAFR in the EU (Choudhury, 2017) and the US (PCAOB, 2011) during formal consultation with industry stakeholders.

Two participants suggested that MAFR can contribute to a reduction in the rendering of non-audit services which have long been identified as threat to auditor independence (Tepalagul & Lin, 2015). This position was rejected by the remaining interviewees who felt that MAFR is, at best, only an indirect response to the risks arising from non-audit services. The participants also pointed out that codes of professional conduct and external regulations (like SOX in the USA and the Auditing Profession Act in South Africa) already limit non-audit services (see also Hay, 2015; Knechel, 2016).

A key concern raised by several participants, including auditors, is the existing “funding model” ^[C2] in terms of which the auditor is remunerated by audit client (P43, Academic). While steps have been taken to ensure that audit committees, rather than executive managers, set the auditor’s remuneration, participants felt that there is still a material threat to auditor independence which is not addressed by MAFR. Consider, for example, the following comment:

“When the client is such a dominant number in your world; you know, four or five per cent of your fee income, you can never be truly independent... I’m ultimately coming back to the client for my fee discussion...whether you rotate or not.” (P22, Auditor)

Participants agreed that MAFR will do little to resolve the tensions between the application of professional standards and the need to manage client relationships. Instead, the auditor and non-auditor participants viewed the regulation as being “pushed by the IRBA to influence public *perceptions* of auditor independence” (P07, Auditor) irrespective of the practical challenges of implementing firm rotation and whether it in fact improves independence (P24, Auditor).

The consensus was that public trust in the profession had deteriorated in the wake of the global financial crisis and local corporate failures. However, all participants, especially auditors, expressed the view that the general public (and in some cases the ‘investing public’⁹) misunderstood the audit function and its inherent limitations. Consistent with long-standing findings on the audit expectation gap (Humphrey, Moizer, & Turley, 1992; Ruhnke & Schmidt, 2014), the general public was painted as expecting the auditor to prevent or detect *all* errors and instances of fraud in a company, yet:

“there is no appreciation for materiality concerns, the intentional nature of hiding fraud and the fact that the auditor expression of opinion on audited financial information, rather than a guarantee.” (P12, Auditor)

Participants believe the public expects more of the auditor than can be reasonably delivered. Consistent with views expressed by audit committee members interviewed in Canada (Fontaine et al., 2016), auditors are promptly blamed for corporate failures, regardless of the circumstances. The assumption is that “all problems should have been found by the auditor”¹⁰ (P11, Auditor) and that MAFR will, “by

⁹ This distinction was commonly made by participants who considered investors as a sub-set of the public who have a more informed and experienced view of the audit function.

¹⁰ Audit partners who expressed the strongest resistance to MAFR felt that the IRBA was also inclined to take this view.

some mysterious process, make corporate failures disappear (P24, Auditor). The auditors argued that MAFR would not remedy limitations inherent to an audit, i.e., it would not result in auditors detecting *every* instance of fraud or error.

Similarly, not all financial scandals were believed to be the result of audit failures:

“There is a lack of understanding that these circumstances could arise as a result of factors outside of the auditor’s control and that the auditor cannot test everything or be reasonably expected to always detect that which is deliberately hidden from them.” (P14, Auditor)

In these circumstances, MAFR will do little to improve an auditor’s ability to detect material fraud or error. MAFR is unlikely to reduce the occurrence of corporate failures and bolster long-term confidence in the profession. This finding is consistent with earlier research which argues that the enactment of external regulation is often a symbolic response to a loss of public trust in the profession but does not yield material benefits in terms of improved audit practice and independence in fact (see, for example Black, 2008; Maroun & Atkins, 2014; Unerman & O’Dwyer, 2004).

Importantly, participants (including the auditors) acknowledged that there are cases where audits are not completed to the highest standards. In these instances, however, interviewees pointed out that audit quality is influenced by *both* the auditor’s capabilities and independence ^[C1] ^[C7] (Knechel, 2016; Tepalagul & Lin, 2015). When the auditor is at fault, no distinction is made between auditor *incompetence* (error) and compromised *independence in fact*. The public (and some claimed, the regulator) misunderstand MAFR as a tool to address *all* audit failures. Yet, it is specifically designed to limit firm tenures and mitigate independence threats arising from these tenures (IESBA, 2018, Section 540). MAFR is not effective for improving the capability or competence of the auditor. As one auditor put it:

“If you have an incompetent auditor and you rotate [the firm] what have you achieved? You’ve solved your problem because that firm is no longer your auditor and someone else inherits the problem. [MAFR] does not fix incompetence, it just moves it around.” (P09, Auditor)

Similarly,

“I’m thinking of last year, we had an error with a listed company. I think it’s an easy scapegoat to say, ah, you guys have been the auditors for thirty years and that’s why you missed it. I think they missed the point completely ... I think there’s no correlation between an error and how long you’ve been their auditor.” (P12, Auditor)

The above sentiment was expressed broadly among audit partners, financial managers and analysts. They confirmed that material fraud and errors are often detected by both newly appointed firms and long-serving incumbents. This point is arguably anecdotal but it does echo earlier archival studies which note that longer tenures do not automatically result in poor professional judgement ^[C7], the misapplication of professional standards or an increase in the risk of undetected material misstatements (Cameran et al., 2016; Mali & Lim, 2018; Tepalagul & Lin, 2015).

Overall, participants (regulators excepted) expressed doubts about the efficacy of MAFR to improve independence in fact and promote more rigour in audit testing. There was concern that the public, by misunderstanding the objective of MAFR, would conclude that audits had become more effective at whistleblowing against fraud, that audit methodologies had changed or that auditors were somehow now more capable.

“[MAFR] is not a regulatory tool for bad auditors or incompetence – at best it will only **possibly** improve independence.” (P39, Academic, emphasis added)

As a result:

“...there’s a total misunderstanding as to what audit is and what MAFR is designed for - and we shouldn’t surely change regulations based on perceptions.” (P12, Auditor)

4.2 Professional judgement, experience and expertise

A common theme, emphasized by auditors and academics, was the likelihood of impaired audit quality because of the relative unfamiliarity of the incoming audit team^{[C1][C3]}. Participants stressed this would be especially relevant in the first year of an engagement when the incoming auditor would not have the deep understanding of the complexities of the client’s business which was possessed by the outgoing firm.

“...when you start out with a new organisation, particularly these massive, multi-national organisations, you don’t know what you don’t know. As a result, you don’t know what questions to ask.” (P12, Auditor)

This finding is consistent with prior research and represents the primary counter-argument to MAFR (Casterella & Johnston, 2013). As discussed in Section 2, while some studies have examined how audit quality surrogates change in the years immediately following firm rotation, the results are often mixed and offer only a high-level account of how audit quality is actually influenced by firm rotation.

As auditor tenure progresses, the auditor develops a better understanding of the business, so that management becomes “acutely aware” that they “can no longer pull the wool over your eyes” (P17, Auditor). In this sense, the audit acts as a preventative control against misconduct, becoming more effective as audit firm tenure increases. Most auditor participants felt that the loss of experience and expertise resulting from MAFR would be a major threat to audit quality, especially with larger, more complex and more geographically diverse audit clients.

Knowledge and expertise are pre-requisites for the effective application of professional judgement^[C1]^[C3]^[C7] (Knechel, 2016; Tepalagul & Lin, 2015). Areas of judgement highlighted by participants included going concern assessments, evaluation of significant risks, determining key audit matters and evaluating complex valuations of financial instruments^[C3]. According to the participants, these areas need a thorough knowledge of the business and the industry and, as a result, could be adversely affected by MAFR and the immediate loss of the experience and expertise of the incumbent engagement team.

The threat to audit quality was viewed as especially high in niche industries, such as banking, insurance and telecommunications, which required specialized knowledge of operational, regulatory and financial risks. Commenting on the effect of MAFR in these sectors, one audit partner stated that:

“I am sure an Audit Committee Chair and management will tell you that the most value an auditor can bring to the auditing process is their deep-seated industry knowledge and expertise within that particular industry and relating to that organisation. And that institutional knowledge, if you institute mandatory firm rotation, is completely lost.” (P11, Auditor)

Another, possessing numerous years’ experience at a large telecommunications company, explained how difficult it was to become familiar with a new client, even when it is in the same industry.

“And having spent probably the better part of 15 years in the telecommunications industry I pretty much thought I knew the industry well. But I can tell you this new company was very different... if I haven’t had that experience it would have been much harder.” (P12, Auditor)

However, not all participants agreed with the above comments. A minority view among the auditor participants was that the auditor should “understand the client before you do all procedures” (P03, Auditor).

“the work gets done properly or else the [audit] report won’t be signed.” (P06, Auditor)

This view was more common with the academic and regulator participants. Shortcomings in skills and expertise should be managed before providing the audit opinion, even if this means that additional resources will be required in the first year of an engagement. Consider the following statements:

“[The incoming] auditor does not have the luxury to take two or three years, or one year even, to get out of the starting blocks. They’ve got a duty to know the client and know the business, have the skills and all of those things – even if they make less profit doing so due to overruns.” (P38, Regulator)

This view emphasises the importance of professionalism and competency^{[C1][C7]}, as well as proper pre- and post-engagement planning^{[C4][C5][C6]}. It was believed that an auditor would not ‘sign off’ on a set of financial statements in the first few years of an audit without having conducted sufficient audit work, regardless of the investment required to do so (P06, P38, P44)^{[C1][C7]}. As a result, especially considering the potential bias among auditors against MAFR, the claim that a relative lack of experience and expertise of the client will threaten audit quality may be over-stated. This provides one explanation for why some studies have found that audit quality remains constant or even increases after firm rotations (such as Choi et al. (2015), Corbella et al. (2015) and Kim & Yi (2009)).

4.3 Impact on firm infrastructure and human resources

Some research suggests the possibility of MAFR discouraging audit firms from investing in technologies, systems and processes which can contribute to higher quality audits because the costs of those investments cannot be recouped over shorter audit tenures (Elitzur & Falk, 1996). This view was not widely expressed by the participants. Rather, the 10-year audit firm tenure period (as applicable under the new rules) was considered sufficient to allow firms to recoup set-up costs incurred in the early years. Auditor participants also expressed the growing use of audit technologies which require audit firms to update their IT infrastructure, irrespective of the requirement to rotate audit firms. These technologies, such as data analytics, will drive efficiencies and lower the expected impact of reduced profitability expected from MAFR^{[C3][C4][C6]}.

“You do not invest in your own resources on a basis of a client that exists but... on the basis that you feel that your staff or resources need to be capacitated. This has nothing to do with a particular client and remember, even [before MAFR], there is nothing that is stopping a client from walking away.... You could take the money and invest, and the client can still walk away.... Nobody invests and then goes to a client and says, ‘you see, this is how much money we have invested so you must stay with us for the next 100 years’” (P07, Auditor)

While participants felt that MAFR is not expected to undermine investment in technology, it was also not expected to drive it. The same view was expressed concerning human resources. MAFR would not likely have a material impact on investment in staff in terms of recruitment and training.

Furthermore, MAFR was not expressed as a factor influencing the change of audit methodologies^{[C3][C6]}. A notable exception was the perceived additional time and resources needed to be spent with client acceptance processes and work required to understand the client’s business (part of the broader risk assessment process)^[C2]. Otherwise, the audit work logic was determined rather by the international standards (ISAs) and the client’s risk profile, i.e., internal risk-management policies. Changes were then applied throughout the firm by way of ongoing internal quality review processes^{[C4][C7]}. It was not determined by the regulatory environment. Auditors expressed agreement that existing approaches to executing risk assessment procedures, testing of controls and substantive testing would *not* be revised due to the MAFR ruling^{[C3][C6]}. These findings are consistent with earlier research showing that external regulations designed to expand the scope of an auditor’s reporting duties has limited impact on how

audits are executed at individual clients. What is more relevant is the internal culture of quality control (see Knechel et al., 2013; Maroun & Atkins, 2014).

4.4 Internal culture of quality control

An audit involves the application of “a rigorous audit process and appropriate quality control procedures” (IAASB, 2014, p. 12). An internal culture of audit quality, quality reviews and the need for engagement leader responsibility, has been entrenched at audit firms as part of the requirements of ISQC 1 (IFAC, 2009; Maroun & Atkins, 2014).

Prior research shows many positive effects of sound internal quality control processes, including higher audit quality¹¹. Some participants expressed concern that internal quality control processes ^{[C4] [C5] [C7]} may deteriorate because of the strain MAFR will place on firm resources. However, most auditor participants did not raise this as a concern. The consensus was that audit firms are already held to a high standard of quality control because of their commitment to professionalism and the effect of other regulatory measures such as practice inspections (both internal and regulatory). This is confirmed by both the international and South African-specific literature on the relevance of regulatory inspections for audit quality (see, for example Logie & Maroun, 2020; Löhlein, 2016; Westermann et al., 2019). Audit partners also raised the reputational consequences of audit failures ^[C7] which exist independently of firm rotation. For example:

“You’re personally invested. It’s my name. I’ve signed. You’re out there in the public... You’re holding yourself out there. It’s me, it’s not just [firm name], I’m signing there as well.” (P15, Auditor)

“Based on my experience working here and overseas, between the two Big 4 firms... [in South Africa], we do take audit quality seriously. Our quality control is higher than what I saw overseas, and I think there is a good quality element.” (P26, Manager)

Quality control depends on effective engagement performance, active monitoring and review and a drive for continuous improvement (IAASB, 2014). Echoing the views discussed in Section 4.2 above, the general position was that these quality control features are “part of the groundwork” or the “DNA of what [auditors] do”, meaning they should not be impacted by MAFR. The same was true when it came to engagement leaders taking responsibility for, and actively directing, their audits ^[C5]. Auditor participants expressed how engagement partners would need to devote considerably more time to new clients as part of the client acceptance and planning phases of the engagement. Other stages of the audit would not likely require more investment of time. Therefore, overall, it appears as though MAFR will require more senior staff time in these two aspects of the audit (client acceptance and planning procedures) ^{[C2] [C5]}, which will again impact the cost of the engagement. Other responsibilities of senior staff, such as reviewing audit work and monitoring the audit team, being core aspects of a high-quality audit, would not likely change materially for a new client.

Regulators argued that MAFR would actively promote an internal culture of quality control ^{[C4] [C6]} because of the reputational concerns associated with the outgoing auditor having their work reviewed by the incoming audit firm ^[C7].

“So, if I am the outgoing auditor and I know that next year another firm is going to take over, I don’t want to look bad. So, I think there is a very strong motivation not to slack in quality control towards the end.” (P38, Regulator)

A senior audit partner, responsible for overall firm leadership, raised a specific concern about audit quality resulting from the change of priorities imposed on auditors to replace outgoing clients’ fee revenue. In his view, there was an incentive:

¹¹ Refer to the engagement quality literature reviews by Epps and Messier (2007) and Schneider and Messier (2007).

“...to turn this client, this audit client into an advisory client...To turn this thing around and make sure our tax and advisory offerings are well entrenched in this client, so that when the day comes, year ten (or whatever period MAFR requires). We sign off those accounts. We flip over.” (P15, Auditor)

Partners are under pressure ^[C7] to retain and grow client revenue ^[C2] while also performing their role in safeguarding financial reporting quality ^[C1]. This conflict has long been acknowledged as a threat to auditor independence and quality (Lee, 1995; Sikka, 2009; Thornburg & Roberts, 2013). The concern is that the vested interests of auditors to maintain a profitable ^[C7] enterprise may result in them “taking the eyes off the ball” (P08, Auditor). The audit partners, because of their preoccupation with securing advisory services with the client post rotation, may compromise quality standards. The risk to audit quality may be especially true for smaller firms which do not have the resources to operate units dedicated to tendering for new audits. These findings are consistent with earlier research, indicating that the quality of auditor judgements can be adversely impacted by the perceived risk of losing a client (Blay, 2005; Farmer et al., 1987) and other client-related and engagement pressures (Kadous, Kennedy, & Peecher, 2003).

4.5 The audit context: fees, costs and engagement hours

The quantum of audit fee should reflect the amount of work required to perform an audit engagement, including the degree of seniority of the staff on the engagement team (IESBA, 2018). Audit fees and billable engagement hours are considered a proxy of audit quality as they provide a measure of expended effort (Deis & Giroux, 1996; Kwon et al., 2014; Simnett et al., 2016). In addition, ISQC 1 requires the audit firm to have sufficient personnel, with the necessary capabilities, time and resources to complete the engagements (IFAC, 2009b, p. 44). This requires continual investment in human resources (IFAC, 2009b, p. 45).

Other than the loss of client-specific knowledge and expertise (as discussed above), most frequently raised is the cost implication of MAFR for audit firms ^{[C5][C6]}. Participants, particularly auditors, argued that MAFR would result in “a poorer profession” (P03, Auditor). Firstly, auditors claimed that the costs involved in producing a competitive tender were “astronomical” (P13, Auditor) and required significant investment by senior staff in the firm ^[C7]. Under a system of MAFR, audit firms will need to engage in more attempts to replace clients and secure appointments. Participants explained that this will lead to a material increase in tendering costs which will either have to be absorbed by the audit firm or recovered from existing clients by fee increases.

One mid-tier audit partner was of the view that audit firms would need to develop dedicated departments to producing tender documents and presentations to audit committees (P24, Auditor). This effort would probably prove fruitless, auditors explained, considering that multiple firms often competed for the appointment and non-Big 4 firms were not perceived as acceptable for the larger companies. Auditors from both the Big 4 and non-Big 4 noted an unwillingness of audit committees and shareholders to appoint the smaller firms. This view was corroborated by managers, analysts and academics. Although research does suggest larger firms may produce higher quality audits, they also charge a fee premium over smaller firms (Carson, Simnett, Soo, & Wright, 2012).

A senior partner from a mid-tier firm explained that non-Big 4 firms may shy away from competing for larger engagements preferring to target the audits of non-listed entities ^[C2]. Similarly, a participant who was currently in the process of producing a tender proposal for a client stated:

“I look at this now relatively small proposal that I had to run with now, the amount of time spent for the actual proposal... just to go through the processes of getting a document out and then also to do the presentation. With the amount of time that I personally had to put into that process, if mandatory audit firm rotation comes in, I want to be out of here” (P14, Auditor).

The audit practitioners are best placed to explain the resources required to produce a competitive tender bid ^[C2]. However, one participant (a regulator) did not accept this argument, believing that the industry would adjust to increased competition.

“I think if it becomes sort of run-of-the-mill to tender, they will cut down on the bells and whistles... they are going to have to start re-thinking how they tender.” (P36, Regulator)

Nevertheless, auditors believed that significant “overruns and losses”, especially in the first few years after engagement, were inevitable (P03, Auditor). A related concern is that

“due to total lack of familiarity and knowledge [of the business]... the cost of performing the audit will have to go up... and the clients will not be prepared to pay for it.” (P22, Auditor)

The auditors agreed that it was uncertain whether the direct and indirect costs of MAFR would be recouped¹². Audit partners felt that audit fees will need to increase post-MAFR to compensate for additional costs but audit committees will be reluctant to allow this given that the nature of the services provided to clients will not change (see also Sections 4.2 and 4.3). Managers and analysts confirmed that tensions between auditors and audit committees on fees are to be expected. The implications for audit quality are not immediately clear.

On one hand, fee pressure has been linked to lower audit quality as it affects auditor judgement and diligence (Gramling, Krishnan, & Zhang, 2011; Houston, 1999). Profitability concerns may impair audit quality if auditors “cut corners” in work performed (P03, Auditor) or do not sufficiently invest in staff, in an effort to ensure firm profitability (IFAC, 2009). Interestingly, this was seen as a greater risk on larger engagements. The more complex the audit, the higher the planned engagement hours to perform testing and the greater the need for more senior staff with the result that these engagements may be most susceptible to a net decline in fees. This position is supported by earlier research (in different settings) which show that fee-related pressures can result in lower levels of testing and an overall reduction in audit quality (Calderon, Wang, & Klenoptic, 2012; Caramanis & Lennox, 2011; Harber, Marx, & De Jager, 2020; Johnstone & Bedard, 2001). Consequently, while audit partners took the position that “if our fees drop, we’ll make a plan...we’ll have to adjust” (P14, Auditor), there is no guarantee that MAFR will not impact audit quality adversely.

“And then now [regarding] quality control, there is no scope for it in the budget.” (P17, Auditor)

Linked closely to concerns about audit fees and costs was the argument that MAFR would likely disrupt the market by creating a high turnover of clients and this creates unintended consequences from a leadership and planning perspective. Audit firms will attempt to replace clients but new clients will not perfectly match outgoing ones in terms of client fees, timing of audit deadlines or resource requirements. The auditor participants who held senior leadership positions in their firms explained that firm budgets and revenues may be adversely affected ^{[C5] [C6]}. This can have a negative knock-on effect for retention and development of staff:

“It is more like an egg and chicken situation - who will hire a hundred people if you do not have the income to pay them?” (P19, Auditor)

“Capacity is a consequence of access to resources so if you don’t have clients that are sufficiently large enough to back it up, you are not going to hire people.” (P44, Academic)

Regulators also acknowledged the potentially disruptive effects of MAFR:

¹² These aspects are largely unresearched with respect to MAFR as the data concerning engagement effort and audit fee negotiation are proprietary information. Greece presents one of the few jurisdictions in which engagement hours data are available. Japan, although not mandating disclosure of hours, does require disclosure of audit team members (Simnett *et al.*, 2016).

“What am I going to with all my people and all these offices that I got? In some places the whole audit office will have to close!” (P34, Regulator, speaking as though an auditor)

Disruptions to the audit market may also make the industry less attractive with adverse implications for the human capital necessary for executing high-quality audits ^[C7]:

“The talented youngsters who are coming through the universities are not staying in the profession and so there will be a decrease in [audit] quality as the numbers of the grey hairs start to retire from their positions... Young people don’t want to be here; they don’t want these IRBA regulations.” (P22, Auditor)

The “risk-reward imbalance” between corporate and public practice careers for professional accountants meant that the personal costs of remaining in audit may exceed the benefits ^[C7] (P15, Auditor). This appeal-impact of MAFR has not yet been explored by researchers although it has the potential to impact audit quality over the long-term¹³. For example, job satisfaction and talent retention among employees has been found in organizational behaviour research to be a driver of organizational performance (Balouch & Hassan, 2014; Trivellas, Akrivouli, Tsifora, & Tsoutsas, 2015). Applying the same logic to the audit profession:

“Because [the risk in the profession] has gone up so dramatically and the reward hasn’t gone up...in the professions used to do well but I think there are problems ahead.” (P22, Auditor)

4.6 Audit outcomes

Despite the considerable disruption of the firm and engagement partner expected by the auditors from MAFR, none felt that audit outcomes would be affected ^[C6]. Audit reports will continue to be issued in compliance with the auditing standards ^[C1] and, as discussed in Section 4.2 and Section 4.3, material changes to engagement processes ^[C3] are not expected, barring the impact on client acceptance and planning processes ^[C2]. This belief that MAFR would not impact the detection, prevention and reporting of misstatements, error or fraud, and going concern uncertainties at clients is consistent with archival studies which do not indicate audit quality improvements after firm rotation (for example, Cameran, Francis, et al., 2015; Cameran et al., 2016; Ruiz-Barbadillo et al., 2009).

Interestingly, and consistent with the opinions reported in a Canadian study on MAFR (Fontaine et al., 2016), some participants felt that periodically forcing firm rotation by regulation called into question the role of audit committees to discharge their duties ^[C1]. In South Africa, the responsibility to find a suitable and independent auditor and maintain the ongoing relationship with that auditor is that of the audit committee. These responsibilities are established by codes on corporate governance and company law (IoDSA, 2016; RSA, 2008). The audit committees’ responsibility to apply their mind to auditor independence was believed to be somewhat diminished as the rotation of audit firms is prescribed by law. Views expressed by the participants suggest that the regulation could (counter intentionally) undermine confidence in audits. MAFR is being introduced by the regulator to bolster trust in the audit profession but, paradoxically, is only required because trust itself is no longer sufficient (Black, 2008; Unerman & O’Dwyer, 2004). The regulator appears to have unwittingly signalled that auditors and audit committees – fundamental components of the corporate governance machinery – cannot operate effectively without State intervention when it comes to managing their relationship with each other. If this is the case, why should non-experts place any confidence in the audit opinion if the same regulator has not overseen the “rituals of verification” (Power, 1997) on which the opinion itself is based?

¹³ Audit partner career and quality of life impacts in the US, following the stricter partner rotation rules imposed through SOX, was explored by Daugherty, Dickins, Hatfield and Higgs (2012).

5. Summary and conclusion

This paper adds to the limited body of research on MAFR which, to date, has relied predominantly on archival tests to conclude on the impact of firm regulation on quality surrogates. By engaging with practitioners who are currently grappling with how to respond to the promulgation of MAFR, the current study makes an important contribution to theory and practice by offering empirical evidence on *possible* implications in practice of this increasingly common audit regulation. In doing so, the study responds directly to the calls by Humphrey (2008), Khalifa et al. (2007) and Power (2003) for additional field-work research into the operation of the audit process, as well as by Choudhury (2017), Ewelt-Knauer et al. (2013) and Hay (2015) for research on the link between MAFR and audit quality at the firm- and engagement-level. The paper also addresses the need to conduct research in an emerging economy context to understand the functioning of regulation designed to bolster audit quality.

The results indicate considerable resistance to MAFR and its ostensible outcome of improving audit quality. The risk to audit quality following firm rotations because of the relative unfamiliarity of the client's business by the new audit firm, remains the primary argument against the regulation. The more established partner rotation rules, supplemented by audit committee oversight, as currently endorsed by international standards (IESBA, 2018), is viewed by auditors as a more cost-effective means of preserving auditor independence. There was consensus among participants that auditors in South Africa were already acting with the requisite diligence, technical expertise and independence required by the professional standards. Specific examples to the contrary from recent corporate failures¹⁴ were felt to be exceptions rather than indicative of a general decline in audit quality, often the result of auditor error rather than a lack of independence.

The IRBA was criticised for conflating independence in appearance with independence in fact. Both auditors and non-auditors have also questioned whether MAFR will result in material changes to the systems, processes and methodologies which are essential for ensuring high-quality audits. In this way, the enactment of MAFR in South Africa may be more a symbolic response to a perceived decline in audit quality than a well-planned strategy for driving more rigorous audit practice. The public is believed to misunderstand the role of the auditor and the purpose of MAFR. If non-experts assume that MAFR automatically results in more thorough audits being executed by independent practitioners the regulation may, paradoxically, undermine confidence in South African assurance. This is especially true when considering that, because MAFR does not lead to substantive changes to audit practice, it is unlikely to prevent audit failures or reveal previously undetected instances of fraud and error.

The implications of MAFR for the audit profession must also be considered. Even if some benefits from improved independence and audit quality are realised, it is unclear whether these will exceed the costs of the regulation. The primary cost impact is likely to be in the client acceptance, tendering and marketing processes required to secure new clients, as well as in the efforts (mostly by senior audit staff) to understand the new client in the early years of appointment. Auditors will also need to invest considerable time and financial resources in gaining an understanding of new clients and training their engagement teams, particularly in cases in which a client is based in a new industry or sub-sector. The costs are expected to be material and are unlikely to be recovered from clients because MAFR does not change the nature and scope of the services which auditors are providing.

Internal quality control practices were not believed to be at risk under the regulation. On the contrary, as the outgoing firm's work is available for scrutiny by the new auditor, they may even improve. The inspection of the audit work (by the incoming audit firm) and the potential for prior year restatements may provide a reputational incentive to improve internal firm controls. Examples include ethics checks, audit work documentation procedures and internal engagement quality control reviews.

The current paper's findings yield several implications and practical recommendations. Firstly, the regulator needs to be aware of the likelihood that MAFR will reduce profitability. In addition, senior

¹⁴ Refer to footnote 7.

audit staff identified the adverse incentive created whereby fee replacement strategies may distract the audit partners as the rotation event approaches. This may compromise the diligence applied to the engagement. In audit fee negotiation, audit committees need to be aware of these cost pressures and consider allowing higher audit fees to compensate. If fees do not increase, lower profitability is likely to impact audit quality negatively as it places a constraint on the allocation of staff resources to the engagement. Over the longer term, lower profitability may also present a problem in the industry with talent retention.

Secondly, auditors are concerned that MAFR will cause periods of over- and under-capacity which are difficult to budget. There is a danger that the initial disruptions caused by firm will impact staff morale, skill development and career progression adversely. The audit profession may become less appealing to university graduates with long-term implications for audit quality. Both audit firms and the regulator need to review how MAFR impacts client-auditor dynamics, the demand for trainee accountants and the progression of longer-serving individuals.

Thirdly, the burdensome and costly tender proposal process can be mitigated through guidelines issued jointly by the regulator and profession. This would standardise and streamline the competing for appointment, as well as promote more thorough communication between the incoming and outgoing audit firms. Facilitating a more effective knowledge transfer will reduce the inexperience threat to audit quality. The two audit firms may, for example, formalise agreements to share information on key audit matters and significant risks. Where practical, the incoming audit partner can 'shadow' the outgoing audit partner, similar to the approach followed when dealing with partner rotations on a client within an audit firm. This will require support from both audit firms and the client with careful planning to avoid inefficiencies and unnecessary costs. Guidelines for compensating auditors for the investments made to understand a new client's business in the first few years of appointment may also be helpful.

Finally, the participants expressed concern that the regulator has moved too quickly with the introduction of MAFR. The regulation has been enacted and the first rotations must be completed before April 2023, i.e., between June 2017 (date of the ruling) and April 2023. Careful post-implementation review will be required to evaluate the impact of these firm rotations on audit firms, the clients, and the users of financial statements. The costs of MAFR may indeed be lower than the findings of this study suggest, even more so if these findings and recommendations are considered by the regulator and result in mitigating responses to unintended consequences.

As in any study of this type there are inherent limitations and additional research will be required. The research is based on a single jurisdiction which has recently implemented MAFR. Future research can target other jurisdictions and a broader set of stakeholders with interpretive qualitative designs. A weakness of the current paper is that it is based on data collected from participants who had either not yet experienced a firm rotation or were in the process of rotating for the first time under the MAFR rule. As a result, it is possible that the advantages and disadvantages of rotation are not fully understood and have, therefore, been over- or under-estimated. A longitudinal study is required to evaluate how experiences with MAFR and its implications for audit quality change over time. This should be done using a similar exploratory approach to that followed in this paper to avoid over-simplifying the interconnections between external regulation and audit quality. Complementary quantitative analysis, either to confirm or refute qualitative findings, will also be useful.

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APPENDIX 1: Description of participants

Participant identifier	Participant description
<i>Auditors</i>	
P1	Non-Big 4 firm (mid-tier)
P2	Big 4 firm
P3	Big 4 firm
P4	Big 4 firm
P5	Non-Big 4 firm (mid-tier)
P6	Non-Big 4 firm (mid-tier)
P7	Non-Big 4 firm (mid-tier)
P8	Non-Big 4 firm (mid-tier)
P9	Non-Big 4 firm (mid-tier)
P10	Big 4 firm
P11	Big 4 firm
P12	Big 4 firm
P13	Big 4 firm
P14	Big 4 firm
P15	Big 4 firm
P16	Non-Big 4 firm (mid-tier)
P17	Non-Big 4 firm (mid-tier)
P18	Non-Big 4 firm (mid-tier)
P19	Non-Big 4 firm (mid-tier)
P20	Non-Big 4 firm (mid-tier)
P21	Non-Big 4 firm (mid-tier)
P22	Non-Big 4 firm (mid-tier)
P23	Non-Big 4 firm (mid-tier)
P24	Non-Big 4 firm (mid-tier)
<i>Managers</i>	
P25	Non-executive director and audit committee member
P26	Senior financial manager and professional accountant
P27	Senior financial manager and professional accountant
P28	Chief financial officer and professional accountant
P29	Senior financial manager and professional accountant
P30	Senior financial manager and professional accountant
<i>Regulators</i>	
P31	Senior staff member at the IRBA
P32	Member of stock exchange (JSE) regulatory body
P33	Senior role in professional accounting institute
P34	Member of accounting standards regulatory body
P35	Senior staff member at the IRBA
P36	Member of accounting standards regulatory body
P37	Member of corporate governance regulatory body
<i>Academics and Analysts</i>	
P38	Auditing academic (South African university)
P39	Auditing academic (South African university)
P40	Auditing academic (South African university)

P41	Auditing academic (South African university)
P42	Senior analyst (third-party asset management company)
P43	Auditing academic (South African university)
P44	Auditing academic (South African university)
P45	Auditing academic (South African university)
P46	Auditing academic (South African university)
P47	Auditing academic (South African university)
P48	Auditing academic (South African university)
P49	Senior analyst (third-party asset management company)

APPENDIX 2: Interview sheet

1. Please describe what you understand as the purpose of the IRBA in pursuing MAFR regulation in South Africa.
2. In comparison to the current system of mandatory partner rotation, do you believe MAFR will achieve its primary objective of preserving or improving audit quality? Please explain.
3. Comment on the impact of MAFR on the public's perception of the audit industry.
4. Will MAFR affect the performance of audit engagements in any way? (resources, staff, the extent of monitoring, supervision and review, for example).
5. Please comment on your view concerning the primary argument against MAFR (namely, that the incoming audit firm is comparatively less familiar with the client's business).
6. What changes, if any, do you foresee the audit firms implementing in response to MAFR?
7. What further or final implications do you perceive MAFR will have on audit quality in South Africa?