Accountant’s’ perceptions of legislative changes in the auditing profession in South Africa

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ABSTRACT

During the past decade there have been a number of high-profile corporate failures, both locally and internationally. This has led to numerous legislative and regulatory changes, both locally and internationally. In South Africa, the Auditing Profession Act was released for comment in October 2004 and this led to the Auditing Profession Act, Act No.26 of 2005, which was signed into legislation on 16 January 2006; this took effect on 1 April 2006, as did the Corporate Laws Amendment Act of 2006. The draft Companies Bill of 2007 was released for comment in February 2007 and will replace the Companies Act of 1973.

The purpose of this study was to research accountants' perceptions regarding the effectiveness of legislative changes to the audit profession in South Africa with regard to the prevention of audit failure. Quantitative, non-experimental research was conducted to test the propositions developed from the literature review through a questionnaire that was sent to chartered accountants within South Africa.

The majority of chartered accountants surveyed agreed that the reputation of the audit profession in South Africa had been affected adversely by high-profile business failures internationally and nationally, and that this necessitated the legislative changes to the audit profession in this country. There are certain aspects of these legislative changes that will be efficient in the prevention of audit failure and in ensuring greater independence of the external auditor; this was the opinion of the chartered accountants surveyed, and included the functioning of the independent audit committee, legal backing to accounting standards and increased liability for directors and parties involved in the preparation of financial statements. Legislative changes that were not perceived to be efficient included increased liability for the external auditor, practice reviews and the mandatory rotation of audit partners.

DECLARATION

I, Valerie-Joan Slabbert, declare that this research report is my own work except as indicated in the references and acknowledgements. It is submitted in partial fulfilment of the requirements for the degree of Master of Business Administration in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in this or any other university.

Valerie-Joan Slabbert

Signed at ……………………………………………………

On the …………………………….. day of ………………………… 2008

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LIST OF ABBREVIATIONS

CEO	-	Chief executive officer
CFO	-	Chief financial officer
CPA	-	Certified Public Accountant
GAAP	-	Generally Accepted Accounting Practice
ICAEW	-	Institute of Chartered Accountants in England & Wales
IRBA	-	Independent Regulatory Board for Auditors
NYSED	-	New York State Education Department
PA	-	Public Accountant
PAAB	-	Public Accountants and Auditors Board
PCAOB	-	Public Company Accounting Oversight Board
POB	-	Public Oversight Board
SAAS	-	South African Auditing Standards
SAICA	-	South African Institute of Chartered Accountants
SEC	-	Stock Exchange Commission
SPE	-	Special Purpose Entity
SRO	-	Self Regulatory Organisation
USA	-	United States of America

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CHAPTER 1: INTRODUCTION

1.1 Context of the study

The auditing profession has always relied on the principles of objectivity, integrity, ethics and independence (Whittington & Pany, 1995).

During the past decade there have been a number of high-profile corporate failures, both locally and internationally. The role played by prominent accounting firms in these high-profile corporate failures has severely tarnished the reputation of the audit profession, both locally and internationally (Sergeant, 2004).

This has led to numerous legislative and regulatory changes, e.g. the signing of the Public Company Accounting Reform and Investor Protection Act in the United States of America (US) in 2002, also known as the Sarbanes-Oxley Act of 2002. In South Africa, the Auditing Profession Act was released for comment in October 2004, which lead to the Auditing Profession Act, Act No.26 of 2005, which was signed into legislation on 16 January 2006 and which took effect on 1 April 2006. The draft Companies Bill of 2007 was released in February 2007, and will replace the Companies Act of 1973.

1.2 Purpose of the study

The objective of an audit is “to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework” (SAICA, 2004:12). South African Audit Standards, in line with international audit standards, require that an auditor who performs an audit to attest the financial statements be independent. Independence means that the auditor must be and must be seen to be free from the influence of clients or other interested parties who might exert pressure on an auditor to express an opinion which is to their advantage (Puttick & Van Esch, 1998).

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This has led to numerous legislative and regulatory changes, e.g. the signing of the Public Company Accounting Reform and Investor Protection Act in the United States of America in 2002, also known as the Sarbanes-Oxley Act of 2002. In South Africa, the Auditing Profession Act was released for comment in October 2004 and this led to the Auditing Profession Act, Act No.26 of 2005, which was signed into legislation on 16 January 2006; this took effect on 1 April 2006, as did the Corporate Laws Amendment Act of 2006. The draft Companies Bill of 2007 was released for comment in February 2007 and will replace the Companies Act of 1973.

The purpose of this research was to determine the accountants' and auditors' perceptions regarding the effectiveness of legislative changes to the audit profession in South Africa with regard to the prevention of audit failure.

1.3 Problem statement

The purpose of this study was to research the accountants' perceptions regarding the effectiveness of legislative changes to the audit profession in South Africa with regard to the prevention of audit failure.

1.4 Delimitations

The study was limited to the impact of the proposed changes to the audit profession in South Africa from the perspective of South African chartered accountants, including chartered accountants performing the attest function and hence registered with the Independent Regulatory Board for Auditors, as well as chartered accountants in the corporate environment. The perspective of members of the public and investors were excluded for the purpose of this research.

1.5 Assumptions

There are currently no assumptions that, if they do not hold, will influence the outcome of the research.

1.6 Significance of the study

The Auditing Profession Act, Act No.26 of 2005, was signed into legislation on 16 January 2006 in order to introduce measures for more comprehensive and modern legislative framework for regulating the auditing profession (Republic of South Africa, 2006). The main objective of the legislation is to enhance the independence of the external auditor and to improve the integrity of South Africa's financial sector and financial reporting (Kemp, 2004).

Although the auditing profession has never been under so much public scrutiny in its history, there is no recent research available in South Africa. A study that was conducted in 1993 entitled "The audit expectation gap in the Republic of South Africa" (Gloeck, 1993), researched the expectation gap between the perceived role and responsibilities of the external auditor from the profession's perspective versus that of the public. In a subsequent study entitled "Will practice reviews assist in solving the problem of the audit expectation gap in South Africa?" (Green, 1994) the application of practice reviews in order to address the audit expectation gap, was researched. In 2008, an article was written entitled "Regulation of the auditing profession in South Africa", that explored the concept of self-regulation of the auditing profession in South Africa and comparing that with trends worldwide (De Jager & Odendaal, 2008).

Although chartered accountants could submit comments on the proposed legislative changes before the Auditing Profession Act, Act No.26 of 2005 was enacted, no research has been done on the accountants' perceptions of legislative changes to the audit profession in South Africa.

CHAPTER 2: LITERATURE REVIEW

2.1. Introduction

"Company financial reporting is key to the efficient and effective operation of capital markets" (ICAEW, 2002:1). The auditor plays a key role in ensuring the integrity of the financial reporting system. The objective of an audit is "to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework" (SAICA, 2004:12). This opinion is expressed in the audit report that is published with the annual financial statements.

In order to express an opinion on the annual financial statements, the auditor has to accumulate and evaluate "evidence about quantifiable information related to a specific economic entity for the purpose of determining and reporting on the degree of correspondence between the quantifiable information and established criteria" (Arens & Loebbecke, 1991:2).

Audit engagement risk is the risk that the opinion expressed by the auditor is inappropriate (Puttick & Van Esch, 1998). The nature and extent of the audit evidence gathered will be influenced by the auditor's professional judgement when assessing audit risk.

The underlying quantifiable information that constitutes the annual financial statements comprises a vast number of transactions, depending on the complexity, nature and size of the company. In order to gain 100% assurance all transactions have to be examined. It is not economically viable or practically possible for the external auditor to examine each transaction individually and hence the collection of audit evidence to support the opinion will be limited, to ensure reasonable assurance of the opinion expressed (SAICA, 2004), i.e. "in all material aspects" (SAICA, 2004:203).

Samples of transactions are examined, and sample sizes are calculated based on the materiality determined by the auditor. Materiality is determined through the judgement of the auditor (Loeb & Neary, 1985). As a result of the judgement to be exercised, auditors must not only be independent of audit clients, but must also be seen to be independent of audit clients (Thomas, Ward & Henke, 1991). The independence of the auditor contributes to the quality of the audit work performed and contributes towards the financial statement user's reliance on the financial statements (Whittington & Pany, 1995). Independence is a mental state and investors and the public can only evaluate an auditor's appearance of objectivity. As a result, investor and public confidence can be "eroded if investors and other users of the financial statement information do not perceive that the auditor was independent in appearance" (Lindberg & Deck, 2004:1).

The main criticism against auditing firms during recent high-profile business failures has been the perceived lack of independence (Armstrong, 2002). According to the New York State Education Department, there has never been a time in the 107 year history as a licensed profession in New York, that the public has "focused so much serious attention and concern on the independence of the certified public accountant (CPA) and public accountant (PA)" (New York State Education Department, 2003:1).

2.2 High-profile business failure and the impact on the audit profession internationally

On 8 November 2001 Enron announced that it was restating its earnings for the past three years by $600 million. The restatement was due to three unconsolidated special purpose entities (SPE's) that should have been consolidated in order to comply with generally accepted accounting practice (GAAP); audit adjustments relating to 1997 that were not adjusted in 1997 as it was deemed to be immaterial; and the reclassification of receivables from stock subscriptions with a subsequent reduction in assets and equity (Armstrong, 2002).

The audit adjustments amounted to $51 million which would have reduced 1997 reported earnings from $105 million to $54 million (Armstrong, 2002). The third SPE had not been consolidated as Enron officials withheld information relating to the SPE from the external auditors, Arthur Andersen. Had Arthur Andersen been aware of the existence of the third SPE, it would have required consolidating the results of all three SPE's, including the massive liabilities, with Enron's financial statements (Byrnes, 2002).

By 2 December 2001, Enron filed for bankruptcy, resulting in an accounting and auditing scandal that would change the face of the profession (Byrnes, 2002). With assets approximating $62 billion, it was the largest bankruptcy case filed in US history, resulting in a loss of $32 billion in market capitalisation and employees losing more than $1 billion in retirement funds (Sergeant, 2004).

Although subsequent analysis has shown that Arthur Andersen's role in the demise was relatively minor compared to that of investment bankers and the company's management, the fact that the auditors destroyed audit work papers and records before the investigation fuelled public suspicion of negligence and wrongdoing. Arthur Andersen, one of the big five auditing firms in the world with annual revenues of $9.6 billion, was fired by 1 440 audit clients in the US in 2002 and was one of the first casualties of the Enron failure (Davis, 2002).

Arthur Andersen was not the only big-five audit firm under investigation in the US: Ernst & Young had to return all audit fees received from PeopleSoft between 1994 and 2000 due to a violation of auditor-independence rules (Dettmer, 2002); Deloitte faced a wave of lawsuits from shareholders of Adelphie Communications after revelations of accounting irregularities (Sergeant, 2004); after a settlement with the SEC a partner from PriceWaterhouseCoopers was barred from the profession for life after being accused of issuing fraudulent audit reports for Tyco International (Brewster, 2004); and KPMG also failed to identify accounting policies by Xerox to inflate revenue but denied any wrongdoing (Dettmer, 2002).

The auditor’s role in the above high-profile business failures severely tarnished the reputation of the profession in the US. In 2003, the American Institute of Certified Public Accountants conducted a national survey, interviewing more than 1000 business decision-makers and investors/shareholders across the United States of America. Ninety percent of correspondents believed that the profession’s credibility had suffered as a result of the high-profile business failures during the previous five years and the audit profession’s part therein. Over 80% of the correspondents were of the opinion that an external auditor has a function to prevent and detect fraud. Eighty percent of correspondents interviewed believed that the auditor’s independence is impaired by the corporate client being responsible for paying professional fees and 20% of respondents believed that the audit firms were the most to blame for the corporate accounting scandals (New York State Education Department, July 2003).

2.3 High-profile business failure and the impact on the audit profession in South Africa

South Africa has also experienced a number of high-profile business failures during the past 17 years. Masterbond collapsed in 1991, “owing R595 million to 22 000 investors” (Matthews, 2005:1). Although 67% of the investor’s investments were recovered, it took fourteen years before final restitution was made, and some investors lost 53.75% of their investments, depending on the scheme in which they invested.

Ernst & Young, the external auditors of Masterbond, were severely criticised for their role in the collapse, and eventually reached a R40 million out-of-court settlement with investors. Six auditors of Ernst & Young were subjected to disciplinary hearings by the Public Accountants and Auditors Board. Judge Hennie Nel, who was chairman of the Nel Commission that investigated the Masterbond scandal, said that “the saga of dishonest or inefficient auditors which further emerged during the course of the investigations conducted by the commission belied the generally perceived honesty, integrity, efficiency and independence of auditors” (Kincaid, 1998:2). The Nel Commission highlighted the apparent dishonesty, inefficiency and lack of independence of the external auditors, as well as the inefficiency of legislation regarding the duty of auditors to report irregularities.

Other high-profile business failures in recent years include Health & Racquet, Leisurenet, MacMed, Regal Treasury, Unifer, Saambou, Prima Bank, Owen Wiggins Group, Alpha Bank, Surpreme Group and more recently in 2004, CS Holdings.

In his 2002 Budget speech, finance minister Trevor Manual referred to “weak or non-existent governance structures, the fiduciary responsibility of directors, negligent and sometimes reckless management, ineffective auditing, independence of auditors and conflicts arising from inadequate separation between auditing and consultancy” (Sergeant, 2004:2).

2.4 Legislative changes to the audit profession internationally

The impact of the high-profile business failures in the US necessitated regulatory and legislative reform to “address the public’s rising concern over unethical accounting practices and the impact that the latest corporate failures have had on consumer confidence and world financial markets” (New York State Education Department, July 2003). Until 2002, the profession functioned on a self-regulatory basis and the auditors were determined to remain self-regulatory. An earlier bill passed by the House of Representatives that proposed an accounting board consisting of five members, of whom only one had to be independent of the auditing profession, was supported by the audit profession in the US (Dettmer, 2002). The claim for self-regulation was supported by SEC Chairman, Harvey Pitt. According to the Center for Responsible politics, the profession lobbied aggressively with nearly $15 million in donations to congressional candidates and national political parties (Dettmer, 2002).

From Congress at federal level to the New York State Attorney General at State level, there were proposals for reform advocating greater professional responsibility and more control over audit engagements (New York State Education Department, 2003).

From a government perspective, it was imperative to restore the public's perception of the profession and its function, and as a result the most comprehensive, far-reaching corporate responsibility and accountancy reform legislation since 1934 was signed into law when the Public Company Accounting Reform and Investor Protection Act of 2002, also known as the Sarbanes-Oxley Act of 2002, was enacted in July 2002 (New York State Education Department, 2003).

Key provisions of the Sarbanes-Oxley Act of 2002 include the following (New York State Education Department, 2003)**:**

- the establishment of a five-member Public Company Accounting Oversight Board (PCAOB) that is subject to SEC oversight;
- public accounting or auditing firms must register with the PCAOB in order to be eligible to issue any audit report with respect to a public company;
- public accounting or auditing firms registered with the PCAOB must prepare and maintain audit work papers and other information related to an audit for at least seven years in sufficient detail to support the conclusions reached in the audit report;
- public accounting or auditing firms registered with the PCAOB that regularly provide audit reports for more than 100 public companies on an annual basis will be inspected annually, or at least once every three years if less than 100 audit reports are issued on an annual basis;
- the provision of most non-audit services to audit clients is prohibited;
- public accounting or auditing firms registered with the PCAOB may not audit any SEC registered client if a senior board member, e.g. the CEO, CFO, controller or equivalent office, is employed by the public accounting or auditing firm, and who participated in the client audit, within one year of the first acceptance of the engagement; and
- compulsory rotation of audit partners responsible for an audit every five years.

The Sarbanes-Oxley Act of 2002 also recognises the need for greater responsibility from senior management, and requires that a chief executive will not only be responsible for the signing of financial statements, but must also have a thorough understanding of the financial statements. In fact, he or she must be able to explain exactly how the numbers in his or her company's financial statements are computed.

According to Edward Nusbaum, chairman and CEO of Grant Thornton, fifth-largest accounting firm, chief executives "didn't even read the footnotes to the financial statements" (Brewster, 2004:2).

As a result of the provisions of Sarbanes-Oxley, audit fees increased by 27% in the year following the passage of the Act (Brewster, 2004).

2.5 Legislative changes to the audit profession in South Africa

Previously, the auditing profession in South Africa was governed by the Public Accountants and Auditors Act of 1991. In order to perform the attest function in South Africa, professionals had to be registered with the Public Accountants and Auditors Board (PAAB). Registered accountants and auditors are also registered with the South African Institute of Chartered Accountants (SAICA), although a Chartered Accountant could only perform the attest function if registered with the PAAB. Registered accountants and auditors were also required to adhere to SAICA's Professional Code of Conduct. In essence, the profession in South Africa was self-regulatory (Van Wyk, 2003).

In October 2004, the Auditing Profession Act was circulated for comments and on 16 January 2006 the Auditing Profession Act, 2005 (Act No.26 of 2005) was signed into law. "Like Sarbanes-Oxley, the Bill is aimed at taking all known steps to restore public confidence in the capital market system, and in the accounting and auditing profession" (Sergeant, 2004:1).

According to the Department of Trade and Industry the main aims of the Act are to:

- introduce a more comprehensive and modern legislative framework for regulating the auditing profession than exists at present;
- improve the integrity of South Africa's financial sector and financial reporting; and
- introduce measures to a) ensure potential conflicts of interest between auditors and clients are minimised and b) facilitate swift and appropriate actions to rectify a situation in the event that circumstances give rise to an undermining of the independence of an auditor.

The act will effectively end the self-regulation of the profession in South Africa as in the US. The Public Accountants and Auditors Board, which has been in existence since 1951, has been replaced with the Independent Regulatory Board for Auditors (IRBA) as appointed by the minister of finance. The IRBA is overseen by the National Treasury on behalf of government, and is set to have greater authority than the PAAB and is designed to reinforce the independence of auditors, as this lies at the heart of the act (Sergeant, 2004).

The act introduced the following legislative changes to the audit profession in South Africa:

a) The end of self-regulation
b) More regular practice reviews
c) Harsher punishment for the contravention of the Auditing Profession Act, 2005 of up to ten years in jail

The Auditing Profession Act, 2005, is accompanied by a comprehensive rework of corporate law in South Africa.

The Department of Trade and Industry published a policy document, "South African Company Law for the 21st Century: Guidelines for Corporate Law Reform" in June 2004, outlining the "framework for detailed technical consultation in which the DTI has engaged with key stakeholders" (Dekker, 2007:1). The policy paper proposed "that company law should promote the competitiveness and development of the South African economy" by, inter alia, "encouraging transparency and high standards of corporate governance" (Companies Bill, 2007).

The draft Companies Bill 2007, released in February 2007, is a direct result of the corporate reform envisioned by the DTI in 2004, which was released for comment and is expected to be signed into law in 2009, replacing the Companies Act of 1973.

The following provisions in the Companies Bill of 2007 relate specifically to the audit profession in South Africa:

a) the establishment, composition of and functions of the audit committee;
b) the appointment of and rotation of the external auditor; and
c) the rights, duties and functions of auditors, including a limitation on non-audit services that the external auditor may perform for an audit client.

The legislative changes to the audit profession in South Africa identified above will be discussed in more detail in the remainder of the literature review.

2.6 Discussion: Legislative changes to the audit profession in South Africa

2.6.1 The end of self-regulation

Up until the public outcry following the Enron collapse and the involvement of Arthur Anderson therein, the accounting and auditing profession had always been "proud of its solid, long-standing history of being largely self-regulated" (Grumet, 2002:1).

According to the New York State State Education Department, the "role that several prominent accounting firms have played in a series of unprecedented recent corporate failures underscores the urgent need for an examination of the regulatory structure" (New York State Education Department, 2003:2). In the United States, this led to the establishment of a Public Company Accounting Oversight Board (PCAOB) that is subject to the United States Securities & Exchange Commission.

In South Africa, the auditing profession was regulated by the Public Accountants' and Auditors' Board (PAAB). The PAAB functioned in terms of the Public Accountants' and Auditors' Act, 1991 (Act 80 of 1991). The PAAB consisted of the Auditor General of South Africa, as well as four members appointed by the Minister of Finance from among the State departments, accountancy professionals appointed by the provincial societies of chartered accountants, two academics nominated by the Committee of University Principals, as well as one auditor in public practice who practised within 100km of the City Council building of Johannesburg. The eight members of the PAAB nominated by provincial societies of chartered accountants, as well as the final member appointed by the Minister of Finance, had to be registered with the PAAB.

The corporate mission statement of the PAAB declared that the basic purpose of the PAAB was to "protect the financial interests of the people of South Africa, and other stakeholders, through services rendered by registered accountants and auditors" (Public Accountants' and Auditors' Board Annual Report, 2001). One of the PAAB's tasks, also highlighted in the corporate mission statement, was to support and protect its members, i.e. registered accountants and auditors, who carried out their duties "competently, fearlessly and in good faith" (Accountants' and Auditors' Board Annual Report, 2001).

Although the 2001 chairman of the PAAB, Zarina Bassa, recognised the challenges that faced the PAAB in 2001 owing to the unprecedented number of corporate failures, she stated in the PAAB's chairman report that media reports were speculative and "misleading and generally does not give recognition to our unique 50-year South African system of statutory regulation" (Accountants' and Auditors' Board Annual Report, 2001).

The establishment and functioning of a regulatory authority per se does not automatically result in effective regulation. "The regulator must not only be independent from those being regulated, but must be seen to be independent" (Odendaal & De Jager, 2008:5). Odendaal and De Jager identified two main factors that impact on the independence and perceived independence of a regulatory authority: external representation in the regulatory structure and the funding of the regulatory authority.

The PAAB has always comprised a majority of registered accountants and auditors. Following the recommendations of the Kings Report II on Corporate Governance, the PAAB appointed two members of the executive committee who were not registered accountants and auditors with the PAAB, out of a total of 16 members, i.e. 12.5% (Accountants' and Auditors' Board Annual Report, 2002). The PAAB was also funded by levies and fees paid by registered accountants and auditors. In essence, the auditing profession in South Africa was thus self-regulated.

In 2004, the National Treasury had issued a statement that "the Government of South Africa is committed to ensuring that the new authority would be entirely independent of the profession" (Kemp, 2004:2).

In South Africa, the promulgation of the Auditing Profession Act, 2005, effectively ended the self-regulation of the profession with the establishment of the Independent Regulatory Board for Auditors.

In the final newsletter issued by the PAAB in March 2006, the chief executive officer of the PAAB, Kariem Hoosain, highlighted two significant changes with the promulgation of the Auditing Profession Act (Act 26 of 2005) that would "ensure both the substance and appearance of independence" (PAAB, 2006), namely, the fact that the new Independent Regulatory Board for Auditors would comprise a maximum of forty percent registered accountants and auditors, and that although funding would still be obtained through the charging of fees and levies to members, the IRBA would be funded in part by government. The Independent Regulatory Board for Auditors should consist of no more than ten members, all appointed by the Minister of Finance, of which a maximum of forty percent may be registered auditors with the Independent Regulatory Board for Auditors.

2.6.2 More regular practice reviews

In the United States of America a different form of practice review was introduced, namely the peer review. The original purpose of the peer review, as conceived by the AICPA, was to function as "an educational tool for its members to enhance their knowledge of administrative policies and procedures when conducting financial statement services" (New York State Education Department, 2003:1).

Two limitations in this system were identified: The limited number of peer firms and the fact that the peer review was only conducted on a tri-annual basis (New York State Education Department, 2003).

The limitations and inadequacies of the peer review system became more evident when Arthur Andersen announced on the 3rd of January 2002, shortly after the Enron scandal broke, that is Houston office, responsible for the Enron audit, had successfully passed the peer review conducted by Deloitte & Touche shortly before. Up until 2002, only a few of the smaller audit firms in the United States had ever been censured following a peer review, and not one of the firms that had previously been known as the Big Five had ever failed a peer review (Armstrong, 2002; Byrnes, 2002). As a result, the Securities and Exchange Commissioner, Harvey L. Pitt, proposed a new Self-Regulatory Organisation (SRO) in addition to the Public Oversight Board (POB) that was charged with the consideration of the public's interest in the governance of auditors which would consist largely of non-auditors and would take over the responsibility for the practice review.

The shortcomings of the peer review process was however addressed in one of the provisions of the Sarbanes-Oxley Act enacted in July 2002, with the implementation of a mandatory inspection of all registered public accounting firms, on an annual basis, if the audit firm issues opinions on more than a hundred clients per annum, and every three years if on less than a hundred clients (New York State Education Department, 2003).

In South Africa, the Public Accountants and Auditors Board could from time to time conduct a practice review as legislated in section 22A of the Public Accountants and Auditors Act 80 of 1991. If a registered auditor refused, withheld information or did not cooperate and was found guilty he/she could be fined or imprisoned for up to one year. According to the Practice Review Guidelines published by the Public Accountants and Auditors Board, the primary goal of a practice review is to monitor compliance with professional standards. Although the act stipulates that a practice review can be conducted at any given time, the guide stipulates that each registered auditor who performs the attest function in public practice will be subject to a practice review at least once during every review cycle. The first cycle commenced in 1994, the second in May 1999 and the third in January 2005. Technically, the practice review could occur only once every five years. The review would also be conducted by registered chartered accountants employed by the Public Accountants and Auditors Board.

In the Auditing Profession Bill, as introduced in the National Assembly as a section 75 Bill and published in the Government Gazette of 30 August 2005, chapter 5, section 47, which dealt with the accountability of registered auditors it was determined that practice reviews could again be undertaken by the Independent Regulatory Board at any given time, but that they “must at least annually inspect or review the practice of a firm registered as a public interest company” (Republic of South Africa, 2005). The one year review cycle was in line with the stipulations of Sarbanes Oxley.

In the final Auditing Profession Act (Act 26 of 2005), the section was changed to stipulate that the Independent Regulatory Board for Auditors, or any person authorised by it, must perform a practice review of a registered auditor that audits a public interest company at least every three years. Registered auditors that perform the attest function for any other companies will be subject to a practice review at least every six years.

According to the IRBA Manual of Information, two types of reviews are distinguished: engagement reviews, which entail the examination of audit engagement files in order to ensure compliance with professional standards when performing an audit, and audit firm reviews, in order to inspect the quality control systems of audit firms (IRBA, 2008). Should either of the two types of practice reviews raise a reason for concern or non-compliance, it will be referred to the Inspection Committee, a sub-committee of the IRBA. The Inspection Committee, however, comprises eleven members, of which at least seven are registered auditors, one is an IRBA board member, who could be one of the forty percent of registered auditors on the board, and only three non-registered auditors. The costs for the practice review will also be for the account of the registered auditor or firm being reviewed.

2.6.3 Harsher punishment for the contravention of the Auditing Profession Act, 2005

The objective of an audit is "to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework" (SAICA, 2004:12).

In the Ministerial Panel for the Review of the Draft Accountancy Profession Bill's report to the Minister of Finance, a clear distinction is made between the responsibilities of the external auditor, who expresses an opinion as to the reasonability of the financial statements, and management which is responsible for the preparation of the financial statements. Already, in 2004, Trevor Manual, the Minister of Finance, suggested "increasing management's liability for their company financial statements" (Kemp, 2004).

The public in general expects that if an auditor is negligent or incompetent in the carrying out of his or her professional duties, he/she will be held professionally accountable (New York State Education Department, July 2003). High-profile business failures like Enron, Waste Management and WorldCom in the US made the public aware of the fact that penalties and punishment for auditors who acted without due care or fraudulently, were seriously inadequate.

Auditors could not be held professionally responsible for non-audit services, e.g. financial advisory and consulting services.

During the Enron investigations it was alleged that Arthur Andersen's staff had wilfully destroyed work papers and documentation relating to the Enron audit in order to eliminate evidence. One of the provisions in the Sarbanes-Oxley Act of 2002 is that persons who deliberately alter, destroy, mutilate, conceal, cover up or make false entries in records or documents with the intent to mislead, obstruct or influence an investigation or the proper administration of an organisation, can be fined and imprisoned up to 20 years (Van Wyk, 2003). Sarbanes-Oxley did not address liability of external auditors alone – company officials' liability has also increased drastically. The chief executive officer (CEO) and chief financial official (CFO) of the company is required to certify the financial statements and should the financial statements be restated, the CEO and CFO may have to repay profits made from share options and bonuses received as a result of the mis-stated financial statements. Should the CEO and CFO have certified the financial statements, knowing that the financial statements did not fairly present the financial results of the company, the penalty can be up to $1 million and 10 years' imprisonment. Should they have wilfully certified the financial statements knowing that they did not fairly present the financial results of the company, the penalty can be up to $5 million and twenty years imprisonment (Van Wyk, 2003).

According to the Public Accountants' and Auditors Act 80 of 1991, section 13 (h) (i), the Public Accountants and Auditors Board could punish a registered auditor who was found guilty of improper conduct with either a reprimand, a warning, a fine, suspension from practice or permanent suspension from practice. In section 2.3 the maximum penalty was set at R150 000.

According to the Auditing Profession Act, 2005, the Independent Regulatory Board for Auditors could still issue a reprimand or caution, suspend the right to practice or cancel registration as a registered auditor, but the fine that could be imposed if found guilty of improper conduct has been adjusted to an amount "not exceeding the amount calculated according to the ratio for five years' imprisonment prescribed in terms of the Adjustment of Fines Act, 1991"

(Section 51 (3), Auditing Professions Act, 2005). In terms of section 52 of the Auditing Professions Act, any registered auditor who fails to report a reportable irregularity to the Independent Regulatory Board for Auditors, or who knowingly or recklessly "expresses an opinion or makes a report or other statement which is false in a material respect" (Auditing Professions Act, 2005, section 52 (1)(b)), can be imprisoned for up to ten years. If any of the duties of the auditor as stipulated in section 44 of the Act is contravened, the registered auditor can be imprisoned for up to five years.

2.6.4 The establishment, composition of and functions of the audit committee

Although the appointment of an audit committee had been compulsory in the United States prior to 2002, the composition and functioning of the audit committee was not clearly defined (Sergeant, 2004). In 1999, the Securities & Exchange blue-ribbon commission in the United States made certain recommendations regarding the composition of the audit committee: It had to be comprised solely of independent directors, of which at least one had to be a financial expert (Byrnes, 2002). These recommendations were not implemented and even individuals with a significant business relationship with the company were permitted to serve as audit committee members as long as the board of directors of the particular company determined that it would not interfere with the audit committee members' judgement.

The inefficiency of the audit committee to monitor the functioning and independence of the external audit firm and the integrity of management, was clear in the Enron business failure. Senior management at Enron "were egged on by, and worked hand-in-glove with, Enron's audit committee" (Sergeant, 2004:2). Three members of Enron's six-member audit committee were not independent of the company: one member rendered consulting services to the company to the value of $72 000 a year and two others are employed by universities that have received significant charitable contributions from Enron, its Chairman Kenneth L. Lay and their foundations (Byrnes, 2002). By 2002, proposals were “being pressed for audit committees to be more independent and aggressive” (Dettmer, 2002:1).

In order to improve US corporate Governance in this regard, Sarbanes-Oxley now regulates the composition and functioning of the audit committee. The Act stipulates that each member of the audit committee should sit on the board of directors of the company as non-executive directors, and that they should be independent of the company (Van Wyk, 2003). The SEC’s interpretation of independence is based on the “audit-committee member’s judgement not being compromised by other income from the company and the audit committee member not being an affiliated person” (Van Wyk, 2003:3). An affiliated person is defined as someone who has a significant degree of control over the company, or who is to a significant degree under the control of the company. Audit committee members are not permitted to receive any fees other than board member fees from the company.

In South Africa, the appointment and existence of an audit committee in a company has never been a legislative requirement. It was recommended in order to enhance good corporate governance in the King Report on Corporate Governance in 1994, but has never been legislated by the Companies Act of 1973. In the King Report on Corporate Governance for South Africa 2002, which replaced the King Report on Corporate Governance in 1994, a Code of Corporate Practices and Conduct was issued with which all companies listed on the JSE Securities Exchange of South Africa had to comply. It stipulated that the board of directors should appoint an audit committee that should comprise a majority of independent, non-executive directors, of which the majority should be financially literate (King Report, 2002). The Code also stipulated that the audit committee should act according to terms of reference which deal with, inter alia, its composition and duties.

The appointment, composition and duties of the audit committee were finally legislated with the replacement of the Companies Act of 1973 by the Companies Bill of 2007. The new Companies Bill of 2007 stipulated that the audit committee had to comprise at least two independent, non-executive directors of the company, and defines that independence to exclude amongst others, shareholders, suppliers, customers, full time employees at the time or during the past three years of the company, or individuals related to the said exclusions (Republic of South Africa, 2007).

The audit committee's responsibilities include the appointment of an independent external auditor, the determination of remuneration to be paid to the said auditor, the determination and approval of any non-audit services to be rendered by the external auditor to the company, as well as to deal with any issues or complaints regarding the accounting practices and internal audit of the company.

However, "the mere existence of an audit committee (created to comply with, for example, stock exchange listing requirements) does not result in effective control" (Negash, 2003:10).

2.6.5 The appointment of and rotation of the external auditor.

The South African Audit Standards require that sufficient knowledge of the business is obtained before an opinion can be expressed on the financial statements. Sufficient knowledge of the business is necessary in order to enable the auditor to identify and understand transactions and events that may have an impact on the financial statements of the business (SAICA, 2004).

To obtain sufficient knowledge of business requires time which translates to costs, and it follows logically that it requires more time and effort for an initial engagement as opposed to succeeding audits where the auditor merely has to update his knowledge of any changes in the business" (Puttick & Van Esch, 1998:128). Auditors can thus audit more efficiently if the same core clients are audited year after year as knowledge of the business has merely to be updated (Thomas, Ward & Henke, 1991). Some authors describe the ongoing client base as "the cash cow for the business" (Davis, 2002:3).

There are two forms of rotation promoted from various regulatory bodies internationally: audit firm rotation and the less extreme audit partner rotation, both aimed at enhancing the independence of the external auditor.

The audit partner is responsible for attesting the financial statements and signs the audit report on behalf of the audit firm. Decision-making regarding significant auditing, accounting and reporting matters that affect the financial statements is the responsibility of the audit partner on the engagement (Van Wyk, 2003). The audit partner also maintains regular contact with management and the audit committee.

In the US, Sarbanes-Oxley provides for audit partner rotation every five years.

Finance minister Trevor Manual has rejected the recommendation to introduce audit partner rotation and has suggested that international trends be investigated before being enforced in South Africa. In a submission to the SEC, KPMG estimated that the cost of a single partner-rotation can be in the region of $250 000 (Van Wyk, 2003). Vassi Naidoo, the chairman of Deloitte, agrees and questions whether rotation of auditors would improve the quality of the audit. "Parmalat's collapse took place in Italy where auditor rotation is required – it is likely to add to already increasing audit costs" (Pile, 2004:1).

Others argue in favour of audit firm rotation. Ellen Seidman, director of the Office of Thrift Supervision, testified before the Senate banking committee after the failure of Superior Bank in the US that auditor rotation would "benefit investors and regulators" (Byrnes, 2002:4). According to John H. Biggs, chief of TIAA-CREF in the US, auditor rotation would solve all issues with regard to auditor independence (Byrnes, 2002).

The chairman of the PAAB, Ruth Benjamin-Swales, does not agree that auditor rotation would enhance the quality of audits and argues that the costs would increase significantly because audit firms would have to continually pitch to new clients (Pile, 2004). In Italy, however, where audit firm rotation failed to prevent the audit failure associated with the Parmalat collapse, the legislation was not drafted properly and an audit partner from one firm could at the end of the term move to the next audit firm and take over as partner on the same audit again (Negash, 2003).

In South Africa, mandatory audit partner rotation after five years was implemented in section 101 (10) of the Companies Bill of 2007.

2.6.6 The rights, duties and functions of auditors, including a limitation on non-audit services that the external auditor may perform for an audit client

During the 1970's, the Federal Trade Commission in the United States was concerned that the then Big Eight audit firms were acting as a "price-fixing oligopoly" and pressured the audit firms to compete for audits based on price (Healy & Palepu, 2003). The Federal Trade Commission's intention was to reduce the cost of financial information by reducing audit fees while simultaneously improving audit quality. Audits were commoditised with "severe price competition" (Healy & Palepu, 2003:79), with a resulting decline in not only the quality of audit work performed, but also the profitability.

The range of services provided by external auditors to audit clients have expanded dramatically over the past few years, including a number of non-traditional services, including financial advisory services, the provision of internal audit services, and the design and implementation of computer systems (New York State Education Department, July 2003).

Arthur Andersen earned approximately US$25 million in audit fees from Enron in 2000, and another US$27 million in consulting fees and other work, including the responsibility to conduct Enron's internal audits in the mid 1990's (Byrnes, 2002). The role and function of the internal auditor is to evaluate the effectiveness and compliance with the established policies of management regarding internal controls (Thomas, Ward & Henke, 1991). Arthur Andersen was effectively accepting responsibility for the effectiveness of internal controls while auditing those internal controls in their capacity as external auditors. Arthur Andersen also earned $11.8 million in non-audit fees from Waste Management, compared with the $7.5 million in audit fees during 1991 to 1997 before the collapse of the company (New York State Education Department, July 2003).

Other audit firms have also become increasingly dependent on non-audit fees. PriceWaterhouseCoopers earned only 40% of its worldwide fees from auditing in 2001. In a study at the University of Illinois' it was found that "on average, for every dollar of audit fees, clients paid their independent accountants $2.69 for non-audit consulting" (Byrnes, 2002:3). Puget Energy in Washington paid PriceWaterhouseCoopers $534 000 for audit fees and over $17 million for consulting fees in 2001.

In the US, a number of authors have called for "reform requiring all auditors to cease consulting for clients they audit" (Dettmer, 2002:1). Based on research conducted on the audit expectation gap in South Africa in 1993, Gloeck recommended that no non-audit services may be rendered by the external auditor to audit clients (Gloeck, 1993). This view was mirrored by finance minister Trevor Manual, who believes "this area has the greatest potential for compromising the independence of the external auditor" (Kemp, 2004:2).

Sarbanes-Oxley prohibits the provision of a number of non-audit services to audit clients, including bookkeeping and other services relating to the accounting records or financial statements, information system services, valuation services and internal auditing services (Van Wyk, 2003).

Finance minister Trevor Manual was adamant that there are certain services that should never be performed by external auditors for their clients, and as a result he "rejected the recommendation that no minimum statutory prohibitions be placed on consulting services" (Kemp, 2004:2).

Previously, the provision of other services to the client by the registered auditor was not prohibited by law, but left to the auditor's judgement as to whether the rendering of such services would impair the independence of the auditor. With the introduction of the new Companies Bill of 2007, certain accounting services have been prohibited and it is now the responsibility of the audit committee to determine whether or not the rendering of other services might impair the judgement and independence of the external auditor.

CHAPTER 3: PROPOSITIONS

The following propositions were derived from the literature:

Proposition 1: The audit profession's reputation has been affected adversely by the high-profile business failures (Armstrong, 2002; Sergeant, 2004; Dettmer, 2002; Kincaid, 1998; Matthews, 2005).

Proposition 2: The legislative changes to the auditing profession in South Africa were necessitated by the high-profile business failures locally and internationally (Van Wyk, 2003; Dettmer, 2002; Sergeant, 2004).

Proposition 3: The perceived independence of the external auditor has been affected adversely by the high-profile business failures (Armstrong, 2002).

Proposition 4: The perceived independence of the external auditor and quality of the attest function can be enhanced through compulsory rotation of audit partners (Davis, 2002; Pile, 2004; Byrnes, 2002; Van Wyk, 2003; Negash, 2003).

Proposition 5: The provision of non-audit services to audit clients affects the independence and perceived independence of the external auditor adversely (Gloeck, 1993; Byrnes, 2002; Van Wyk, 2003; Kemp 2004).

Proposition 6: The composition and function of the audit committee can enhance the quality of the audit and the perceived independence of the auditor (Sergeant, 2004; Byrnes 2002; Dettmer, 2002; Van Wyk, 2003; Negash, 2003).

Proposition 7: More regular practice reviews can enhance the quality of the audit and the perceived independence of the auditor (Armstrong, 2002; Barnes, 2002).

Proposition 8: Increased individual liability of the auditor will enhance the quality of the audit by the external auditor (Van Wyk, 2003; Kemp, 2003).

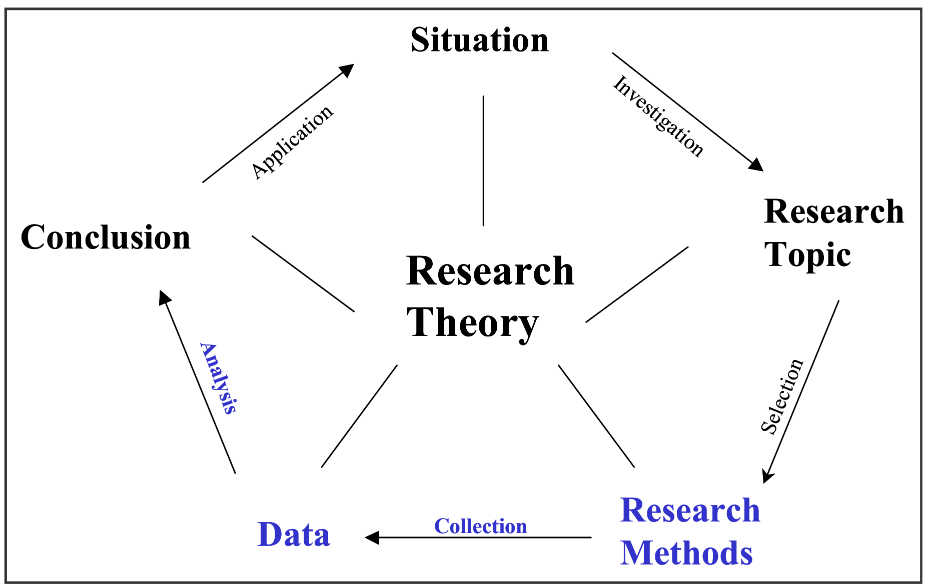
Proposition 9: The end of self-regulation will restore the public's perception regarding the independence of the external auditor (Odendaal & De Jager, 2008; Grumet, 2002; Kemp, 2004).

CHAPTER 4: RESEARCH METHODOLOGY

4.1 Introduction

Figure 3.1 by William (2005) illustrates the different steps in the research process. While the preceding chapters served to analyse the situation and describe the research topic, the purpose of this chapter is to present the methods and techniques used to collect and analyse the data to enable the researcher to arrive at the conclusions.

Figure 1: The research process



Source: Adapted from William (2500:238)

Specifically, the aspects covered in the chapter include a broad classification of the research deign, a definition of the population and sampling methodology, the measurement instrument, the data collection methods and the analysis procedures and techniques applied.

4.2 Research design

The purpose of the proposed study is to determine the accountants' perception regarding the effectiveness of legislative changes to the audit profession in South Africa.

There are two basic types of research designs: Experimental and non-experimental research. Wellman and Kruger (2001) explain that an experimental design involves an intervention. An intervention refers to the exposures of research subjects to something to which they otherwise would not have been subjected.

Non-experimental research is defined as a "systematic, empirical inquiry in which the scientist does not have direct control of the independent variable because their manifestations have already occurred or because they are inherently not manipulable" (Kerlinger, 1986:348). One of the great weaknesses of the non-experimental design, as compared to experimental research, is that non-experimental research lacks control over the independent and dependent variables (Kerlinger, 1986).

The research problem in the current study is however not suitable for manipulation as it requires opinions on a subject and it can therefore be classified as non-experimental in nature.

Within non-experimental research designs there are again various ways of describing the specific types of research. Descriptive research is described as a design where the research aims to describe the characteristics of an existing phenomenon (Salkind 2000). According to Breakwell, Hammon and Fife-Schaw (2000) cross-sectional surveys involve approaching a sample of respondents only once. The sample is then also regarded as a cross-section of the population on which the study focuses.

Both these descriptions fit the design of this study. The current study is therefore a descriptive non-experimental study that involves doing a cross-sectional survey of the population to determine their opinions on a particular phenomenon (legislation) at one moment in time only.

4.3 The research population

A population is defined as the complete set of individuals that the research is interested in, Clayton (1984). According to Salkind (2000) a population is the entire group of people that the researcher desires to learn about.

The population for this research study is defined as and limited to Chartered Accountants of South Africa registered with the South African Institute of Chartered Accountants (SAICA). In March 2008, there were 20 877 registered chartered accountants in South Africa, of whom 4 322 were registered with the IRBA.

4.4 Sample size and selection

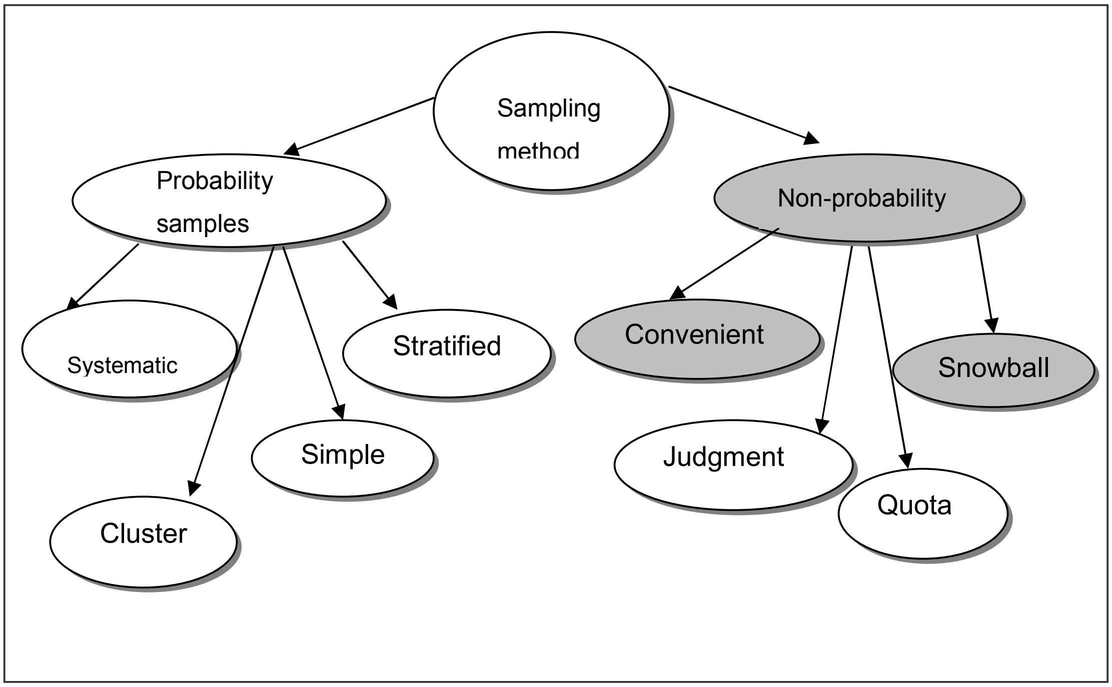
Sampling refers to the selection of people to participate in a research project, usually with the goal of being able to use responses from these people to make inferences about a larger group of individuals. In sampling we can distinguish between probability and non-probability samples. In probability sampling the researcher determines the probability that any element or member of the population will be included in the sample. In non-probability sampling, by contrast, the researcher cannot specify this probability (Welman and Kruger, 2001).

The sampling method chosen often depends on the objectives of the study, the financial resources available, time limitations and the nature of the problem under investigation (McDaniel & Gates, 2001). Non-probability sampling is less complicated and more economical than probability studies (Welman & Kruger, 2001).

The current research made use of non-probability sampling, as time and financial limitations did not allow for a random sample. Obtaining a complete sample frame of all CA qualified individuals would have proven too costly and time intensive.

Figure 4.1 indicates the various classifications of sampling methods and those used by the current research.

Figure 2: Classification of sample methods



(Source: McDaniels & Gates, 2001:416)

Welman and Kruger (2001) define the non-probability methods as follows:

- **Convenient or accidental sampling**: Sampling those most convenient to locate.
- **Purposive sampling**: Researchers use experience and knowledge to deliberately find units of analysis (member of the population) in such a manner that the sample might be considered as representative of the relevant population.
- **Quota sampling**: An effort is made to have the same proportions of units of analysis in important strata such as sex, age, and so on as are in the population but we obtain the units of analysis in any particular stratum accidentally.
- **Snowball sampling**: The researcher approaches a few individuals who then act as informants and identify other members from the same population for inclusion in the sample.

As the subject matter is fairly general and the researcher could not foresee any obvious bias that could occur as a result of non-probability sampling, a combination of convenience and snowball sampling methods were used. The research instrument was sent out to all the chartered accountants known to the researcher personally. When this did not generate a sufficient number of responses to perform factor analysis, the email addresses of all chartered accountants on SAICA's website were downloaded and utilised.

4.5 Research instrument

A questionnaire was developed based on the literature review. The questionnaire consisted of three parts:

- The first part pertained to basic demographic details.
- The second part consisted of 23 constructs with a 5-point Likert scale, ranging from strongly disagree to strongly agree. Respondents were asked to rate the extent of their agreement or disagreement with each of the constructs.
- The third part consisted of an open-ended question whereby respondents were invited to list any suggestions not encompassed in the current legislative changes that, in their opinion, would further assist in the prevention of audit failure.

According to Struwig and Steed (2001) some of the limitations of questionnaires relate to the fact that they do not allow for probing, prompting and clarification of questions and do not provide the opportunity for additional information to be collected. Questionnaires have the advantage that they allow the participants to respond to questions with the assurance that their responses will be anonymous, and this may allow the respondents to be more truthful than if they were in a personal interview. In general, questionnaires are more cost effective than interviews (Salkind 2000).

The current study made use of data collected through the Internet. A self-completion was programmed into a web-based questionnaire with the assistance of the program SurveyMonkey.

According to Solomon (2001), email offers one option for distributing Internet surveys. Up until a few years ago email surveys were the predominate means of Internet surveying. As the World Wide Web (WWW) has grown in popularity, the use of Hypertext Markup Language (HTML) forms or Web-based surveys are becoming the dominant methods of gathering survey data.

Zanutto (2001) explains that one of the many reasons for the popularity of this type of survey is the relatively low cost. Zanutto (2001) further elaborates on the advantages of Web surveys highlighting: a faster response rate, the ease of sending out reminders to participants, the ease of processing data, since responses could be downloaded to a spreadsheet, data analysis package, or a database, the dynamic error checking capability, the option of putting questions in random order, the ability to make complex skip pattern questions easier to follow, the inclusion of pop-up instructions for selected questions, and the use of drop-down boxes.

Solomon (2001) warns of the following concerns when dealing with Internet surveys:

- The biggest concern in Internet surveying currently is coverage bias or bias due to sampled people not having or choosing not to access the Internet. Despite expediential growth of the Internet there are still large numbers of people who do not have access and/or choose not to use the Internet. The current study focuses on individuals who, owing to their professional occupations, should all have access to email.

- The Web is a very public place and unless steps are taken to limit access to a survey, it may be found and responded to by people who are not among those sampled by the researcher. This can either happen by accident or maliciously. The program used for the current survey generates a unique link and only respondents using this link can “find” the survey. While this link might still end up in the wrong hands, so to speak, the chances of this happening are no greater than a postal survey being opened and completed by the wrong person.

- Since one only has to "click" the mouse pointer on the "submit" button to respond to a Web-based survey instrument once it is filled out, it is also quite possible for respondents to either mistakenly or purposefully submit multiple copies of their responses. The SurveyMonkey program used in the current survey allows only one answer from a respondent. Each answer is recorded “live” and the respondent need not press any “done” or “submit” button to ensure that answers are recorded.

4.6 Pilot test

A pilot test was conducted before the study commenced to ensure that all questions were understood clearly and that all questions that were ambiguous, potentially confusing or loaded, could be eliminated. Pilot testing can be conducted in order to test the validity and reliability of the questionnaire to be used (Leedy & Ormrod, 2005).

The questionnaire was distributed to five Chartered Accountants: two academics, two in public practice and one in commerce. Respondents were asked to complete the questionnaire and to comment on the completeness and validity of the questionnaire. Responses during the actual research of the five Chartered Accountants used in the pilot study were excluded from the results.

4.7 Validity and reliability

4.7.1 External validity

External validity refers to the ability of the research to be generalised (Leedy & Ormrod, 2005). In order to ensure external validity, the sample selected has to be random and representative of the population.

As the questionnaire was sent to Chartered Accountants registered on the South African Institute of Chartered Accountants mailing list, which includes members in academics, the corporate environment, and the consulting environment, as well as those in public practice, wide coverage was expected.

4.7.2 Internal validity

Internal validity is concerned with content validity and construct validity. Content validity is essential to ensure that the measuring instrument provides adequate coverage of the topic under study. To ensure content validity in the proposed research a thorough literature review was conducted, on which the questionnaire was based and a pilot test was conducted, drawing on the expertise and knowledge of five Chartered Accountants in different professional fields.

Construct validity relates to the question of the underlying variable or construct being measured (Stacey, 2005). It determines "the extent to which an instrument measures a characteristic that cannot be directly observed" (Leedy & Ormrod, 2005:92). Construct validity in the proposed research is once again achieved through a thorough review of the literature and the pilot testing of the questionnaire.

4.7.3 Reliability

Reliability is defined as the extent to which another researcher would draw the same conclusion in the same or a similar project (Leedy & Ormerod, 2005). In order to achieve reliability, questions have been phrased as clearly and precisely as possible. To ensure that no questions were potentially confusing, ambiguous or loaded, a pilot study was conducted before the questionnaire was distributed.

To measure the reliability of the scales in the current study, the Cronbach Alpha was used as a measure of internal consistency reliability.

The Cronbach alpha value ranges from 0 to 1, where 0 is no internal consistency and 1 is the maximum internal consistency. By convention, a lenient cut-off of .60 is common in exploratory research. The Cronbach alpha should be at least .70 or higher to retain an item in an adequate scale, and many researchers require a cut-off of .80 for a good scale (Rosnow & Rosenthal,1996).

4.7.4 Data analysis

The data was downloaded from Surveymonkey in a spreadsheet.

Descriptive statistics used in this study include frequency counts, mean scores and standard deviations. Frequencies are defined as the number of objects in sets or subsets (Kerlinger, 1986).

The mean calculates an average across a number of observations and the standard deviation is the square root of the variance around the mean, in other words, how well the mean represents the data (Field 2005:6). Standard deviations are normally also calculated when computing the mean. A standard deviation is defined as the average amount by which scores in a distribution differ from the mean.

The following inferential techniques were used:

- **The t-test for independent measures**

The t-test assesses whether the means of two groups are statistically different from each other. The t-test is defined as the difference between the means of the two samples divided by the standard error of the difference (Field, 2005). In the current study the means from respondents who are chartered accountants registered with the IRBA are compared with chartered accountants who are not registered with the IRBA by means of a t-test.

- **Analysis of variance (ANOVA)**

When one compares more than two groups (nominal or ordinal data) with regard to their mean scores on interval or ratio data the appropriate technique is the analysis of variance (ANOVA). This test calculates the F-value and a p-value. A p-value of 0.05 and less is considered significant.

- **Factor analysis**

Correspondence analysis was used to rescale the five point Likert scale adopted in the questionnaire. It was necessary to rescale the ordinal data to interval level data so that factor analysis could be applied to the data.

Factor analysis is used to "examine the correlations among a number of variables and identify clusters of highly interrelated variables that reflect underlying themes, or factors, within the data" (Leedy & Ormrod, 2005:274).

Factor analysis was applied to the interval level data to determine whether the high profile business failures had an adverse impact on the reputation of the audit profession in South Africa and to determine which aspects of the proposed changes in legislation to the auditing profession would have the most significant impact on the audit profession in South Africa.

CHAPTER 5: PRESENTATION OF RESULTS

5.1 Introduction

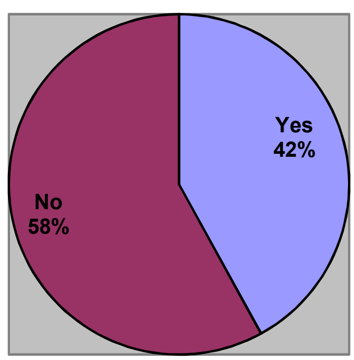
The purpose of the current chapter is to present the findings from the empirical research section of the study. An online survey was distributed via email and this chapter details the results from 240 completed questionnaires. The first section describes the demographic profile of the respondents. The second section presents the descriptive statistics, including the means, standard deviations and frequencies in percentages. The third section focuses on the inferential statistics, including the factor analysis and reliability of the instrument.

5.2 Demographic profile of respondents

The first question asked respondents to indicate whether they are chartered accountants registered with the IRBA or not.

58% or respondents are not registered with the IRBA and 42% are.

Figure 3: Demographic profile of the respondents



5.3 Descriptive statistics

Descriptive information for each of the individual items in the questionnaire is presented below. Descriptive information includes means (averages), standard deviations, and the maximum and minimum score for each question.

Table 1: Descriptive information for questionnaire items (n = 240)

	Minimum	Maximum	Mean	Std. Deviation
1. The provisions in the Auditing Profession Act 2005 will reduce the risk of audit failure	1	5	3.20	.899
2. The reputation of the audit profession in South Africa has been affected adversely by high-profile business failures both internationally and nationally	1	5	3.59	.990
3. The perceived independence of the external auditor has been affected adversely by the high-profile business failures	1	5	3.54	.957
5. High-profile business failure internationally necessitated legislative changes to the audit profession in South Africa	1	5	3.49	.973
6. The provisions in the Auditing Profession Act will ensure greater independence between external auditors and corporate clients	1	5	3.49	.814
7. The provision of non-audit services to audit clients can impair the auditor's independence	1	5	3.43	1.099
8. Self-regulation by the auditing profession in South Africa was sufficient	1	5	3.21	1.016
9. Tri-annual practice reviews will be effective in the prevention of audit failure	1	5	2.84	1.060
10. An independent audit committee will be effective in ensuring greater independence between the external auditor and management	1	5	3.75	.795
11. Increased individual liability of the auditor be effective in the prevention of audit failure	1	5	3.08	1.141
12. The external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees	1	5	3.08	1.177
13. Mandatory rotation of external audit partners will increase the external auditors independence	1	5	3.43	1.053
14. Practice reviews can enhance the quality of the audit services rendered by the external auditor	1	5	3.69	.924
15. The establishment of the Independent Regulatory Board for Auditors will reduce the risk of audit failure	1	5	3.05	.940

16. The legislation of continuous professional education will decrease the number of audit failures	1	5	3.10	1.040
17. Mandatory rotation of the external audit partner will decrease the risk of audit failure	1	5	3.16	1.069
4. External auditors should be allowed to provide internal audit services to audit clients	1	5	2.55	1.177
20. Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure	1	5	2.80	1.205
21. Legal backing to accounting standards will assist in the prevention of audit failure	1	5	3.46	.968
22. Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure	1	5	4.02	.843
23. If material fees are earned from the provision of non-audit services to audit clients it will impair the auditor's independence	1	5	3.64	.968

A high score indicates a high level of agreement. Therefore a mean score of 4.02 for "Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure"., is the statement with the highest level of agreement. Statements with lower levels of agreement are:

- External auditors should be allowed to provide internal audit services to audit clients (2.55)
- Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure (mean 2.8)
- Tri-annual practice reviews will be effective in the prevention of audit failure (2.84)

Another form of descriptive statistics is percentages and the table below presents the percentages in each of the answer categories, differentiating between chartered accountants registered with the IRBA, chartered accountants not registered with the IRBA, and an average for all respondents.

Table 2: Percentage distribution of answers for each statement (IRBA/Non-IRBA/Total average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1. The provisions in the Auditing Profession Act 2005 will reduce the risk of audit failure	5% 2% 2.9%	30% 15% 21.5%	27% 33% 30.2%	36% 49% 43.4%	2% 2% 2%
2. The reputation of the audit profession in South Africa has been affected adversely by high-profile business failures both internationally and nationally	2% 0% 1%	21% 18% 19.0%	14% 16% 15.1%	50% 50% 50.2%	13% 16% 14.6%
3. The perceived independence of the external auditor has been affected adversely by the high-profile business failures	1% 0% 0.5%	20% 22% 21%	15% 12% 13.2%	57% 53% 54.6%	7% 13% 10.7%
5. High-profile business failure internationally necessitated legislative changes to the audit profession in South Africa	7% 2% 3.9%	20% 13% 15.6%	14% 17% 15.6%	53% 61% 57.6%	6% 8% 7.3%
6. The provisions in the Auditing Profession Act will ensure greater independence between external auditors and corporate clients	2% 1% 1.5%	19% 8% 12.2%	26% 26% 25.9%	52% 60% 56.6%	1% 6% 3.9%
7. The provision of non-audit services to audit clients can impair the auditor's independence	6% 3% 4.4%	24% 18% 21%	19% 13% 15.1%	41% 50% 45.9%	10% 16% 13.7%
8. Self-regulation by the auditing profession in South Africa was sufficient	1% 6% 3.9%	14% 33% 24.9%	19% 27% 23.4%	55% 32% 41.5%	12% 3% 6.3%
9. Tri-annual practice reviews will be effective in the prevention of audit failure	15% 4% 8.8%	38% 35% 36.6%	15% 20% 18%	30% 38% 34.6%	1% 3% 2%
10. An independent audit committee will be effective in ensuring greater independence between the external auditor and management	1% 1% 1%	10% 8% 9.3%	14% 13% 13.7%	65% 67% 66.3%	9% 10% 9.8%
11. Increased individual liability of the auditor be effective in the prevention of audit failure	15% 5% 9.3%	33% 22% 26.3%	14% 21% 18%	34% 44% 39.5%	5% 8% 6.8%
12. The external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees	6% 7% 6.3%	24% 44% 35.6%	15% 11% 12.7%	41% 30% 34.6%	14% 8% 10.7%
13. Mandatory rotation of external audit partners will increase the external auditors independence	3% 3% 2.9%	29% 17% 22%	17% 15% 16.1%	45% 48% 46.8%	5% 18% 12.2%
14. Practice reviews can enhance the quality of the audit services rendered by the external auditor	5% 3% 3.4%	19% 3% 9.8%	20% 8% 13.2%	48% 72% 62%	9% 13% 11.7%
15. The establishment of the Independent Regulatory Board for Auditors will reduce the risk of audit failure	7% 3% 4.4%	37% 18% 25.9%	31% 33% 32.2%	21% 45% 35.1%	3% 2% 2.4%

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
16. The legislation of continuous professional education will decrease the number of audit failures	8% 4% 5.9%	26% 29% 27.3%	22% 22% 22%	41% 40% 40.5%	3% 5% 4.4%
17. Mandatory rotation of the external audit partner will decrease the risk of audit failure	5% 4% 4.4%	33% 29% 30.7%	15% 17% 16.1%	43% 42% 42.4%	5% 8% 6.3%
4. External auditors should be allowed to provide internal audit services to audit clients	21% 21% 21%	31% 41% 37.1%	12% 9% 10.2%	33% 28% 29.8%	3% 1% 2%
20. Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure	24% 6% 13.7%	38% 33% 35.1%	21% 13% 16.1%	13% 38% 27.3%	3% 11% 7.8%
21. Legal backing to accounting standards will assist in the prevention of audit failure	3% 1% 2%	27% 13% 18.5%	26% 17% 20.5%	34% 61% 49.3%	10% 9% 9.8%
22. Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure	1% 1% 1%	6% 8% 6.8%	8% 8% 7.8%	53% 61% 57.6%	31% 24% 26.8%
23. If material fees are earned from the provision of non-audit services to audit clients it will impair the auditor's independence	2% 3% 2.4%	12% 13% 12.7%	24% 13% 18%	52% 51% 51.7%	9% 19% 15.1%

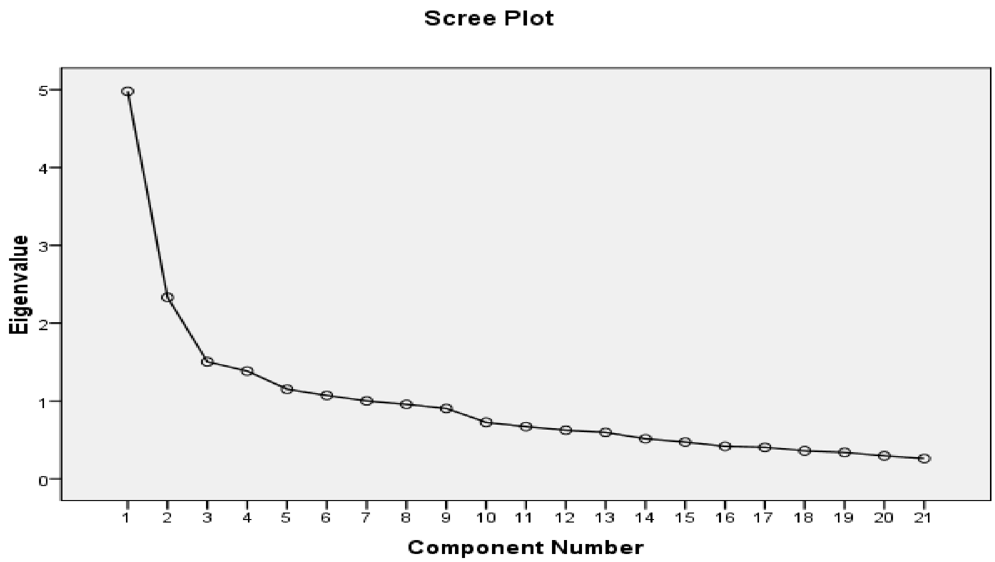
5.4 Inferential statistics

5.4.1 Factor analysis

Correspondence analysis was used to rescale the five point Likert scale adopted in the questionnaire from ordinal data to interval level data so that factor analysis could be applied.

A factor analysis was performed to investigate the underlying structure of the data and determine if it is possible to reduce the large number of items into smaller groups or factors. A principle factor analysis was performed and a scree plot was drawn of the eigen values. The scree plot assists that researcher in deciding on the number of factors to extract. The scree plot presented below smoothes out after the third factor, indicating to the possible existence of three factors. Another method of deciding on the number of factors to extract is using the rule of “eigen values with a score above 1”. Using this rule, 6 factors can be extracted.

Figure 4: Scree plot of the eigen values



Having examined a three, four and six factor solution, it was decided that a three factor solution is the most appropriate; the results from the three factor solution are presented in Table 4. Values with factor loadings less than 0.25 were suppressed.

Table 3: Three factor analysis results

	Factor		
	1	2	3
15. The establishment of the Independent Regulatory Board for Auditors will reduce the risk of audit failure	.723		
9. Tri-annual practice reviews will be effective in the prevention of audit failure	.652		
16. The legislation of continuous professional education will decrease the number of audit failures	.631		
6. The provisions in the Auditing Profession Act will ensure greater independence between external auditors and corporate clients	.614		
14. Practice reviews can enhance the quality of the audit services rendered by the external auditor	.609		
1. The provisions in the Auditing Profession Act 2005 will reduce the risk of audit failure	.585		
17. Mandatory rotation of the external audit partner will decrease the risk of audit failure	.497		
13. Mandatory rotation of external audit partners will increase the external auditors independence	.492		
21. Legal backing to accounting standards will assist in the prevention of audit failure	.433		
11. Increased individual liability of the auditor be effective in the prevention of audit failure	.432		
5. High-profile business failure internationally necessitated legislative changes to the audit profession in South Africa	.421		.269
20. Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure	.266		
10. An independent audit committee will be effective in ensuring greater independence between the external auditor and management			
23. If material fees are earned from the provision of non-audit services to audit clients it will impair the auditor's independence		.827	
7. The provision of non-audit services to audit clients can impair the auditor's independence		.724	
19. External auditors should not be allowed to provide internal audit services to audit clients		.532	
8. Self-regulation by the auditing profession in South Africa was sufficient			
3. The perceived independence of the external auditor has been affected adversely by the high-profile business failures			.780
2. The reputation of the audit profession in South Africa has been affected adversely by high-profile business failures both internationally and nationally			.766
12. The external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees			.293

22. Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure		.259	

Some items do not load on any factor with a factor loading above 0.25 and these will be excluded from the factors created. From the above table it appears that three clear factors emerge and each was given a more descriptive name:

Factor 1 = Legislation/regulation to prevent breakdown

Factor 2 = The provision of non-audit services to audit clients

Factor 3 = Effect of high profile business failure on the audit profession

An average factor score was created by obtaining the average across the items in each factor. For example:

Factor 3 = (item 3+item2+item 12)/3

The average scores on these three factors are presented in the figure below. Table 5 provides the full descriptive information (including minimum, maximum and standard deviation for the three factors). A high mean score indicates high agreement.

Figure 5: Average scores on the 3 factors factor analysis

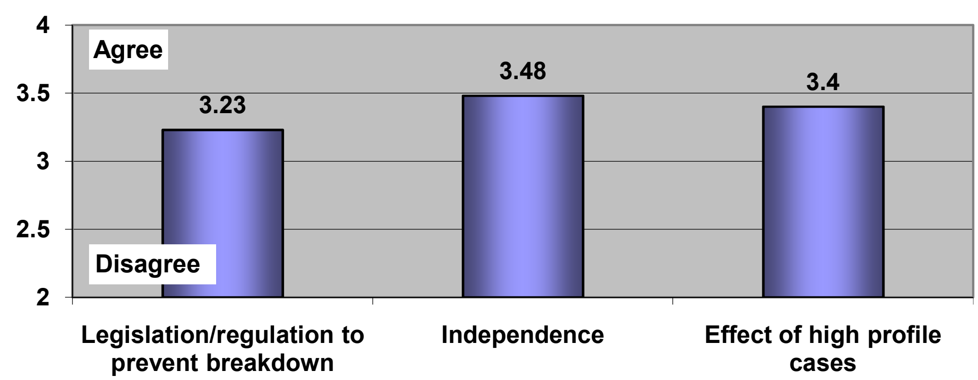


Table 4: Descriptive information for the factors identified

	N	Minimum	Maximum	Mean	Std. Deviation
Legislation/regulation to prevent breakdown	240	1.33	4.75	3.23	0.596
The provision of non-audit services to audit clients	240	1.00	5.00	3.48	0.858
Effect of high profile business failure	240	1.67	5.00	3.40	1.783

5.4.2 Reliability analysis

The next step is to examine the reliability of the factors that are created as well as the overall reliability of the questionnaire.

Reliability is described as the consistent measurement of the concepts being measured (Fields, 2005). Simply put, a researcher should get the same score on the questions at two different points in time. The most common internal consistency measure is Cronbach's alpha, which is usually interpreted as the mean of all possible split-half coefficients (Cortina 1993).

The Cronbach’s alpha was calculated for the total test, as well for the three factors created.

Table 5: Reliability of the questionnaire and factors

	Cronbach's alpha
Overall	0.788
Legislation/regulation to prevent breakdown	0.826
The provision of non-audit services to audit clients	0.710
Effect of high profile cases	0.608

The overall scale has a good Alpha of 0.788. Two of the factors also have high reliability values of above 0.7. The third factor, the effect of high profile cases, has a reliability score of 0.608 which is lower than the 0.7 cut off but still considered an adequate measure of reliability.

In addition to the internal reliability consistency, another measure of the quality of the data is to examine answers to items that are either identical or the reverse of one another. One would expect items that are identical to have a very high positive correlation and items that are the reverse of one another to show very high negative correlations.

The current questionnaire included two identical questions as well as two items that are the reverse of one another:

Item 4 External auditors should be allowed to provide internal audit services to audit clients.

Item 19 External auditors should **not** be allowed to provide internal audit services to audit clients.

Item 14 Practice reviews can enhance the quality of the audit services rendered by the external auditor.

Item 18 Practice reviews can enhance the quality of the audit services rendered by the external auditor.

The correlations between these items are given in Table 7.

Table 6: Correlations between similar items to test the quality of responses

	Item 14	**Item 4**
Item 18	r = 0.765 p = 0.000	
Item 19		r = -0.769 p = 0.000

Items 19 and 4 do show a significant negative correlation. The r value is -0.769. Items 14 and 18 do correlate significantly and positively with an r value of 0.765. Cohen (1992) gives the following guidelines for the social sciences in interpreting the size of the r-value: small effect size, r = 0.1; medium, r = 0.3; large, r = 0.5. Therefore the values of 0.76 found for the correlations are large. It can therefore be concluded that the respondents answered these questions correctly and this gives a level of added confidence in the data.

5.4.3 Comparing the results of those registered with the Regulatory Board

The scores of the two groups, the registered auditor (with the Regulatory Board as per the Auditing Professions Act) and those not registered are compared by means of a t-test for independent means. The results of the test are presented in Table 8.

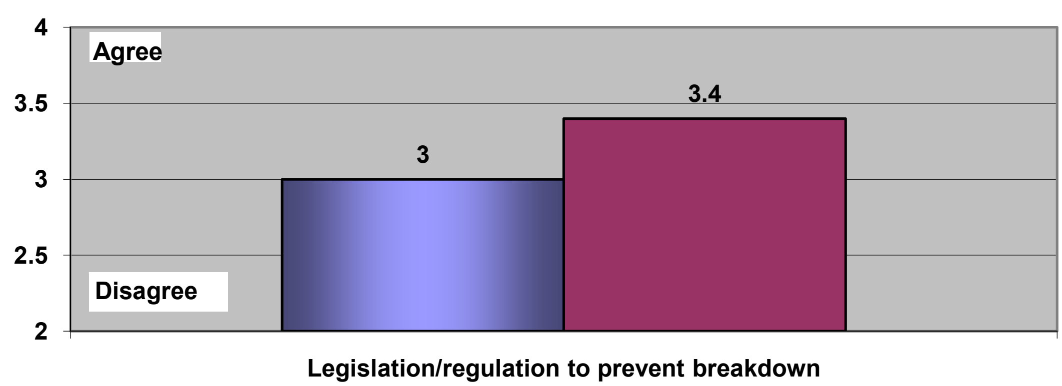
Table 7: Comparing the opinions of IRBA registered CA's with non-IRBA registered CA's on the 3 factors: T-test for independent means

	t	df	p-value
Legislation/regulation to prevent breakdown	-4.824	203	0.000
Independence	-1.779	203	0.077
Effect of high profile cases	0.564	203	0.573

Using the conventions of $p<0.05$ to reflect a significant result, there is only one difference between the scores of the two groups; in terms of legislation/regulation to prevent breakdown. The mean scores of both groups are plotted in Figure 6.

The score of those not registered (3.4) is therefore significantly higher than that of the registered auditors (3.0).

Figure 6: Comparison of average scores on factor 1



CHAPTER 6: DISCUSSION OF THE RESULTS

6.1 Introduction

The purpose of the current chapter is to discuss the findings from the empirical research section of the study. The demographic profile of the respondents is discussed, followed by a discussion of the results per proposition and the results from the open-ended question inviting respondents to list any suggestions not encompassed in the current legislative changes that, in their opinion, will further assist in the prevention of audit failure.

6.2 Demographic profile of respondents

Fifty-eight percent of the 240 respondents are not registered with the IRBA and 42% are registered with the IRBA. Only 20.7% of chartered accountants in South Africa are registered with the IRBA. The demographic profile of the respondents is hence not representative of the demographic profile of chartered accountants in South Africa. As non-probability sampling was employed and the opinions of chartered accountants registered with the IRBA, as well as those not registered with the IRBA, were solicited, the researcher does not believe that this led to an undue bias in the results.

6.3 Results pertaining to the propositions:

6.3.1 Results pertaining to Proposition 1: The audit profession's reputation has been affected adversely by the high-profile business failures.

Table 8: Question 2: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. deviation
2. The reputation of the audit profession in South Africa has been affected adversely by high-profile business failures both internationally and nationally	1	5	3.50 3.65 3.59	0.990

Table 9: Question 2: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
2. The reputation of the audit profession in South Africa has been affected adversely by high-profile business failures both internationally and nationally	2% 0% 1%	21% 18% 19.0%	14% 16% 15.1%	50% 50% 50.2%	13% 16% 14.6%

From the results to question 2 presented in tables 9 and 10, 65% of chartered accountants surveyed believe that the reputation of the audit profession in South Africa has been adversely affected by high-profile business failures, both internationally and nationally. Twenty percent either disagreed or strongly disagreed with this statement.

In a survey conducted by the American Institute of Certified Public Accountants, interviewing more than a thousand business decision makers, investors and shareholders, 90% of the respondents believed that the profession's credibility has suffered as a result of the high-profile business failures during the past five years and the audit profession's part therein (New York State Education Department, 2003).

6.3.2 Results pertaining to Proposition 2: The legislative changes to the auditing profession in South Africa were necessitated by the high-profile business failures locally and internationally.

Table 10: Questions 1 and 5: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. deviation
1. The provisions in the Auditing Profession Act 2005 will reduce the risk of audit failure	1	5	3.01 3.34 3.2	0.899
5. High-profile business failure internationally necessitated legislative changes to the audit profession in South Africa	1	5	3.31 3.61 3.49	0.973

Table 11: Questions 1 and 5: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
1. The provisions in the Auditing Profession Act 2005 will reduce the risk of audit failure	5% 2% 2.9%	30% 15% 21.5%	27% 33% 30.2%	36% 49% 43.4%	2% 2% 2%
5. High-profile business failure internationally necessitated legislative changes to the audit profession in South Africa	7% 2% 3.9%	20% 13% 15.6%	14% 17% 15.6%	53% 61% 57.6%	6% 8% 7.3%

Sixty-four point nine percent of the chartered accountants that participated in the survey either agreed or strongly agreed that high-profile business failure internationally necessitated legislative changes to the audit profession in South Africa. However, 27% of chartered accountants registered with the IRBA disagreed and strongly disagreed with this statement, compared to 15% of chartered accountants not registered with the IRBA. The mean calculated for this question is 3.49.

Subsequent to the Enron scandal in 2001, the most comprehensive, far-reaching corporate responsibility and accountancy reform legislation since 1934 was signed into law when the Public Company Accounting Reform and Investor Protection Act of 2002, also known as the Sarbanes-Oxley Act of 2002, was enacted in July 2002 in the United States (New York State Education Department, 2003).

Forty-five point four percent of the chartered accountants surveyed agreed or strongly agreed with the statement that the provisions of the Auditing Profession Act of 2005 would reduce the risk of audit failure while 30% remained neutral and 24.4% disagreed or strongly disagreed with the statement.

6.3.3 Results pertaining to Proposition 3: The perceived independence of the external auditor has been affected adversely by the high-profile business failures.

Table 12: Questions 3 and 6: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. deviation
3. The perceived independence of the external auditor has been affected adversely by the high-profile business failures	1	5	3.49 3.58 3.54	0.957
6. The provisions in the Auditing Profession Act will ensure greater independence between external auditors and corporate clients	1	5	3.31 3.62 3.49	0.814

Table 13: Questions 3 and 6: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
3. The perceived independence of the external auditor has been affected adversely by the high-profile business failures	1% 0% 0.5%	20% 22% 21%	15% 12% 13.2%	57% 53% 54.6%	7% 13% 10.7%
6. The provisions in the Auditing Profession Act will ensure greater independence between external auditors and corporate clients	2% 1% 1.5%	19% 8% 12.2%	26% 26% 25.9%	52% 60% 56.6%	1% 6% 3.9%

Sixty-five point three percent of the respondents surveyed agreed with the statement that the perceived independence of the external auditor has been affected adversely by the high-profile business failure. The means calculated for this statement of the chartered accountants registered with the IRBA vs. the chartered accountants not registered with the IRBA, varies by only 3%, indicating a high level of agreement on this statement.

6.3.4 Results pertaining to Proposition 4: The perceived independence of the external auditor and quality of the attest function can be enhanced through the compulsory rotation of audit partners.

Table 14: Questions 13 and 17: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. Deviation
13. Mandatory rotation of external audit partners will increase the external auditors independence	1	5	3.19 3.61 3.43	1.053
17. Mandatory rotation of the external audit partner will decrease the risk of audit failure	1	5	3.10 3.19 3.16	1.069

Table 15: Questions 13 and 17: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
13. Mandatory rotation of external audit partners will increase the external auditors independence	3% 3% 2.9%	29% 17% 22%	17% 15% 16.1%	45% 48% 46.8%	5% 18% 12.2%
17. Mandatory rotation of the external audit partner will decrease the risk of audit failure	5% 4% 4.4%	33% 29% 30.7%	15% 17% 16.1%	43% 42% 42.4%	5% 8% 6.3%

According to John H. Biggs, chief of TIAA-CREF in the US, auditor rotation would solve all issues with regard to auditor independence (Byrnes, 2002).

Fifty percent of chartered accountants registered with the IRBA agreed or strongly agreed with the statement that mandatory rotation of external audit partners would increase the external auditors' independence, compared with 66% of chartered accountants not registered with the IRBA. The means calculated for this statement of the chartered accountants registered with the IRBA vs. the chartered accountants not registered with the IRBA varies by 13%, indicating a low level of agreement on this statement.

Forty-eight point seven percent of respondents agreed or strongly agreed with the statement that mandatory rotation of the external audit partner would decrease the risk of audit failure, whilst 35.1% of respondents disagreed or strongly disagreed with this statement. The means calculated for this statement of the chartered accountants registered with the IRBA vs. the chartered accountants not registered with the IRBA varies by 3%, indicating a relatively high level of agreement on this statement.

One of the comments made in part 3 of the research instrument, the open-ended question, is that mandatory rotation of auditors, not just audit partners, would be the single most effective way of reducing audit failures, as the respondent believes that this will introduce a fresh approach to the audit and will result in the auditor focusing efforts on the audit rather than retaining the client.

6.3.5 Results pertaining to Proposition 5: The provision of non-audit services to audit clients affects the independence and perceived independence of the external auditor adversely.

Table 16: Questions 4, 7, and 23: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. deviation
4. External auditors should be allowed to provide internal audit services to audit clients	1	5	2.66 2.46 2.55	1.177
7. The provision of non-audit services to audit clients can impair the auditor's independence	1	5	3.26 3.56 3.43	1.099
23. If material fees are earned from the provision of non-audit services to audit clients it will impair the auditor's independence	1	5	3.55 3.71 3.64	.968

Table 17: Questions 4, 7, and 23: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
4. External auditors should be allowed to provide internal audit services to audit clients	21% 21% 21%	31% 41% 37.1%	12% 9% 10.2%	33% 28% 29.8%	3% 1% 2%
7. The provision of non-audit services to audit clients can impair the auditor's independence	6% 3% 4.4%	24% 18% 21%	19% 13% 15.1%	41% 50% 45.9%	10% 16% 13.7%
23. If material fees are earned from the provision of non-audit services to audit clients it will impair the auditor's independence	2% 3% 2.4%	12% 13% 12.7%	24% 13% 18%	52% 51% 51.7%	9% 19% 15.1%

Based on research conducted on the audit expectation gap in South Africa in 1993, Gloeck recommended that no non-audit services may be rendered by the external auditor to audit clients (Gloeck, 1993).

There is a low level of agreement between chartered accountants performing the attest function vs. chartered accountants not performing the attest function on this issue. Fifty-two percent of chartered accountants registered with the IRBA disagree with the statement that external auditors should be allowed to provide internal audit services to audit clients, compared with 62% of chartered accountants not registered with the IRBA. The means calculated on this question varies by 8%.

On the statement that the provision of non-audit services to audit clients can impair the auditor’s independence, the means vary by 9% with 66% of non-IRBA registered chartered accountants either agreeing or strongly agreeing with this statement, compared with 51% of chartered accountants registered with the IRBA.

Seventy percent of non-IRBA registered chartered accountants believe that material fees earned from the provision of non-audit services to audit clients would impair the auditor’s independence, compared with 61% of chartered accountants registered with the IRBA.

6.3.6 Results pertaining to Proposition 6: The composition and function of the audit committee can enhance the quality of the audit and the perceived independence of the auditor.

Table 18: Questions 10 and 12: Descriptive statistics

	Minimum	Maximum	Mean	Std. deviation
10. An independent audit committee will be effective in ensuring greater independence between the external auditor and management	1	5	3.71 3.77 3.75	.795
12. The external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees	1	5	3.33 2.90 3.08	1.177

Table 19: Questions 10 and 12: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
10. An independent audit committee will be effective in ensuring greater independence between the external auditor and management	1% 1% 1%	10% 8% 9.3%	14% 13% 13.7%	65% 67% 66.3%	9% 10% 9.8%
12. The external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees	6% 7% 6.3%	24% 44% 35.6%	15% 11% 12.7%	41% 30% 34.6%	14% 8% 10.7%

Although the existence and functioning of an audit committee has been recommended in order to enhance good corporate governance in the King Report on Corporate Governance in 1994, the statutory functioning of the audit committee was only incorporated in legislation with the introduction of the Companies Bill of 2007. However, “the mere existence of an audit committee (created to comply with for example stock exchange listing requirements) does not result in effective control” (Negash, 2003:10).

Seventy-six point one percent of the respondents in the survey agreed or strongly agreed that an independent audit committee would be effective in ensuring greater independence between the external auditor and management.

The mean calculated for this question is 3.75 and the standard deviation .795, indicating that the mean represents the data well.

On the statement that the external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees, the means calculated from responses from chartered accountants registered with the IRBA vs. chartered accountants not registered with the IRBA, varies by 13%. Fifty-five percent of respondents registered with the IRBA agreed or strongly agreed with the statement, with a mean of 3.33, while only 38% of respondents not registered with the IRBA agreed or strongly agreed with the statement, with a mean of 2.9.

6.3.7 Results pertaining to Proposition 7: More regular practice reviews can enhance the quality of the audit and the perceived independence of the auditor.

Table 20: Questions 9 and 14: Descriptive statistics

	Minimum	Maximum	Mean	Std. deviation
9. Tri-annual practice reviews will be effective in the prevention of audit failure	1	5	2.64 2.99 2.84	1.060
14. Practice reviews can enhance the quality of the audit services rendered by the external auditor	1	5	3.38 3.91 3.69	.924

Table 21: Questions 9 and 14: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
9. Tri-annual practice reviews will be effective in the prevention of audit failure	15% 4% 8.8%	38% 35% 36.6%	15% 20% 18%	30% 38% 34.6%	1% 3% 2%
14. Practice reviews can enhance the quality of the audit services rendered by the external auditor	5% 3% 3.4%	19% 3% 9.8%	20% 8% 13.2%	48% 72% 62%	9% 13% 11.7%

Although 73.7% of respondents surveyed agreed or strongly agreed with the statement that practice reviews can enhance the quality of audit services rendered by the external auditor, only 36.6% agreed with the statement that tri-annual practice reviews will be effective in the prevention of audit failure.

The high level of disagreement between respondents registered with the IRBA vs. respondents not registered with the IRBA is evident in the 13% variance between the means calculated on this question. Thirty-nine percent of respondents not registered with the IRBA disagreed or strongly disagreed with this statement, compared with 53% of respondents registered with the IRBA.

6.3.8 Results pertaining to Proposition 8: Increased individual liability of the auditor will enhance the quality of the audit by the external auditor.

Table 22: Questions 11, 16, 20 and 21: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. deviation
11. Increased individual liability of the auditor be effective in the prevention of audit failure	1	5	2.80 3.29 3.08	1.141
16. The legislation of continuous professional education will decrease the number of audit failures	1	5	3.06 3.13 3.10	1.040
20. Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure	1	5	2.33 3.15 2.80	1.205
21. Legal backing to accounting standards will assist in the prevention of audit failure	1	5	3.21 3.65 3.46	.968
22. Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure	1	5	4.08 3.98 4.02	.843

Table 23: Questions 11, 16, 20 and 21: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
11. Increased individual liability of the auditor will be effective in the prevention of audit failure	15% 5% 9.3%	33% 22% 26.3%	14% 21% 18%	34% 44% 39.5%	5% 8% 6.8%
16. The legislation of continuous professional education will decrease the number of audit failures	8% 4% 5.9%	26% 29% 27.3%	22% 22% 22%	41% 40% 40.5%	3% 5% 4.4%

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
20. Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure	24% 6% 13.7%	38% 33% 35.1%	21% 13% 16.1%	13% 38% 27.3%	3% 11% 7.8%
21. Legal backing to accounting standards will assist in the prevention of audit failure	3% 1% 2%	27% 13% 18.5%	26% 17% 20.5%	34% 61% 49.3%	10% 9% 9.8%
22. Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure	1% 1% 1%	6% 8% 6.8%	8% 8% 7.8%	53% 61% 57.6%	31% 24% 26.8%

There is a high level of disagreement between chartered accountants responsible for performing the attest function vs. chartered accountants not in public practice on the questions relating to this proposition.

Fifty-two percent of CA's not registered with the IRBA agreed or strongly agreed with the statement that increased individual liability of the auditor would be effective in the prevention of audit failure, compared with only 39% of CA's registered with the IRBA. Forty-eight percent of chartered accountants registered with the IRBA disagreed or strongly disagreed with this statement. The means calculated for this question between the two groups varied by17%.

Forty-eight point percent of respondents surveyed disagreed or strongly disagreed with the statement that harsher punishment for external auditors, e.g. ten years incarceration for failure to report a reportable irregularity, would reduce the risk of audit failure. The mean calculated for this question from data gathered from chartered accountants registered with the IRBA is only 2.33, 36% lower than that of chartered accountants not registered with the IRBA.

In contrast to this, 84.4% of respondents surveyed agreed or strongly agreed with the statement that penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports, would assist in the prevention of audit failure. This is also the statement with the highest mean calculated in the research instrument of 4.02, and the means between the two groups varied by only 2%.

Forty-four point nine percent of respondents agreed or strongly agreed with the statement that the legislation of continuing professional education would decrease the number of audit failures, and the means on this question between the two groups varied by only 2%.

Fifty-nine point one percent of chartered accountants agreed with the statement that legal backing for accounting standards would assist in the prevention of audit failure.

6.3.9 Results pertaining to Proposition 9: The end of self-regulation will restore the public's perception regarding the independence of the external auditor.

Table 24: Questions 8 and 15: Descriptive statistics (IRBA/Non-IRBA/Average)

	Minimum	Maximum	Mean	Std. deviation
8. Self-regulation by the auditing profession in South Africa was sufficient	1	5	3.62 2.92 3.21	1.016
15. The establishment of the Independent Regulatory Board for Auditors will reduce the risk of audit failure	1	5	2.77 3.26 3.05	.940

Table 25: Questions 8 and 15: Percentages (IRBA/Non-IRBA/Average)

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
8. Self-regulation by the auditing profession in South Africa was sufficient	1% 6% 3.9%	14% 33% 24.9%	19% 27% 23.4%	55% 32% 41.5%	12% 3% 6.3%
15. The establishment of the Independent Regulatory Board for Auditors will reduce the risk of audit failure	7% 3% 4.4%	37% 18% 25.9%	31% 33% 32.2%	21% 45% 35.1%	3% 2% 2.4%

Sixty-seven percent of chartered accountants registered with the IRBA agreed or strongly agreed with the statement that self-regulation of the auditing profession in South Africa was sufficient, compared with 35% of chartered accountants not registered with the IRBA. The means on this question varied by 19%, indicating a high level of disagreement on this statement.

Forty-four percent of respondents registered with the IRBA disagreed or strongly disagreed with the statement that the establishment of the IRBA would reduce the risk of audit failure, while only 24% agreed or strongly agreed with this statement. This is in stark contrast to the 47% of chartered accountants not registered with the IRBA who agreed or strongly agreed with this statement. The means on this question varied 18%, underlining the high level of disagreement on this statement.

6.4 Results from open-ended question: Further suggestions from respondents for measures not currently encompassed in current legislation that will assist in the prevention of audit failure.

From the responses gathered to part three of the research instrument, it is clear that the chartered accountants who participated in that part of the survey believe there should be a greater emphasis on the enforcement of the legislative changes and not just on the legislative changes themselves. It appears as if there is no confidence that the laws are being enforced properly.

A second major part identified from the comments is that the legislative changes to the audit profession in South Africa have led to over-regulation to the point where the cost of regulation is disproportionate to the benefits obtained. The general consensus is that this over-regulation will not prevent audit failure or dishonesty but will simply make it "more expensive to hide". One respondent feels that the profession has been destroyed and has been turned into a "checklist compliance exercise" which will lead to an increase in audit failure as less professional judgement is exercised and more emphasis is placed on checklist compliance. Another respondent noted that if the same regulatory requirements were made of a medical doctor, "he would be lucky to see 1 patient a day". Most of the respondents that commented on this issue are also in agreement that the regulatory and legislative requirements for non-listed companies should be reduced significantly.

One of the key issues highlighted by respondents in the open-ended question is the inexperience of audit staff conducting the actual audits. Audit firms have always tended to hire young, inexperienced and academically successful candidates (Davis, 2002). Most of the actual field work is conducted by articled clerks and then reviewed by a manager and ultimately by the audit partner who signs off the audit report. Unfortunately, the cost of the audit is directly related to the time spent by the audit staff on the audit and the charge-out rate of the audit staff is directly related to the experience and qualifications of the staff. Should more experienced audit staff be employed to conduct the audit, the costs would rise dramatically. A number of respondents expressed the opinion that audit clerks simply copy the approach and methodology from the previous year's work papers.

A number of chartered accountants surveyed commented on the integrity and professional judgement of the external auditor. A suggestion was made that the chartered accountants' training should incorporate an element of human sciences to strengthen the human judgement capabilities of auditors. The New York State Education Department regulates the number of hours a CPA or PA must spend on training related to ethics and professional judgement, per annum (New York State Education Department, 2003). In South Africa, however, the concept of continuing professional education with a mandatory number of training hours in a three-year cycle has been introduced by SAICA but training related to ethics and the code of conduct is not mandatory.

There were also a number of suggestions to improve auditor independence through the establishment of an independent body, e.g. the Registrar of Companies, or the IRBA, or SAICA, which would be responsible for the payment of audit fees. The regulatory authority charged with this task would be responsible for the collection and administration of all audit fees from entities requiring or requesting an audit.

One respondent suggested stronger regulations about new client acceptance as a measure to protect external auditors from accepting high-risk engagements. Another respondent is of the opinion that the IRBA should keep a public database with the full details of all entities for which a reportable irregularity has been exposed so that auditors can consult this database before accepting a new engagement.

Finally there have been a number of suggestions for increased liability for company directors, and that the stringent regulatory and legislative requirements should be aimed at the directors who perpetrate and benefit from the fraud committed. Recommendations were made ranging from mandatory training and induction courses for all new company directors, to an entrance type exam for directors before they can qualify to act as directors.

CHAPTER 7: CONCLUSIONS AND RECOMMENDATIONS

7.1 Introduction

The purpose of this chapter is to present a summary of the findings and to make recommendations based on the results of the research, as well as recommendations for further research.

7.2 Summary of findings

The purpose of this report was to research the accountants' perceptions of legislative changes to the audit profession in South Africa.

The majority of chartered accountants surveyed agreed that the reputation of the audit profession in South Africa has been affected adversely by high-profile business failures internationally and nationally, and that this necessitated the legislative changes to the audit profession in South Africa.

There are certain aspects of the legislative changes to the audit profession in South Africa that will be efficient in the prevention of audit failure and in ensuring greater independence of the external auditor, including:

- the functioning of an independent audit committee;
- legal backing for accounting standards; and
- penalties for directors and parties who are involved in the preparation and approval of non-compliant financial reports.

Although the majority of the respondents believed that practice reviews can enhance the quality of the audit services rendered by the external auditor, 45.4% disagreed or strongly disagreed that tri-annual practice reviews would be effective in the prevention of audit failure.

The majority of chartered accountants surveyed agreed that mandatory rotation of external audit partners would increase the external auditors' independence, but only 48.7% agreed that it would decrease the risk of audit failure, while 35.1% disagreed with this statement.

There was a strong level of agreement on the fact that the provision of non-audit services to audit clients could impair the auditor's independence and that if material fees were earned from the provision of non-audit services to audit clients, it would impair the auditor's independence. With the introduction of the Companies Bill of 2007 the nature and extent of these non-audit services would be regulated and determined by the audit committee and no longer be left to the professional judgement of the external auditor.

The greatest level of disagreement between the chartered accountants registered with the IRBA vs. the chartered accountants not registered with the IRBA, was on the statement that harsher punishment for external auditors would reduce the risk of audit failure. Sixty-two percent of chartered accountants registered with the IRBA disagreed or strongly disagreed with this statement, compared with 49% of chartered accountants not registered with the IRBA who agreed or strongly agreed with this statement. There was, however, a high level of agreement on the statement that directors and parties involved in the preparation of non-compliant financial reports should be penalised and held liable – this statement had the highest mean of all the statements in the research instrument, namely that of 4.02.

Finally, only 37.1% of the chartered accountants that participated in this survey agreed that the establishment of the IRBA would reduce the risk of audit failure while 47.8% agreed that self-regulation by the auditing profession in South Africa was sufficient.

7.3 Recommendations

The Auditing Profession Act, Act No.26 of 2005, has been signed into legislation and the IRBA has been established. The Companies Bill of 2007 has not yet been signed into legislation and this has been postponed to 2009 owing to the political situation in South Africa. The regulatory and legislative requirements governing the audits of non-public interest companies should be re-examined and addressed in future legislation. Perhaps legislators in South Africa can learn from legislators in the United States and increase the penalties and individual liability of the company directors who gain the most from the non-compliant and sometimes fraudulent financial statements prepared, and not focus all the regulations and legislation on the external auditor. A further recommendation would be for the Registrar of Companies to implement mandatory training for directors on their fiduciary duties.

7.4 Suggestions for further research

This research was limited to the perspective of chartered accountants in South Africa. The study could be repeated but from the perspective of directors and investors.

A study could be conducted to research the impact of legislative changes to the audit profession on audit fees to determine with what percentage, if any, audit fees increased as a result of the stringent legislative and regulatory requirements.

Research could also be conducted to determine the impact of legislative changes to the audit profession in South Africa on small and medium size audit firms.

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APPENDIX A

Actual research instrument

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
The provisions in the Auditing Profession Act 2005 will reduce the risk of audit failure					
The reputation of the audit profession in South Africa has been affected adversely by high-profile business failures both internationally and nationally					
The perceived independence of the external auditor has been affected adversely by the high-profile business failures					
High-profile business failure internationally necessitated legislative changes to the audit profession in South Africa					
The provisions in the Auditing Profession Act will ensure greater independence between external auditors and corporate clients					
The provision of non-audit services to audit clients can impair the auditor's independence					
Self-regulation by the auditing profession in South Africa was sufficient					
Tri-annual practice reviews will be effective in the prevention of audit failure					
An independent audit committee will be effective in ensuring greater independence between the external auditor and management					
Increased individual liability of the auditor be effective in the prevention of audit failure					
The external auditor's independence is influenced by the fact that management was responsible for paying the auditor's professional fees					
Mandatory rotation of external audit partners will increase the external auditors independence					
Practice reviews can enhance the quality of the audit services rendered by the external auditor					
The establishment of the Independent Regulatory Board for Auditors will reduce the risk of audit failure					

	Strongly disagree	Disagree	Neutral	Agree	Strongly agree
The legislation of continuous professional education will decrease the number of audit failures					
Mandatory rotation of the external audit partner will decrease the risk of audit failure					
External auditors should be allowed to provide internal audit services to audit clients					
Harsher punishment for external auditors, e.g. ten year incarceration for failure to report a reportable irregularity, will reduce the risk of audit failure					
Legal backing to accounting standards will assist in the prevention of audit failure					
Penalties for directors and parties who are party to the preparation and approval of non-compliant financial reports will assist in the prevention of audit failure					
If material fees are earned from the provision of non-audit services to audit clients it will impair the auditor's independence					

Open ended question:

Do you have any suggestions not encompassed in the current legislative changes that will further assist in the prevention of audit failure?

APPENDIX B

Consistency matrix

Accountants perceptions of legislative changes in the auditing profession in South Africa				
Literature Review	**Hypotheses or Propositions or Research questions**	**Source of data**	**Type of data**	**Analysis**
Armstrong, 2002; Sergeant, 2004; Dettmer, 2002; Kincaid, 1998; Matthews, 2005	The audit profession's reputation has been affected adversely by the high-profile business failures	Question 2 of the research instrument	Ordinal data	Mean, frequency, standard deviation, factor analysis
Van Wyk, 2003; Dettmer, 2002; Sergeant, 2004	The legislative changes to the auditing profession in South Africa were necessitated by the high-profile business failures locally and internationally	Questions 1, 5 and 21 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis
Armstrong, 2002	The perceived independence of the external auditor has been affected adversely by the high-profile business failures	Questions 3 and 6 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis

Accountants perceptions of legislative changes in the auditing profession in South Africa				
Literature Review	**Hypotheses or Propositions or Research questions**	**Source of data**	**Type of data**	**Analysis**
Davis, 2002; Pile, 2004; Byrnes, 2002; Van Wyk, 2003; Negash, 2003.	The perceived independence of the external auditor and quality of the attest function can be enhanced through compulsory rotation of audit partners	Questions 13 and 17 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis
Gloeck, 1993; Byrnes, 2002; Van Wyk, 2003; Kemp 2004.	The provision of non-audit services to audit clients affects the independence and perceived independence of the external auditor adversely	Questions 4, 7, 19 and 23 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis
Sergeant, 2004; Byrnes 2002; Dettmer, 2002; Van Wyk, 2003; Negash, 2003.	The composition and function of the audit committee can enhance the quality of the audit and the perceived independence of the auditor	Questions 10 and 12 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis

Accountants perceptions of legislative changes in the auditing profession in South Africa				
Literature Review	**Hypotheses or Propositions or Research questions**	**Source of data**	**Type of data**	**Analysis**
Armstrong, 2002; Barnes, 2002	More regular practice reviews can enhance the quality of the audit and the perceived independence of the auditor	Questions 9, 14 and 18 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis
Van Wyk, 2003; Kemp, 2004.	Increased individual liability of the auditor will enhance the quality of the audit by the external auditor	Questions 11, 16 and 20 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis
Odendaal & De Jager, 2004; Grumet, 2002; Kemp, 2004.	The end of self-regulation will restore the public's perception regarding the independence of the external auditor	Questions 8 and 15 of the research instrument.	Ordinal data	Mean, frequency, standard deviation, factor analysis