

# The FRIP as a mechanism of accountability in the South African financial reporting environment

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## **Abstract**

This thesis examines the functioning of the Financial Investigations Panel (FRIP) as a mechanism of accountability in the South African financial reporting environment. Detailed interviews with a sample of technical experts are used to reveal the significant source of coercive, normative and mimetic isomorphic pressure the FRIP is able to exert, acting on the organisations themselves, as well as on the individual preparers and their auditors.

This thesis provides the first account of how the FRIP is capable of exerting institutional isomorphic pressure on organisations, those charged with governance, individual preparers and external auditors. In doing so the research contributes to the limited body of interpretive corporate governance research in South Africa, offers evidence in support of the JSE's decision to establish a proactive monitoring review and, finally, offers support to the fact that South African corporate reporting requirements can be enforced and are not just symbolic.

## List of abbreviations and acronyms

<b>Abbreviation / Acronyms</b>	<b>Description</b>
<b>IASB</b>	International Accounting Standards Board
<b>JSE</b>	Johannesburg Securities Exchange
<b>IFRS</b>	International Financial Reporting Standards
<b>IAASB</b>	International Auditing and Assurance Standards Board
<b>IOD</b>	Institute of Directors
<b>IRCSA</b>	Integrated Reporting Committee of South Africa
<b>SOX</b>	Sarbanes–Oxley Act
<b>FRIP</b>	Financial Reporting Investigations Panel
<b>PCAOB</b>	Public Company Accounting Oversight Board
<b>FSB</b>	Financial Services Board
<b>GRI</b>	Global Reporting Initiative
<b>IIRC</b>	International Integrated Reporting Council
<b>FRC</b>	Financial Reporting Council
<b>U.K.</b>	United Kingdom
<b>U.S.A.</b>	United States of America
<b>SEC</b>	Securities and Exchange Commission
<b>SAICA</b>	South African Institute of Chartered Accountants
<b>GMP</b>	GAAP Monitoring Panel
<b>FRRP</b>	Financial Reporting Review Panel
<b>CA</b>	Chartered Accountant

## List of referenced accounting standards

<b>Standard</b>	<b>Description</b>
<b>Conceptual Framework</b>	Conceptual Framework for Financial Reporting
<b>IFRS 7</b>	International Financial Reporting Standard 7: Financial Instruments: Disclosures
<b>IFRS 10</b>	International Financial Reporting Standard 10: Consolidated Financial Statements
<b>IFRS 12</b>	International Financial Reporting Standard 12: Disclosure of Interests in Other Entities
<b>IFRS 13</b>	International Financial Reporting Standard 13: Fair Value Measurement

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# 1. Introduction

## 1.1 Purpose, context and significance of the study

Shareholder-centric models of corporate reporting have evolved to take cognisance of the broader informational needs of a wide group of users (Institute of Directors [IOD], 2009; Solomon, 2010; International Integrated Reporting Council [IIRC], 2011). Nevertheless, financial reporting is still of paramount importance (International Accounting Standards Board [IASB], 2010). In South Africa, in particular, companies primarily listed on the Johannesburg Securities Exchange (JSE) are required to prepare consolidated financial statements which comply in all material respects with International Financial Reporting Standards (IFRS). This is also a statutory requirement, designed to ensure the usefulness of the financial reporting process (Companies Act, 2008; JSE, 2013).

As a formal technical process, the preparation of financial statements is an example of an 'expert systems' (Unerman and O'Dwyer, 2004). Financial statements require a high level of technical expertise to complete (Integrated Reporting Committee of South Africa [IRCSA], 2011); are prepared in compliance with codes of best practice (IFRS) and are designed to communicate information and conceptions of value over time (Rodrigues and Craig, 2007; IASB, 2010). With the majority of users unable to observe directly the preparation process - and appreciate every technical aspect of the financial statements - their role as a legitimate part of the corporate governance landscape relies heavily on the rational assumption that these documents have been prepared with due care (Unerman and O'Dwyer, 2004; Maroun and van Zijl, 2015). One reason for the 'faith' placed by non-experts in the utility of corporate reporting is the proliferation of systems of checks and balances designed to establish a sense of accountability, transparency and 'discipline of the self' on the part of preparers of these reports (Black, 2008; Roberts, 2009).

Formalisation of codes of corporate governance (Solomon, 2010); the use of internal controls to ensure the accuracy of corporate reporting (International

Auditing and Assurance Standards Board [IAASB] 2009a); the promulgation of the Sarbanes Oxley Act (SOX) (Unerman and O'Dwyer, 2004); and, most notably, the external audit function (Power, 1994) are each examples of mechanisms of accountability designed to reassure non-expert users of the credibility of the corporate reporting process and, indirectly, of the capital markets.

When it comes to the financial statements being prepared by companies listed on the JSE, the Financial Reporting Investigations Committee (FRIP) is another example of how technologies of accountability function in a modern capitalist system (Section 2.1.2). Prior literature, however, frequently presents financial reporting, and related quality control systems, as a rational technical function supporting the maximisation of shareholder value (Watts and Zimmerman, 1978; Carruthers, 1995). Whether or not formal structures are able to achieve a sense of accountability or 'discipline of the self' has not been examined in detail. This is especially true in a South African setting where financial accounting research has been dominated by a positivist epistemological focus (Maroun, 2012a).

As a result, the purpose of this thesis is to add to the limited local interpretive accounting research which draws on the experiences of individuals to highlight how corporate reporting operates in the real world (Broadbent and Unerman, 2011; Maroun and Jonker, 2014). More specifically, the research uses commentary from some of South Africa's corporate governance and financial reporting leaders (Section 3) to highlight how the FRIP serves as a mechanism of accountability for companies listed on the JSE. In doing so, the study provides a novel institutional account of mechanisms of accountability in a South African setting and contributes to the need for theoretical and methodological eclecticism in South African financial reporting research (Brennan and Solomon, 2008; Maroun, 2012a). Secondly, it is the first formal study investigating how the review processes carried out by the FRIP operate as sources of isomorphic pressure to ensure high quality financial reporting. As such, the findings are important for academics and other stakeholders seeking to understand the



rationale for the review functions carried out by the FRIP<sup>1</sup>. Finally, the research makes an important contribution for policy-makers. It provides evidence in support of the need for independent review functions and confirms the important role played by regulation in the capital market system.

## **1.2 Structure of the thesis**

Section 2 discusses the theoretical framework and prior literature. Section 2.1 discusses agency theory and different mechanisms of accountability. Section 2.2 discusses the primary theoretical framework, institutional isomorphism, and explains the operation of coercive, normative and mimetic isomorphic pressures in modern institutional settings. These are applied to the function of the FRIP in Section 2.3.

Section 3 explains the thesis's use of detailed interviews with experienced professionals, academics and experts to obtain a well-rounded and balanced account of how the activities of the FRIP are a source of isomorphic pressure. Section 3.1 discusses the research paradigm and the qualitative approach. Section 3.2 addresses the method used (detailed interviews), why this method was selected, how the interview agenda was formulated, and the way in which validity and reliability were ensured throughout the research. Section 3.3 explains how the data was selected and Section 3.4 elaborates on how the data was analysed.

The detailed findings of the research are discussed in Section 4 and a summary of comments can be found in Section 5.1. Section 5.2 provides the research contribution and Section 5.3 discusses possible areas of future research.

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<sup>1</sup> The GAAP monitoring panel does not fall within the scope of this research, despite being established in 2002 and being the predecessor to the FRIP

### 1.3 Research question

The primary research question:

***Is the FRIP an example of a mechanism of accountability in a South African financial reporting context?***

In order to address this question, the following three sub-questions are posed:

*1: Is the functioning of the FRIP a source of coercive isochronism from the perspective of companies, preparers of financial statements and their auditors?*

*2: Is the functioning of the FRIP a source of normative isochronism from the perspective of companies, preparers of financial statements and their auditors?*

*3: Is the functioning of the FRIP a source of mimetic isochronism from the perspective of companies, preparers of financial statements and their auditors?*

### 1.4 Assumptions

The study is grounded in a social constructivist view of reality. Institutions are, therefore, a product of, not only economic forces, but also powerful social and political stimuli (Creswell, 2009). This is best highlighted by an interpretive research style, in this case, detailed interviews (Section 3).

## 1.5 Delimitations

- The research neither summarises nor critiques IFRS. It assumes that compliance with IFRS results in the provision of relevant and reliable information to users and the production of high quality financial statements (IASB, 2010).
- The study does not examine the preparation of integrated or annual reports. In addition, as the review processes of the FRIP are aimed only at financial statements (FRIP, 2011), other information contained in an annual or integrated report is not dealt with.
- Although a review of the history of the development and application of IFRS may shed light on its functioning as an instrument of legitimisation (Georgiou and Jack, 2011; Maroun et al, 2014) or its disciplinary potential (Rodrigues and Craig, 2007; Maroun and van Zijl, 2015), this is not the focus of this thesis.
- In order to retain focus on the operation of the FRIP in a South African context, key differences between IFRS and other accounting standards or requirements are not examined.
- Similarly, the activities of other regulatory bodies may be similar to those of the FRIP and may also be a source of isomorphic pressure. How, for example, the Public Company Accounting Oversight Board (PCAOB) or Financial Services Board (FSB) enforce accounting standards in their jurisdictions; possible sources of isomorphic pressure and similarities with the FRIP are deferred for future research (Section 5.2).
- Finally, as this is a Masters report, it makes use of a single theoretical framework. Other theories could have been used to explain the role and function of the FRIP such as legitimacy theory, theories of power and control, and structuration theory. This thesis, however, concentrates specifically on institutional isomorphism given its widely accepted use for explaining corporate reporting in an international context (Rodrigues and Craig, 2007; Tremblay and Gendron, 2011; Maroun and van Zijl, 2015).

## 1.6 Definition

This proposal refers to 'FRIP reviews'. The initial reviews of the financial statements are carried out by the academics at the University of Johannesburg<sup>2</sup>. Findings are reported to the JSE which reviews the information and refers selected cases to the FRIP for further examination. It is also possible that the JSE will request additional information and conclude that the matter in question need not be sent to the FRIP (JSE, 2011b). The purpose of this research is not to identify precisely which aspects of this financial review process give rise to different types of isomorphic pressure. Instead, the research assumes that all of the activities associated with the review of financial statements work collectively to drive coercive, normative and mimetic compliance with IFRS. In the interest of brevity, this thesis refers to the entire review process as 'FRIP reviews'. The research concentrates only on this review process.

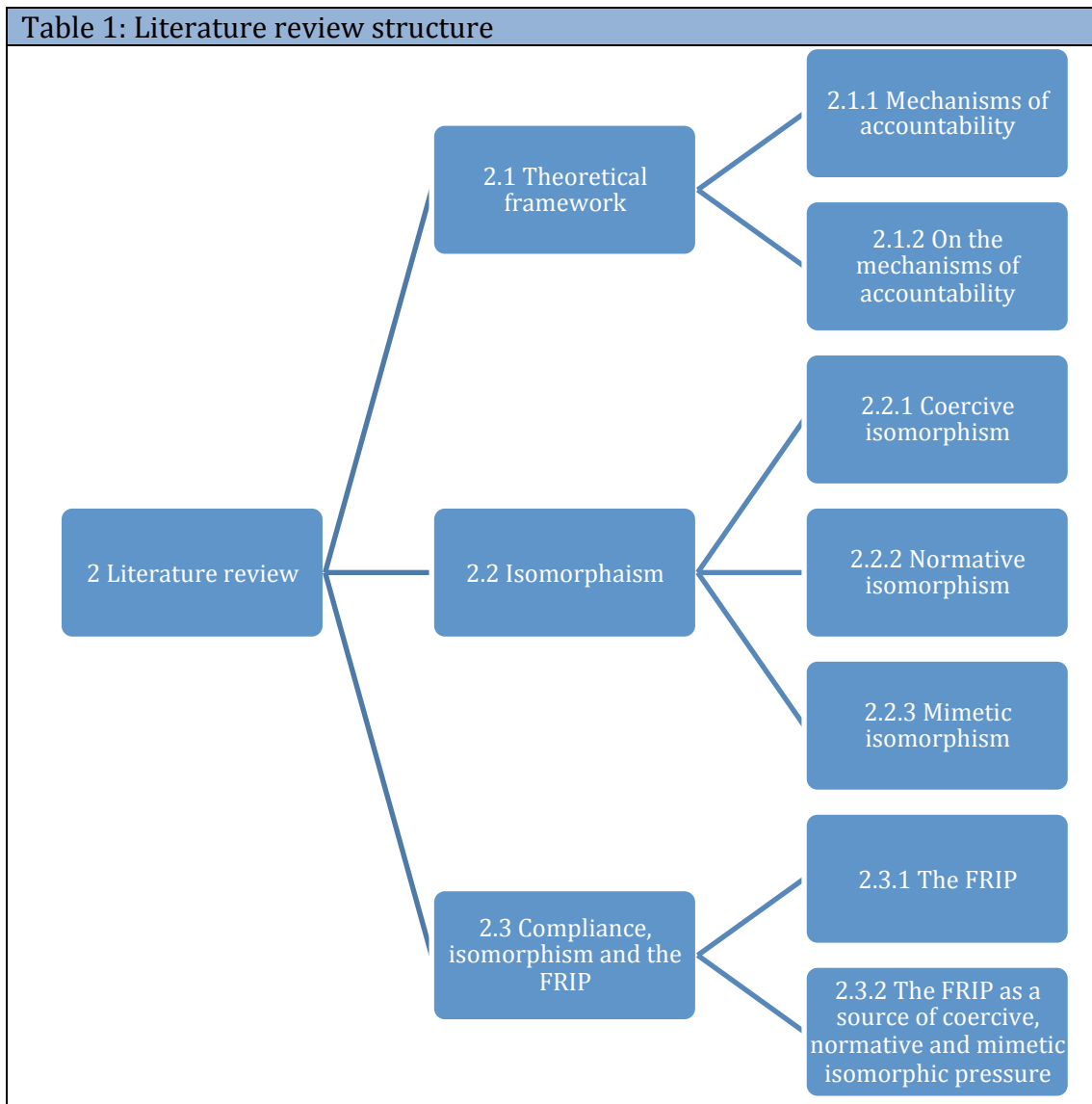
It should be noted that the FRIP is an advisory body to the JSE and does not enjoy direct statutory power (FRIP, 2011). As a result, FRIP reviews are not a source of coercive isomorphic pressure in themselves. Nevertheless as explained in Section 4 the effect of FRIP reviews on preparers and auditors can give rise to different sources of isomorphic pressure.

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<sup>2</sup> Exploring the technical rigour of the analysis being performed by this institution is not within the scope of this thesis.

## 2. Literature review

This literature review is structured as follows:



### 2.1 Theoretical framework

#### 2.1.1 Agency and stakeholder theory

Agency theory predicts that the separation of management and owner functions results in a loss of economic value (Jensen and Meckling, 1976). Agents, being rational utility maximisers, do not necessarily behave as intended by their principals, requiring a system of checks and balances to mitigate residual losses (Solomon, 2010). Examples include incentives, monitoring systems, and additional disclosure designed to reduce information asymmetry between agents and principals (Jensen and Meckling, 1976).

Stakeholder theory can be seen as a progression of agency theory. A key difference is that, where agency theory emphasises the relationship between owners and managers, stakeholder theory adopts a broader perspective (Brennan and Solomon, 2008). An organisation is no longer accountable only for the returns generated for shareholders but also to a wider group of stakeholders in terms of both its financial and non-financial performance (IOD, 2009; Solomon, 2010; IRCSA, 2011). As such, the use of non-executive directors, committees of the board of directors, internal and external auditors, financial reporting standards, and guidelines for the disclosure of non-financial information at the hearts of most codes of corporate governance can be thought of as part of a broader system of checks and balances (La Porta et al, 2000; Brennan and Solomon, 2008). Each is an example of how recommended best practice or statutory requirements are used as mechanisms of accountability designed to manage divergent interests of an ever more complex group of stakeholders.

The financial reporting process can also be seen as part of the process of managing principal/agent relationships. In addition to providing financial information to assist providers of capital with their investment and lending decisions (IASB, 2010), financial statements are an important element in the mechanisms used to hold stewards accountable for the management of the financial resources under their control (Whittington, 2008; Ravenscroft and Williams, 2009).

### **2.1.2 On the mechanisms of accountability**

Due to the nature of the word and the multidisciplinary fields which it needs to address, there can be no single definition of 'accountability' (Ebrahim, 2003). For the purpose of this research 'accountability' refers to '... the means by which individuals and organisations report to a recognized authority (or authorities) and are held responsible for their actions...' (Edwards and Hulme, 1996, p. 976).

As per this definition, accountability comprises two interconnected functions. The first is the responsibility of the individual to report his actions, and the next is to be held responsible for those actions (Alrazi et al, 2015). This transforms the person from an individual to the object of accountability in order to promote normalising change (Roberts, 2009). For this to be effective it is important for the mechanisms of accountability to be accepted as a legitimate means of assessing and correcting performance (Grant and Keohane, 2005; Maroun and Atkins, 2014) and for the authority of the parties to the relationship to promote normalising change (Foucault, 1977; Grant and Keohane, 2005). The prior literature offers most accounting technologies as examples of the functioning of this type of system of accountability.

### ***Accounting as a mechanism of accountability***

According to Hopwood (1987), accountancy is more than a neutral information processing system. It has the ability to construct fields of economic visibility which can be mobilised to hold individuals accountable. For example, Hopper and Macintosh (1993) and Cowton and Dopson (2002) explain how standard costing and budgeting are used as instruments of governmentality. These offer a rational and credible means for quantifying financial performance and contrasting this with predetermined standards. Together with a credible reporting hierarchy, these otherwise technical accounting instruments are used to render individuals visible and subject them to corrective action. Miller and O'Leary (1987) provide a similar account where "accounting by the numbers" is used to rank the performance of individuals, identify abnormalities in the production process and achieve a sense of disciplinary control by relying on the accounting system as a process of examination.

Mennicken and Miller (2012) confirm these findings. They argue that accounting systems can be used to "distil" corporate performance into financial information in order to facilitate comparability and intervention by senior management. To do this, accounting draws on its disciplinary potential (Hopwood, 1987) as well as its generally accepted basis for describing economic reality (Rodrigues and Craig, 2007). In other words, accounting can be used as a mechanism of

accountability because it enables normalising examination and change. Equally important is the fact that the accounting system has, over time, come to be accepted as the primary means of describing economic activity so that the norms and standards used to drive change are readily accepted as legitimate (Hopwood, 1987; Gray et al, 1996; Roberts, 2009; Mennicken and Miller, 2012). This theoretical framework can be applied to the corporate reporting process where the company, in addition to the individual preparers of financial statements, becomes the subject of technologies of accountability.

### ***Financial statements as a mechanism of accountability***

Financial statements are an important tool for those charged with governance to communicate a firm's financial performance to its stakeholders (Healy and Palepu, 2001). The accounting information produced by organisation has been "...institutionalised as the most important, authoritative and telling means whereby activity is made visible..." (Roberts, 1991, p. 359).

In this light, the IASB describes the primary objective of financial statements as providing useful information to investors and lenders to enable them to make a decision on the advancement of funds to potential investees and borrowers (IASB, 2010). The financial statements are, however, also important for holding stewards accountable for the financial resources under their control (Ravenscroft and Williams, 2009). For example, the development of fair value accounting provides a means of comparing the returns generated by an organisation with the fair value of the respective assets in order to gauge the efficient utilisation of capital resources (Maroun and Garnett, 2014).

Similarly, the emphasis placed on comparability of the financial statements by the IASB (2010) is intended to allow investors to contrast the financial position and performance of organisations and allow the efficient allocation of capital. In addition, many codes of corporate governance and company law recognise the importance of financial statements for providing a broad review of how well managers have deployed the capital resources entrusted to them by investors and creditors (Companies Act, 2008; IOD, 2009). For this reason, the importance



of accounting information in the sound functioning of capital markets is evidenced by equity price reactions to the release of new financial information (Healy and Palepu, 2001).

The financial reporting standards underlying statements of financial position, performance and cash flows are not only used to describe the technical features of the accounting craft (Maroun and van Zijl, 2015). Over time they have developed into the very discourse used to describe what constitutes useful information and have become the benchmark against which financial statements are evaluated (Maroun and van Zijl, 2015). Similar to the role of budgeting and standard costing described previously (Hopper and Macintosh, 1993; Cowton and Dopson, 2002), formal accounting standards provide the basis or norm for evaluating the financial position and performance of the reporting entity. In doing so, they offer a framework for evaluating these economic dimensions and holding those charged with the organisation's governance accountable.

As explained by Roberts (1991, p. 359), the preparation of financial statements allows the company to '... present a seemingly unavoidable incontrovertible image of [itself] and [its] activities'. The creation of this 'self-image' allows the company to 'view' itself and understand how its stakeholders view it. This, in turn, drives the company to maintain or modify its reporting (and possibly, its underlying behaviour) to achieve a predetermined 'conceptualisation of the self' and either secure or attain a sense of organisational legitimacy (Roberts, 1991). This point should not be overlooked because, as explained by Grant and Keohane (2005), for the mechanism of accountability to function effectively, a sense of legitimacy is required. In other words, for technologies of accountability to promote conformance or change, they themselves must be accepted as legitimate.

In this context, generally accepted accounting practice has been codified by the IASB with the result that IFRS have become a repository of technical expertise and knowledge (Ravenscroft and Williams, 2009) and an important source of pragmatic and cognitive legitimacy (Maroun and van Zijl, 2015). The

proliferation of IFRS in multiple jurisdictions has added to its accepted status as a legitimate basis for the preparation of general purpose financial statements (Rodrigues and Craig, 2007). Consequently, compliance with IFRS becomes an important means of demonstrating how an organisation has adopted best reporting practice in the interests of its stakeholders and, become, an important source of organisational legitimacy (Rodrigues and Craig, 2007). This results in the acceptance of IFRS as a basis for describing the financial position and performance of the reporting entity. In other words, accountability and legitimacy are inextricably linked. As explained previously, the formal structure of the accounting system, coupled with its potential to construct fields of economic visibility, means that the accounting system acts as a mechanism of accountability. This is, however, only possible because the accounting craft has become a readily accepted part of the capital market paradigm. Its pragmatic and cognitive legitimacy give rise to normative, mimetic and coercive pressures to comply with the accounting standards. To explore this line of thought in more detail, Section 2.2 explains the operation of these isomorphic forces.

## 2.2 Isomorphism

“Isomorphism” is a term commonly used in Natural Science to explain how organisms become the same over time<sup>3</sup>. The term is also applied in sociology to describe a process by which organisations converge as a result of social, political and economic forces (Rodrigues and Craig, 2007). In this way isomorphism is a key part of institutional theory as it can be used to explain how organisations adapt their structures and management practices in order to mirror what is already accepted as legitimate and ensure a continued survival (Meyer and Rowan, 1977; Suchman, 1995). DiMaggio and Powell (1983) go on to identify normative, mimetic and coercive variants of isomorphic pressure.

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<sup>3</sup> As per the *Oxford English Dictionary (2015)*

### 2.2.1 Coercive isomorphism

Coercive isomorphism is isomorphic change caused by external forces exerted on the organisation by a party in a position of relative power and authority, and is the result of both formal and informal pressures (DiMaggio and Powell, 1983; Fogarty, 1992). The clearest example of coercive isomorphic pressure is the need to comply with prevailing laws and regulations in order to avoid sanctions (see Meyer and Rowan, 1977; Suchman, 1995).

#### **Examples of coercive isomorphism**

Companies incur significant financial costs to identify applicable laws and regulations and introduce the necessary systems to ensure that they comply with the relevant prescriptions and discharge their compliance and prescriptive reporting duties (KPMG, 2013). Compliance with these laws and regulations is also an important mechanism through which the organisation gains a sense of moral legitimacy (Roberts, 1991). Moral legitimacy is gained by the organisation when it complies with the prevailing rules of the environment in which it operates (Foldvary, 2011).

For example, KPMG (2013) found that the new regulatory and reporting environment has resulted in a significant increase in compliance costs, which, in the hedge fund industry, as an example, are estimated at more than \$3 Billion, or about seven percent of total operating costs. In a similar study, PwC (2014) found that almost half of the respondents reported an increase in compliance staffing levels. They believe this is an indication that "... business is becoming more complex," which is, in turn, "... driving increased regulatory requirements..." (PwC, 2014, p. 15).

Coercive isomorphism is not only the result of explicitly defined laws and regulations but can also result from the prevailing socio-political context in which the organisations operate. In institutional environments, companies are always under pressure to appear responsive to the needs of stakeholders, morally responsible and cognisant of social expectations in order ensure legitimacy and, in turn, their continued existence (Meyer and Rowan, 1977;

Suchman, 1995; Atkins et al, 2015). For example, much of the development in non-financial reporting over the last 20 years has been attributed to the need to secure legitimacy, rather than as a result of the functioning of specific laws and regulations (de Villiers and van Staden, 2006). The same is true in a South African context where, more broadly, companies dedicate considerable resources to ensuring compliance with recommended corporate governance principles (Carels et al, 2013; Loate et al, 2015; Raemaekers et al, 2015) . Codes of best practice, such as King-III and the Global Reporting Guidelines (GRI), do not enjoy the direct force of law and yet many local companies continue to allocate extensive resources to ensure minimum levels of compliance in line with stakeholders' expectations (KPMG, 2013). The desire to comply with codes of best practice, such as King-III, is an example of how organisations attempt to gain consequential legitimacy through conformity with universal principles (see Roberts, 1991)<sup>4</sup>.

The relevance of the JSE's listing requirements should not be overlooked. These do not mandate directly compliance with King-III but introduce a comply-or-explain model in terms of which companies are *recommended* to comply with codes of corporate governance or provide their reasons for not doing so (JSE, 2013). Again the listing requirements do not have the same authority as Statute but the need to conform with the JSE's expectations becomes a powerful source of coercive isomorphic pressure (Maroun et al, 2014; Maroun and van Zijl, 2015).

Compliance with International Financial Reporting Standards is another example of explicit and implicit coercive isomorphic pressure. On one level company law (Companies Act, 2008) and the JSE (2013) require listed companies to prepare financial statements in compliance with IFRS. However, as explained by Rodrigues and Craig (2007), the technical rigour of these accounting standards and institutionalisation of the standard setting process allow compliance with IFRS to be an important source of procedural legitimacy. Once again the result is

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<sup>4</sup> The importance of the codification of best reporting practice for achieving a sense of normative and mimetic isomorphic pressure cannot be overlooked and is discussed in more detail in Section 4

that the need to meet societal expectations, resulting in coercive isomorphic pressures, is an important part in explaining the proliferation of IFRS across the globe.

One may argue, more broadly, that the day-to-day functioning of accounting systems are, in themselves, also an instrument of coercive isomorphism. As explained by DiMaggio and Powell (1983, p. 150)

*...legal and technical requirements of the State – the vicissitudes of the budget cycle, the ubiquity of certain fiscal years, annual reports, and financial reporting requirements that ensure eligibility for the receipt of federal contracts of funds ...*

have a profound effect on the structure and functioning of the respective organisation and induce compliance. In this way, coercive isomorphic pressure is the result of externally applied force, influencing the organisation to be compliant with prevailing laws and regulations, codes of best practice and societal expectations. The codification of these reporting guidelines can, however, result in the concurrent functioning of both coercive and normative isomorphic pressure. In some instances, the fact that reporting requirements are generally regarded as best practice can give rise to significant pressure to comply even in cases where compliance cannot be enforced directly by law or other coercive means. This is examined in more detail in Section 2.2.2

### **2.2.2 Normative isomorphism**

Another powerful source of isomorphism is the convergence in relative behaviour derived from the effects of professionalization (DiMaggio and Powell, 1983).

‘Professionalisation’, as a concept, has resulted in society granting professional bodies (and their members):

*... (a) monopoly status (laws prohibit non-members of the profession from practising); (b) authority to decide both*

*who enters the required training and how that training is organised, conducted and evaluated, and (c) participation with governmental agencies in monitoring practice. (Hilton and Slotnick, 2005).*

Through this process a fiduciary relationship has been inaugurated, resulting in the establishment of a profession that is self-aware of its responsibility to society, responds to the profession's ideals, and has the accountability of its members as a primary objective (Fogarty, 1992; Hilton and Slotnick, 2005).

### **Examples of normative isomorphism**

The power of professionalisation in a normative isomorphic context is derived from the notion that the preparers of financial statements generally hold similar interchangeable positions across organisations (DiMaggio and Powell, 1983). This is a result of the individuals having undergone similar strict and closely monitored tertiary and professional education, and the establishment of strong professional networks between associates (DiMaggio and Powell, 1983; Fogarty, 1992). Through this process, these professionals have surrendered an element of individuality and instead operate in a manner in which they are able to discharge their professional duties effectively. In addition, the labour market in which these individuals operate is "skewed firmly in favour of the employing organisation" (Roberts, 1991, p. 358). These individuals are ranked according to how the employer has assessed them, against what society defines as competent, and ensuring compliance with this, makes the individual a viable competitor in the market (Roberts, 1991; Suchman, 1995).

An important influence of normative isomorphic pressure is the need to be seen as compliant with the standards of best practice prescribed by the profession (DiMaggio and Powell, 1983). The cognitive legitimacy which these standards enjoy means that adherence to their prescriptions is the most effective means of conferring creditability on the individual preparer (Fogarty, 1992). For example, 'misconduct' is not defined conceptually in terms of generally accepted

theoretical frameworks but rather in terms of deviations from the codes of professional conduct issued by the profession. Similarly high quality corporate reports are not measured according to their perceived usefulness to the respective stakeholder groups but according to the extent to which they comply with the interpretations of what constitutes “useful” information by professional accounting bodies (see Malsch and Gendron, 2011). For example, the EY (2013) report on best corporate reporter makes no effort to engage with stakeholders in order to determine which companies are providing users with the most useful information. Instead the disclosures recommended by the GRI and the IIRC have attained a state of cognitive legitimacy and are automatically accepted as the benchmark for high quality corporate reports. Consequently, the codification of non-financial reporting guidelines and recommended best corporate governance practice gives rise to significant isomorphic pressure to comply with the likes of GRI, King-III and IIRC. As discussed in Section 2.2.1, there are possible sources of coercive isomorphic driving compliance. Contemporaneously, as important sources of procedural and structural legitimacy, these codes of best practice are endorsed by different professional accounting bodies as the primary basis for describing what “good” corporate reports ought to look like and what their individual members should be adhering to. In other words, the guidance provided by the GRI, King-III and the IIRC give rise to a combination of normative and coercive isomorphic pressure.

The same applies from a financial reporting perspective. In some instances, laws and regulations prohibit non-compliance with financial reporting standards and are a source of coercive isomorphic pressure (see Section 2.2.1). At the same time, professionals appointed by the organisation to manage the financial reporting process become the custodians of their institution’s financial reporting duties (see Fogarty, 1992). Their failure to discharge these duties adequately not only has an unfavourable effect on the institution but also on the responsible individual who is identified by important stakeholders, including the relevant

professional bodies, as operating contrary to recommended practice and without sufficient care and skill<sup>5</sup>.

The reason these professional accounting bodies are able to exert this kind of isomorphic pressure on individuals is that they themselves are considered to be legitimate bodies (Fogarty, 1992). These bodies are able to dictate or prescribe what are the socially accepted correct behaviours due to their long establishment, high societal standing, extensive technical skills base, and leadings minds in both its member and steering base. Through the combination of these influences, the professional accounting bodies themselves are considered to be legitimate and this allow them to dictate what is best practice (Roberts, 1991). By adhering to this prescribed best practice, the individual is able both to ensure continued existence and, more importantly, leverage its adherence to gain legitimacy in its operating environment.

As these professionals operate in this highly educated, regulated and interchangeable environment, there is a great deal of pressure to ensure these individuals maintain the sense of moral legitimacy granted to them by the profession (Fogarty, 1992). Maintaining this moral legitimacy is of the utmost importance to the professional due to the cross-hiring of these individuals from firms within the same industry (DiMaggio and Powell, 1983).

Due to the pressure placed on the preparers and the interchangeability of their roles within organisations, they seek to avoid stigmatisation attached to incorrectly compiled financial statements. In an effort to maintain the legitimacy granted, they seek to prepare the highest quality financial statements possible in the current circumstances (Fogarty, 1992) . This ensures the professionals are associated with high quality standards, ensuring their own legitimacy and future within the profession and the organisation (DiMaggio and Powell, 1983). Fogarty (1992) highlights the importance of this:

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<sup>5</sup> The professional is, in effect, associated with a report that does not meet the standard set by the professional bodies. As this is in direct contravention of what the society expects, the legitimacy of the individual is then called into question



*Individuals' awareness of their personal economic viability is likely to be an omnipresent background feature in the direction and magnitude of purposeful personal change.*

### **2.2.3 Mimetic isomorphism**

The final source of institutional isomorphism is mimetic isomorphism. Mimetic isomorphism is the process whereby organisations mimic or gravitate towards others as a response to uncertainties in their operating environment (Meyer and Rowan, 1977; DiMaggio and Powell, 1983). Due to organisations facing similar uncertainties, those who are perceived to address these uncertainties are mimicked by others who seek leverage from this perceived legitimacy. This uncertainty effectively ‘... compels organizations to seek structuration patterns and actions from other organizations.’ (Freitas and Guimarães, 2007, p. 39).

#### **Examples of mimetic isomorphism**

King-III is an example of mimetic isomorphism as it requires a company to prepare an integrated report or explain why such a report has not been prepared. Those charged with preparing these integrated reports in 2010 were “challenged by limited and evolving draft guidance” no limited examples of what these reports ought to represent (EY, 2013, p. 25). Furthermore, the guidance offered by the IIRC is principles – based and not specific to any one industry or business model. The result is a tendency for preparers to refer to other prescriptions, such as those offered by the GRI, to inform the inclusion of information in their integrated reports (Maroun et al, 2014) These reporting guidelines are technical reports prepared by competent authorities after extensive consultation with the relevant stakeholders. Consequently, they are an important source of pragmatic and procedural legitimacy. As discussed in Section 2.2.1 and 2.2.2, the guidelines are also represent a reporting requirement (coercive isomorphism) to use a professionally developed set of principles (normative isomorphism) to achieve an application of disclosures comparable to

the reporting entity's peers<sup>6</sup>. In other words, in the context of an uncertain reporting environment, preparers replicate disclosure requirements, which are already accepted as legitimate (and exert coercive and normative isomorphic pressure) to ensure the credibility of their integrated reports. To paraphrase DiMaggio and Powell (1983), the result is the mimetic proliferation of integrated reports with similar content and structure (for example, see Atkins and Maroun, 2015; Loate et al, 2015).

From an integrated reporting perspective, a source of mimetic isomorphism can be found in the "EY - Excellence in Integrated Reporting Awards" (EY, 2013). This publication surveys the integrated reports prepared by the 100 top JSE-listed companies<sup>7</sup> and the top 10 State-owned companies. The companies' integrated reports are reviewed and benchmarked against the results of the EY Excellence in integrated reporting survey, and a model integrated report prepared using the guidance from local and international integrated reporting bodies. The results of these awards are then published, ranking the integrated reports of these companies, by name, in five categories namely "progress to be made", average, good, excellent, and Top 10. This has provided preparers with a list of integrated reports to which they can turn to as illustrative examples across a large sector base when preparing their own organisation's integrated report. The publication of the reporting survey by a group of experts clarifying expected best practice is itself a source of normative and coercive isomorphic pressure (see Section 2.2.1 and 2.2.2). In addition, by organisations looking to the highly coveted integrated reports and mimicking the form and disclosure of these reports, their own integrated reports start to resemble the reports society believes are best and, as such, converging of a handful of examples in order to overcome the uncertainty which the requirements of preparing an integrated report creates (mimetic isomorphic pressure).

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<sup>6</sup> The researcher would like to thank one of the anonymous reviewers for highlighting this point

<sup>7</sup> Based on market capitalisation

The inverse of mimetic isomorphism can also have a strong influence. An example of this, in terms of integrated reporting, is the publication of the “progress to be made” list in the EY Report (EY, 2013). This provides prepareres with a list of integrated reports which, when judged against the benchmark, have been found lacking and should be avoided. This process, instead of creating something that can be copied, creates a list of companies to be avoided and pushes the environment away from disclosure, which is deemed to be inappropriate.

## **2.3 Compliance, isomorphism and the FRIP**

### **2.3.1 The FRIP**

Of particular interest for the purpose of this research is that repeated corporate scandals and the on-going financial crisis have highlighted the need for independent monitoring bodies (Brown and Tarca, 2005; Malsch and Gendron, 2011). These bodies should have sufficient power to enable effective monitoring and enforcement to drive higher levels of reporting quality and corporate accountability (Brown and Tarca, 2005). For example, the Financial Reporting Council (FRC)<sup>8</sup> in the United Kingdom (U.K.) is responsible for independent monitoring of financial statement quality. The review mechanism is proactive in nature, with the FRC also responding to matters brought to its attention (Hines et al, 2001). The FRC carries out reviews with the aim of ensuring that financial information provided by public companies (and some large private companies) complies with relevant financial reporting requirements. This includes reviews of directors’ reports and company accounts for compliance with applicable laws and regulations (FRC, 2016).

Similarly, in the United States of America (U.S.A.), the Securities and Exchange Commission (SEC) aims to ensure that ‘... investors are furnished with the

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<sup>8</sup> Previously a subsidiary of the FRC known as the Financial Reporting Review Panel (FRRP)

information necessary for informed investment decisions<sup>9</sup> (Hines et al, 2001, p. 3). For example, the Division of Corporation Finance assists the SEC by reviewing material information being provided to investors. Companies are required to comply with regulations dealing with prescribed disclosures when shares are sold and on a continuing and periodic basis (SEC, 2016). The SEC is able to enforce minimum reporting requirements through the rejection of the filing of the company's financial results, preventing the company from obtaining a listing or alternately resulting in the company being barred from trading on the securities exchange (Hines et al, 2001). In addition, the SEC may take civil or administrative action against companies and assist relevant authorities pursue action against perpetrators. In this way, the SEC use a proactive approach to enforcement of reporting standards/guidelines and so enforces accountability for the financial reports issued.

Originally, the JSE and the South African Institute of chartered Accountants (SAICA) established the GAAP Monitoring Panel (GMP). The purpose of the GMP was to create a platform from which financial reporting standards could be enforced, which the JSE was previously unable to do (Mittner, 2002) and to ensure that standards were adequately applied by the reporting company (Hogg, 2004).

During 2011, the GMP was renamed the Financial Reporting Investigations Panel, and its charter was updated to modify the panel from a reactive to proactive one (JSE, 2011a). The FRIP comprises 16 individuals representing 'preparers, auditors, academics and users of listed entities' financial statements' (FRIP, 2011, p. 2) to ensure the panel provides an unbiased review of financial statements. The fundamental role of the FRIP remains unchanged from the function of the GMP but the operational style was modified to a pro-active approach to ensure a greater detection and correction of non-compliance, resulting in a better regulated market (JSE, 2011b). The FRIP still continues to

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<sup>9</sup> The wording of SOX could result in South African companies being subject to review by the SEC. Likewise South African audit firms can be subject to review by the PCAOB. This is, however, beyond the scope of this research.

deal with any queries directed to it by the JSE from either internal or external sources, and, in addition, it oversees the random review of financial statements of all companies listed on the JSE, with each company being reviewed at least once in a five-year period (Bowman Gilfillan Attorneys, 2011).

The FRIP joins other international independent oversight bodies, such as the SEC, which are much needed in the wake of reporting scandals and on-going financial crises (Brown and Tarca, 2005; Malsch and Gendron, 2011; Maroun, 2012b). In addition to the benefits of holding the company and management accountable to third parties, the role that the FRIP plays within the company itself cannot be ignored. As being held accountable for one's actions can engender change (Hopper and Macintosh) - and result in a greater sense of self-discipline (Roberts, 2009) - the FRIP plays a pivotal role in ensuring the company does not attempt to distort the image which it reflects through these financial statements (see Roberts, 1991). In turn, this suggests that the functioning of the FRIP gives rise to different isomorphic pressures driving compliance with best reporting practices.

### **2.3.2 The FRIP as source of coercive, normative and mimetic isomorphic pressure**

#### ***Coercive isomorphic pressure***

The functioning of the FRIP can be easily interpreted as an example of coercive isomorphism. The panel is not the product of Statute and does not have direct power over companies' financial reporting (see Section 1.6). Nevertheless, the body is still able to apply coercive pressure resulting in isomorphic change. This is due to the body's objective of ensuring compliance with IFRS, which is a requirement of the South African Companies Act (2008), and the ability of the body to force a company to rectify any errors or omissions in its financial reporting through the power obtained from its position relative to the JSE. In addition, the capitalistic environment companies operating under calls for high quality financial reporting (IASB, 2010) which if found to be lacking could negatively affect the company's perceived legitimacy. Based on these operations the FRIP, as part of a mechanism of accountability, is able to exert the same force

of isomorphic pressure as if it had been a legislative body, and the decisions of the FRIP (from the perspective of the company) carry the same weight and force as if they were by orders of law<sup>10</sup>.

The first sub-question asks:

**1: Is the functioning of the FRIP a source of coercive isomorphic from the perspective of companies, preparers of financial statements and their auditors?**

### **The FRIP as a source of normative isomorphic pressure**

The FRIP is the physical manifestation of the South African capital market's need for the provisioning of accurate, complete and comparable financial accounts (see Malsch and Gendron, 2011). In addition, the body is constituted by some of the most respected individuals in the South African financial reporting environment<sup>11</sup>.

These factors result in the FRIP being revered as a source of technical financial reporting expertise and, through the review processes, confer a sense of legitimacy to the corporate reports of the companies its reviews (Roberts, 1991). It may also be the case that adverse findings by the FRIP call into question the professional standing of the preparers and auditors associated with those

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<sup>10</sup> It must be reiterated that the FIRP does not enjoy the direct force of law and is not tasked specifically with enforcing compliance. Nevertheless, the Issuer Regulations Department of the JSE (taking into account the opinion of the FRIP) can require restatements or corrections when non-compliance with reporting requirements are identified during a FRIP review (FRIP, 2011).

<sup>11</sup> These include, amongst others, Professor Robert Garnett, Professor Linda De Beer, Graeme Berry and Cobus Grove. As evidence of the technical and professional authority commanded by members of the FRIP, it is noted that Robert Garnett acted as the Technical Director of the South African Institute of Chartered Accountants between 1982 and 1984 and was appointed to the International Accounting Standards Board (IASB) as a member in January 2001, serving till June 2010. Linda De Beer is currently the chairman of the FRIP. Graeme Berry is a past member of the Accounting Practices Committee and a partner in the Deloitte Southern Africa Accounting & Auditing technical division. Cobus Grove is the CFO of the DigiCore Holdings and has recently been awarded the Compliance and Governance Award at the 2015 CFO Awards.

financial statements (Section 2.2.2). In this way, the FRIP may act directly or indirectly as a source of normative isomorphic pressure.

The second sub-question asks:

**2: Is the functioning of the FRIP a source of normative isomorphism from the perspective of companies, preparers of financial statements and their auditors?**

### **The FRIP as a source of mimetic isomorphic pressure**

The FRIP issues an annual “Summary of the outcome of cases investigated by the panel and the resulting actions” (FRIP, 2014). This is a summary of all matters referred to the FRIP including a brief description of the issue, the outcomes, corrective action instructed against the financial report and the disciplinary action taken against the preparer.

This summary of matters provides the preparers with a list of specific items or issues which the FRIP has previously focused on, to ensure are appropriately addressed or avoided while preparing their own financial statements. The effect of this is that preparers are made aware of a list of issues or concerns raised by the FRIP which they, in turn, avoid (Section 2.2.3). This results in a type of mimetic isomorphism in that financial reporting practices which should not be replicated are identified.

The leads to the third sub-question:

**3: Is the functioning of the FRIP a source of mimetic isomorphism from the perspective of companies, preparers of financial statements and their auditors?**

Before answering each of these questions, Section 3 discusses the research method.

### **3. Method**

Section 3.1 discusses the difference between quantitative and qualitative research and explains why the latter is used. Section 3.2 discusses the use of detailed interviews and considers the advantages and disadvantages of this method. This includes a discussion of the sample size, data collection and analysis. The steps taken to ensure validity and reliability are outlined in Section 3.3. Section 3.4 summarises ethical considerations and, finally, Section 3.5 lists inherent limitations.

#### **3.1 Research paradigm**

Quantitative research tends to take a positivist view of reality and, therefore, attempts to test objective theories by investigating the relationships among variables (Creswell, 2009). The intention of quantitative research is to 'establish, confirm, or validate relationships and to develop generalizations that contribute to existing theories' (Leedy and Ormrod, 2010, p. 96). This form of research strives for objective means in studying its subject matter (Broadbent and Unerman, 2011; Maroun, 2012a).

The purpose of qualitative research is neither to verify the existence of a rule or theory, nor to obtain a definitive answer. Instead, the objective of qualitative research is to investigate and explore human behaviour (Creswell, 2009). The benefits of using the qualitative approach, as explained by Leedy and Ormrod (2010), include the ability to review the multifaceted nature of certain situations, settings, relationships and people. It enables a researcher to gain a better understanding about a particular event, develop new concepts or theoretical perspectives and describe problems in order to develop recommendations (Creswell, 2009; Tremblay and Gendron, 2011).

Consequently, as little is known about how the FRIP functions as a mechanism of accountability, it was decided to use a qualitative approach. This is in keeping with the fact that this thesis explores the perceptions of subjects of the review



process, in a social constructivist setting, in order to demonstrate how the FRIP reviews are a source of isomorphic pressure.

In contrast, a quantitative approach would not be able to demonstrate the relevance of institutional isomorphism in explaining the impact of the review process (see Broadbent and Unerman, 2011). Underlying themes, perceptions and relationships would have been overlooked, resulting in a significant loss of detail. Instead, the chosen qualitative method allows the researcher to engage directly with those involved with the subject matter and provide the first formal account of coercive, normative and mimetic isomorphic pressures resulting from FRIP reviews.

### **3.2 Method: Detailed interviews**

This study employs a grounded interpretive epistemological style. The assumption is that reality can only be accessed through socially shared constructs (Myers, 1997). Detailed interviews are used to provide us with a well-founded understanding of our conversational reality (Kvale, 2008).

With detailed interviews, the researcher is involved in the collection and analysis of data. This is common for this type of research and it not a threat to validity and reliability (Creswell and Clark, 2007). Using detailed interviews allows the subject matter to be more intensely investigated and avoid the reductionist trappings of a positivist research approach (O'Dwyer et al, 2011). The interviews provide detailed discussions and first-hand accounts of the operational effects of the FRIP from those who are either involved in the review or are the subjects the monitoring body (see Leedy and Ormrod, 2010; Rowley, 2012).

#### **3.2.1 The case against the questionnaire**

The benefits of using a questionnaire in the data collection process are extensive. A questionnaire can be sent to a large population of potential respondents, the collection of the data is easier and data analysis is simplified by using inferential statistics (Leedy and Ormrod, 2010). However, due to the proactive review

process, there is little third party participation and the population to which questionnaires could be sent is small. In addition, survey methods are limited by low response rates (Leedy and Ormrod, 2010). Finally, as the aim of this thesis is not to generalise findings, it was decided not to use a survey. The shortcomings of employing a questionnaire-based approach are summarised by Dowson and Mcinerney (2001):

*'by specifying all questions in advance, eliminating any other possible questions that could be asked, the researcher is only apt to gain limited and possibly distorted information' (cited in Leedy and Ormrod, 2010).*

### **3.2.2 The development of the interview agenda**

Semi-structured (open-ended) questions were developed by the researcher based on the prior literature dealing with technologies of accountability (examples include Roberts, 1991; Huse, 2005; Solomon, 2010), and professional publications explaining the functioning and role of the FRIP and the proactive review process (examples include Bowman Gilfillan Attorneys, 2011; FRIP, 2011; JSE, 2011b). The questions posed dealt with the importance of accountability for the preparation of high quality financial statements, the review process carried out by the FRIP and the intended or perceived effect of the FRIP's review process (Appendix A). Questions were, to the extent possible, non-leading, and as broad as possible to allow the themes and concepts of the research question to be explored (Creswell and Clark, 2007; O'Dwyer et al, 2011). To further ensure research quality, the final interview agenda had also been piloted with one accounting academic and one senior audit manager at one of the 'Big 4' audit firms in South Africa to ensure accuracy, clarity and focus on the research question (Rowley, 2012). The interview agenda was subject to review by the Ethics Unit of the University of the Witwatersrand and was approved without any ethical issues or concerns noted (Section 3.4).

### 3.2.3 Sample

Due to the specialised nature of both the proactive review and the operations of the FRIP, the population of professionals with in-depth knowledge and understanding of the review is limited. In addition, potential interviewees are all practicing professionals with limited time. It was, therefore, decided to apply purposeful sampling (Leedy and Ormrod, 2010).

Although this does introduce the risk of bias, the sampling method ensures that only those individuals with first-hand experience are engaged in the study and that the findings are detailed and accurate (as per Cohen et al, 2002; Maroun and Solomon, 2013). Relatively small sample sizes also allowed sufficient time for each interview, including follow-up sessions, to ensure that all research questions/agenda points were adequately addressed (Rowley, 2012).

Ten interviews ranging from thirty minutes to one hour were carried out (adapted from Rowley, 2012).<sup>12</sup> Interviewees included audit professionals (4), members of the Panel (3) and preparers (3). This ensured that the results were not dominated by the perspectives of a particular group of respondents but it should be pointed out that it is not the purpose of this thesis to differentiate the views of each group of respondents.

### 3.2.4 Data collection

Data collection and analysis was inspired by a grounded theory approach, and was iterative in nature with the researcher moving constantly between interviews and prior literature (O'Dwyer et al, 2011).

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<sup>12</sup> A comparable approach is followed by Hines et al (2001) who look at the experiences of directors and auditors in dealing with the Financial Reporting Review Panel: they rely on sixteen interviews to obtain saturation of their study. Maroun and Solomon (2013) examining the role of whistle-blowing by external auditors in contributing to the perceived legitimacy of the auditing profession within South Africa used 30 interviews of leading corporate governance experts to explore this issue. Lastly Fearnley et al (2002) use only 15 semi-structured interviews to investigate the impact of the FRRP on the independence of auditors and their attitudes to compliance in the UK.

Potential respondents were contacted telephonically or by e-mail and a brief explanation of the research being conducted was provided. To ensure the highest levels of research ethics, respondents were guaranteed anonymity and informed of the fact that participation in the study is completely voluntary, they may withdraw at any time, and all commentary will be treated with the strictest confidence. This was done in an attempt to ensure that respondents would speak with complete candour (adapted from Alvesson, 2003).

If the potential interviewee agreed to participate, a time and location was established. Interviews were conducted either in person or over Skype, depending on ease of access. The interview agenda (Appendix A) was made available to respondents prior to the commencement of the interview to allow them to familiarise themselves with questions (as suggested by Creswell and Clark, 2007; Leedy and Ormrod, 2010; Rowley, 2012). Due to the open-ended nature of the questions, the risk of 'rehearsed' responses was relatively low, even though the interview agenda was provided beforehand. This was because the order in which the questions were asked was adjusted, and additional questions were asked when clarity was required (see Holland, 2005; Rowley, 2012).

Before the commencement of the interview, each respondent was asked for permission to record the interview. This was done to add to the accuracy of the transcription process and avoid having to keep detailed field notes. It also allowed the researcher to concentrate on the interviewee, ensuring focus on tone and non-verbal cues. The interviewee was given the option to discontinue recording at any stage and the transcribed interviews were made available to the interviewees on request. This ensured that reliability and transparency and accuracy were added to the transcribed interviews. All transcripts were kept logically and physically secure (adapted from Alvesson, 2003). Time was also spent establishing rapport with interviewees (Rowley, 2012).

At the start of each interview the respondent was reminded of the nature and purpose of the research, that there is no 'correct' or 'incorrect' answer, and that all responses would be treated as strictly confidential<sup>13</sup>. As the interviews were semi-formal the interviewees were encouraged to talk as widely as possible. At the same time, respondents were asked to explain particular concepts or statements in different words or from a different perspective to address 'script coherent expressions' or resolve any ambiguities (Alvesson, 2003).

There was some variation in the sequence in which questions are introduced, although each of the issues in the interview agenda (appendix A) was addressed during the course of the interview (Alvesson, 2003; Rowley, 2012). During the interview process, additional questions were posed as required to ensure that the researcher understood interviewees' comments. The highest level of research ethics was maintained throughout the interview process (see also Section 3.4).

### 3.2.5 Data analysis

Once the interviews were transcribed, each transcript was briefly reviewed to obtain a sense of the data, and initial notes on emerging themes or concepts were added. The transcripts were then analysed using a three-tier approach: data reduction, data display and verification (O'Dwyer et al, 2011).

Data reduction and display refer to the 'decomposition' of each transcript into key arguments and counterarguments that can be juxtaposed with the prior literature. Notes were contrasted and general themes, categories and interconnections identified and aggregated using a 'data mind map' (Holland, 1998a; Holland, 1998b; Leedy and Ormrod, 2010). Data was organised under headings and sub-headings (axial codes) informed by the prior literature. These included axial codes on how accountability mechanisms function, the advantages

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<sup>13</sup> Each respondent was assigned a unique code. Any commentary included in the final report was thoroughly sanitised to ensure that any information that could be used to identify the respective interviewee has been removed. This process was explained to each interviewee.

and disadvantages of the review carried out by the FRIP, and elements of resistance to this review. Notes on the different phrases, concepts and principles were made on each transcript and used to summarise the data under these headings (adapted from O'Dwyer et al, 2011; Maroun and Solomon, 2013).

Defining axial codes afforded structure to the interpretation processed and allowed the study to retain focus. While there is a risk that this approach could have restricted the exploratory potential of this study, this is overcome by reclassifying individual transcripts as new information emerges from either additional interviews or the literature. In addition the axial codes were also revised as needed during the course of the study, to accommodate any new or previously unidentified information. In other words, the data analysis process was iterative. Where contradictions or inconsistencies were identified, they were verified during follow-up sessions or subsequent interviews. The aim of this process was to obtain a sense of saturation and not to achieve statistical consensus or a 'result' in a positivist sense. (Follow-up sessions were carried out as described above) (Holland, 2005; Leedy and Ormrod, 2010; O'Dwyer et al, 2011).

### **3.3 Validity and reliability**

As stated above, due to the use of detailed semi-formal interviews, the researcher becomes integrally involved in the data collection and analysis process (Leedy and Ormrod, 2010). This means the study is subjective. This is an inherent characteristic of the chosen method and not, in itself, a threat to validity or reliability<sup>14</sup> (Creswell and Clark, 2007). On the contrary, by exploring the subjective views of a sample of informed respondents, the researcher is able to

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<sup>14</sup> It should be noted the use of 'validity' and 'reliability' does not have the same meanings as one would expect to see in a positivist research context. From a positivist perspective, validity would mean 'how well the measurement instrument measures what it is intended to measure' while reliability would mean 'the consistency with which a measuring instrument yields a consistent result' (Leedy and Ormrod, 2010, p. 91) However, for the purpose of this study, and in an interpretive setting, validity means that 'the researcher checks for the accuracy of the findings by employing certain procedures' and reliability is consistency in the approach used (Creswell and Clark, 2007, p. 90).

examine thoroughly how FRIP reviews function as a mechanism of accountability and give rise to different isomorphic pressures (Brivot and Gendron, 2011), something which would be overlooked by positivist studies (O'Dwyer et al, 2011). In this light, validity and reliability of qualitative research is not a function of clinical data collection techniques, statistical analysis and scientific rigour (Creswell, 2009). Research quality is ensured by detailed analysis and grounding findings in the relevant academic literature (Creswell, 2009; O'Dwyer et al, 2011).

Despite the time-consuming nature and the possibility of research bias, the following steps were taken to ensure validity and reliability (Creswell, 2009; Rowley, 2012): (1) as discussed in Section 3.2.3, only experienced interviewees were chosen to participate in the study and the researcher avoided interviewing only one group of respondents; (2) the interview agenda was carefully developed using the prior literature (Section 3.2.2); and (3) the data analysis process was developed from leading qualitative studies dealing with similar subject matter (Section 3.2.4 and 3.2.5).

### **3.4 Ethical considerations**

In addition to the steps taken in Section 3.2, the following ethical safeguards were put in place:

- As the purpose of this research is to obtain personal accounts, anonymity was guaranteed. Where quotations are used, information which could reveal the identity of interviewees (or their place of employment) has been removed with amendments indicated.
- Transcripts were kept only for the data collection and analysis processes and were destroyed after the completion of the study.
- To ensure accuracy of the interpretation of results, interviewees were offered draft copies of this report.
- Finally, as this research could amount to a moral enquiry, ethical clearance was obtained from the University of the Witwatersrand (Appendix 2).

### 3.5 Limitations

Despite safeguards to ensure reliability and validity of the research, a number of inherent limitations should be noted:

- As discussed in Section 3.2, the researcher inevitably becomes a part of the data collection instrument. This implies that the results are not necessarily conducive to preproduction or generalisation, although such is the aim of more positivist-type studies (See Holland, 1998b; Holland, 2005; Creswell and Clark, 2007).
- There is always the risk that interviewees provide rehearsed responses or modified commentary due to social pressures such as the need to ensure, *inter alia*, political correctness or alignment with the views of their employers (Alvesson, 2003).
- Although the interviews are exploratory, they can produce results that are highly technical, making it difficult for non-experts to interpret the findings (Merchant, 2008).
- There was no indication that the three groups of experts viewed the functioning of the FRIP differently. While this demonstrates that data saturation has been achieved, this should not be interpreted as implying that the research is concluding on how different experts interpret the functioning of monitoring and review bodies.
- Related to the above, and as discussed in Section 1.5, analysis of the data is carried out using a single theoretical perspective. Considering how the FRIP may be used as an instrument of political power by the JSE or SAICA, the relevance of disciplinary power and control, and the FRIP as an instrument of legitimisation, for example, are not be dealt with explicitly. Consequently, while this research will shed light on the functioning of the FRIP, it will not be able to provide a complete account of the review function (Alvesson, 2003).
- Finally, the research examines only the role of the FRIP as a possible mechanism of accountability from the perspective of a group of experts in South Africa. How mechanisms of accountability are viewed by non-expert users is not addressed.



## 4. Results

This chapter documents the findings from the semi-structured interviews performed using the interview agenda provided in Appendix A. Section 4.1 explores the functioning of coercive isomorphic pressure. Section 4.2 examines the effects of normative isomorphic pressure as a result of the operation of the FRIP in a highly professionalised space. Finally, Section 4.3 examines possible evidence of the operation of mimetic isomorphism associated with the review activities being carried out by the FRIP.

### 4.1 Coercive isomorphism

The FRIP does not enjoy the direct force of law in order to drive high quality financial reporting. As a result, it can be argued that a FRIP review is not, in itself, a source of coercive isomorphic pressure. Nevertheless, FRIP reviews can work with the provisions of the Companies Act (2008) and the JSE listing requirements (JSE, 2013) to achieve high quality financial reporting and give rise to coercive isomorphic pressure.

#### 4.1.1 The FRIP, The Companies Act and the JSE listing requirements

The prescriptive use of IFRS in the preparation of listed companies' financial statements is a requirement of the South African Companies Act No 71 of 2008 (Companies Act, 2008) and of the JSE listing requirements ((JSE, 2013). Having the required reporting framework legislated and as a listing requirement provides a statutory backing for its application. It is through this backing that the application of the framework can be enforced by establishing adverse consequences for non-compliance. The consequences of non-compliance depend on the enforcement mechanism contravened and the severity of the contravention, as discussed below. The effect of having the reporting framework requirements legislated is summarised as follows:

*if a company doesn't comply with IFRS then they are guilty of non-compliance with the Companies Act and then they are basically breaking the law, (R6)*

Laws and regulations are, in themselves, a source of coercive isomorphic pressure (DiMaggio and Powell). In addition to potentially material financial and criminal sanctions for non-compliance legislation represents a powerful institutionalised system which contemporary organisations must comply with in order to ensure structural and procedural legitimacy (Meyer and Rowan, 1977; DiMaggio and Powell, 1983; Suchman, 1995). In this context, the FRIP is not, in itself, the cause of legal coercive isomorphic pressure. Instead it works in conjunction with legislation and with the JSE listing requirements to drive compliance with IFRS. This is not achieved by the FRIP imposing penalties directly but by acting as a technology of accountability in terms of which it is able to rely on its data collection and analysis capabilities to identify poor application of IFRS and render the individual organisation visible. Consider the following:

*Companies are starting to realise that somebody is looking at their financial statements and it's somebody they can't bully (R1)*

Due to the relative position of the FRIP within the financial reporting mechanism, and the legitimacy awarded to it by the market, organisations find it difficult to manipulate the panel (R2). Coupled with the technical proficiency of the members, the body is able to ensure adequate evaluation of compliance with the reporting framework. The technical rigor or the process is likely to result in a revelation 'for the company that may not be pleasant' (R1). Essentially, there is somebody 'with the appropriate skills looking over your shoulder' to ensure the framework is correctly and consistently applied (R3).

In addition to rendering non-compliance visible to statutory mechanism, the operations of the FRIP make the transgression visible to the JSE, which can use the result of a review by the FRIP to inform an enforcement decision. A primary objective of the securities exchange is to establish the integrity of the market by ensuring uniform reporting and adherence to the reporting framework (R9). As such, this non-compliance is of particular interest to the JSE (R2; R3; R6). The review of financial statements by the FRIP has established a platform with the necessary expertise and technical rigor to assist the JSE with ensuring

compliance (R1; R3; R5; R6). In other words, the review process allows the JSE to evaluate cases of suspected non-compliance, with the FRIP serving as the mechanism for doing so, and acting on this information in a manner that protects the investors and ensures companies' present their financial position and performance faithfully in accordance with IFRS (R5; R9). Consider the following:

*[The FRIP] has raised the awareness that its not a free for all. They [preparers and their organisations] can't do anything they want and that there is this risk of having to restate, which is the worst thing for any company in the world, have to restate accounts, and that created a caution for the companies that are a little circumspect in the application of IFRS and liberal interpretation of IFRS (sic)*  
(R3)

The risk of restatement causes the organisation to consider its application of IFRS more closely (R5). It influences the company to ensure its interpretations are consistent with IFRS and other market participants (R1; R9). Through this process, the JSE is able to ensure organisations appropriately consider and apply the financial reporting framework. In addition, while the JSE listing requirements do not give the Exchange the power to instruct a company to restate, the JSE is able to uses other avenues made available by the listing requirements (R3). The most serious of these is the suspension of the organisation's listing, as explained:

*Where they say we want you to restate and the company says no, and then what can they do, they can suspend them, that's what they can do, it's punishment, so that suspension is a massive thing* (R3)

Suspension is a serious step that, in most cases, results in a company rather restating its financial statements. It may be the case that a company refuses to do so, with the result that its shares are suspended (R1). Respondents pointed out that this was not a hypothetical consequence. As the JSE has previously suspended shares for non-compliance, several interviewees felt that the threat of

suspended trading, in part as a result of poor financial reporting practices, has been clearly established.

Adding to the coercive isomorphic pressure associated with FRIP reviews and JSE sanctions is the speed at which the FRIP and the JSE act relative to a traditional bureaucratic legal system (R3). This allows the JSE to provide relevant financial information to the market quickly and so preserve confidence in the capital market system while ensuring swift punishment for the non-compliant reporting entity (R1; R5).

The negative consequences of non-compliance are not limited to the company and extends to the other parties involved in the preparation process, as explained:

*You've got to consider than maybe [the FRIP] reports it to the FSB and they follow up, the auditor who signed off, well they get reported to IRBA, and they also get reported to SAICA because they are usually CA's as well, and they may or may not report the IFRS advisor [as well] (R1)*

The FRIP allows for the individuals responsible for the preparation of non-compliant financial statements, as well as the auditor, to be held accountable (R1; R3; R5; R6; R9). As with the consequences for the company, the FRIP itself does not hold these individuals responsible for the transgression. It establishes a process by which pre-existing laws and regulations can be brought to bear on the individual accountants and auditors. In other words, the FRIP is not responsible for holding each of the involved parties responsible; it establishes a process through which non-compliance is identified, evaluated and reported to the relevant professional bodies. This possibility of being reported for a negative FRIP finding, and the consequences of related professional disciplinary, civil or criminal sanction, means that the FRIP exerts a coercive isomorphic pressure (The professional ramifications of a FRIP review are discussed in Section 4.2).

#### 4.1.2 The FRIP and compliance with stakeholder requirements

The capital market has become more aware of the importance of faithful reporting (Atkins and Maroun 2014). Ensuring that material information has been appropriately disclosed becomes of utmost importance if the organisation wishes to continue dealing with its stakeholders (Maroun and van Zijl, 2015).

In this context, many of the new standards released have been in response to the recent spate of corporate failures and financial scandals observed in the global corporate environment (see, for example, IFRS 7; IFRS 10; IFRS 12; IFRS 13). New standards released serve to provide additional information to stakeholders. For example, IFRS 7 was introduced due to the evolution of financial instrument risks and how companies manage these (Jonker and Maroun, 2013). The new standard was introduced to inform the users about the risks the company is facing and how these are being managed. Similarly, IFRS 10 and 12 were introduced to ensure group companies consolidate all organisations they actually control, regardless of legal form (IASB, 2011a). Consolidated financial statements are also required to disclose additional information about the consolidated entities to allow the users to obtain a better understanding of the group and its operations. As with IFRS 7 the aim is to ensure more transparent corporate reporting in the interest of preserving confidence in the corporate reporting capital market processes (Maroun and van Zijl, 2015). Likewise, IFRS 13 was released to define what the IASB meant by 'fair value', and requiring additional disclosure so that users of the financial statements can understand how the organisation calculated different fair values (IASB, 2011b). In addition to new standards, corporate scandals and failures have driven the need for, and proliferation of, codes of corporate governance (see, for example, IOD 2009, Solomon 2010, IIRC 2011). Society has placed greater importance on the accuracy of financial reporting, with the impact of incorrect reporting becoming more severe, as explained:

*If there are accounts that had to be restated, that must mean that the first accounts were not reliable and couldn't be used for their intended purposes, and what does that tell me about management and/or the systems? [It] must put a*

*question mark on the integrity of the data, integrity of the system and/or the way management are reporting it (R3)*

Similarly:

*Because of all the issues that have arisen due to corporate failures, there is an increased expectation that financial statements will be compliant with IFRS, which would increase the transparency of financial reporting and ensure management are discharging their fiduciary duty. Transparency assists stakeholders in assessing the financial results of the business, how it was managed given all the disclosures in that regard, and whether there has been any reckless trading, because if you have paid yourself a R15 million bonus and the business hasn't done very well, it's an indication of poor overall management and adequate compliance with IFRS allows stakeholders to see this... I think having a policemen [such as the FRIP] there forces people to do what they were supposed to do in the first place, allowing these disclosures to be relied on (R5)*

The proliferation of codes of corporate governance, in conjunction with the new, more detailed, financial reporting standards, has resulted in stakeholders expecting higher quality, transparent financial reporting (see Maroun and van Zijl, 2015). The non-compliance with the reporting framework not only casts doubt on the integrity of the information and those responsible for its preparation but also the transparency of the organisation reporting the information (R5; R9). The functioning of the FRIP cannot, therefore, be interpreted in isolation. The review body is, in essence, a means of operationalising stakeholders' demands for high quality financial statements. Users of the financial statements are provided with some assurance that technical experts are reviewing the financial statements for compliance with IFRS. This is the case even if the users are not informed of the detailed findings of the FRIP reviews or understand completely the technical details of the review

process and any identified issues (see Unerman and O'Dwyer, 2004). Conversely, if the FRIP identifies inappropriate accounting practice, the company is held accountable in terms of the provision of the Companies Act (2008) and Listing Requirements (JSE, 2013). Although the identity of the organisation is not disclosed, the respective *accounting treatment* is identified as inappropriate to a broader group of stakeholders who, in turn, are able to hold organisations accountable and demand reforms where similar accounting practices occur. Consequently, even though the FRIP does not enjoy direct force of law (see Section 1.6), its review process acts as a mechanism for identifying inappropriate accounting practices and improving corporate transparency and accountability (R2). In this way, FRIP reviews are an important source of coercive isomorphic pressure.

In addition, although many interviewees did not deal with this directly, some respondents pointed out that compliance with debt covenants or other specific supply contracts can be affected in the same way by a negative finding of a FRIP (R3; R5; R9). Due to the company's reliance on these parties for continued operation, ensuring the quality of the information required is vital (see Maroun and van Zijl, 2015). Subtle coercive pressures are present to conform with the structures and policies of those on whom a company is dependent for support (DiMaggio and Powell, 1983). As such, accountability can also be observed at a transactional level. As is the case with legal isomorphic pressure, the FRIP itself is not in a position to enforce or cancel a contract. Nevertheless, its investigative processes are important as they reveal non-compliance<sup>15</sup>, allowing the relevant stakeholder to act on such an instance. This reaffirms how the FRIP is an important part of the relationship of accountability existing between an organisation and the counterparty to any contract or agreement which requires

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<sup>15</sup> The identity of the company is not disclosed to the public but the respondents pointed out that those charged with the organisation's governance are made aware of the FRIP findings and are required to take appropriate action to ensure compliance with the terms of their relevant contracts. (Additional detail could not be provided due to the need to preserve the confidentiality of the respondents)

compliance with IFRS and, therefore, an indirect source of coercive isomorphic pressure (R1; R5).

## 4.2 Normative isomorphic pressures

The financial costs of restating financial statements or of rectifying a contractual breach may not be material for organisations in direct financial terms. As such the coercive isomorphic pressures discussed in Section 4.1 are not sufficient to ensure compliance with IFRS. For many respondents, more relevant than the direct cost of a contravention of statute, listing requirements or contractual provisions are the professional implications of an adverse finding by the FRIP. Interviewees explained how this normative isomorphic pressure has implications for the company (Section 4.2.1), the preparers of the financial statements (Section 4.2.2) and their auditors (Section 4.2.3).

### 4.2.1 Consequences for the company

Several respondents explained that a restatement of the financial statements sends an important signal to the market which can have significant implications for the company's reputation (R1; R3; R5; R9). Consider the following:

*if there are accounts that had to be restated, that must mean that the first accounts were not reliable, and couldn't be used for their intended purpose (R3)*

Investors rely on financial statements to make decisions. When the investors can no longer rely on the information provided, their decisions regarding the company are called into question and they challenge the appropriateness of continuing to hold an investment in that company (IASB, 2010). In other words, the effect of an adverse FRIP finding are more significant than the direct costs of non-compliance with statute or listing requirements<sup>16</sup>. A report by the FRIP calls

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<sup>16</sup> The actual report prepared by the FRIP is not made public (FRIP, 2011). Nevertheless, respondents confirmed that restatements due to technical errors in the financial statements are automatically associated with the activities of the FRIP. In addition reference to the FRIP may also be made in the SENS announcement dealing with the restatement. Finally, it is possible for key



the integrity of the financial reporting process into question. An error, even if it is isolated, has the potential to cast doubt on the ability or willingness of the company to prepare transparent and useful financial statements. As explained by one respondent, a finding by the FRIP can, therefore, discredit the company in the eyes of its current investors:

*I think it stigmatises the company because if that could happen [a restatement], are their controls really that good and then why did it happen? ... And if it comes out that you had inadequate controls and policies and procedures and you ended up reporting false information, it will stigmatise the company (R9).*

Unsurprisingly, several interviewees also pointed out the implications for a company trying to raise additional capital with new investors and creditors.

*I think it's going to be public knowledge if they put it out on SENS that the company has been forced to withdraw their accounts and restate. The investor has to undoubtedly say: 'does the board of directors tasked with governance of this entity know what the hell they are doing?'... Every investor does not have the opportunity to go to the offices and walk through them and say: 'Are you running a tight ship?'. Here the CEO and the FD, who are paid significant amounts to make sure the numbers they are giving [the investors] are the right numbers, haven't done what they are supposed to. And I am going to base my calculations and decisions [on that incorrect information] (R9)*

There are a large number of investment options with analysts only able to follow the performance of a select number of companies with the result that these

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investors to engage the company directly when there is a restatement and, as a result, become aware of the fact that there has been an adverse finding by the FRIP.

institutional investors rely on a collection of indicators for quickly categorising the appropriateness of the potential investment (Atkins and Maroun, 2015; Atkins et al, 2015). As explained by one expert:

*A restatement is a negative on the tick boxes of many of the investors. You have thousands of companies to search through and you have a screening so [the question you ask is] has a company had to restate in the past three years? [If the answer is] 'yes', it doesn't matter how big the restatement was, it's off the radar. (R1)*

The technical competency of the FRIP, coupled with its significant professional standing, means that it has become an institutionalised part of the capital market system with which organisations must comply in order to secure legitimacy (Section 2.3.2). The converse is also true. The FRIP is regarded as such a respected authority on appropriate financial reporting (R1; R3) that a negative report by the body, resulting in restatement, is quickly accepted as an indicator of poor financial reporting practice. Due to the cognitive legitimacy reserve of the FRIP, an investor does not need to carry out a detailed due diligence on the financial reporting practices of a potential investment. A restatement (due to an adverse finding) is sufficient to cast the legitimacy of the organisation into doubt and negate the need for any additional analysis. The effect of a negative signal by the FRIP is also relevant for a company's broader corporate governance.

Although not a recurring finding, because the FRIP calls into question the integrity of the financial reporting process (R3), it has the potential to cast doubt over other systems and processes related to the financial statements. The identity of the company may not be revealed to the public but senior management and committees of the Board of Directors are aware of the findings with a number of adverse implications. For example, it may raise questions about the appropriateness of the auditor appointed by the audit committee (see Section 4.2.3 for details) or the underlying internal controls used by the company to safeguard financial resources and ensure the integrity of the financial statements (see IAASB, 2009a). In turn, this has important implications

for the perceived rigor of a company's corporate governance systems. As discussed in Section 4.1.1, there is a general expectation by stakeholders for high quality financial statements and an effective system of checks and balances over financial and non-financial resources. As a result, adherence to codes of best practice and governance has become an important source of structural and procedural legitimacy (Maroun and van Zijl, 2015). This means that an adverse FRIP finding challenges any prior claims made by an organisation that it is committed to effective governance and results in significant internal reflection by the organisation on the challenge to underlying legitimacy (R1, R9).

In other words, the FRIP functions concurrently with other systems of accountability to yield a source of normative isomorphic pressure. As explained by (Suchman, 1995, p. 589) 'organizations often pursue professionalization' in order to 'link their activities to external definitions of authority and competence'. Claims to compliance with the principles in, for example, King-III and the COSO framework, have become an important means of defining how organisations are operated and presented to stakeholders and a driver of normative isomorphic change (consider: Meyer and Rowan, 1977; Maroun et al, 2014). The FRIP is an integral part of this, either confirming or challenging the extent to which a company has complied with best practice. This effect is magnified when financial statements are restated. For example, one expert discussing the implications of a FRIP finding and restatement of financial statements for the reputation of an organisation said:

*Because you never restate something that wasn't material that means something serious has gone wrong here and, even if [the company] thought it was right, why didn't [the company] highlight it in their accounts... As an investor, you rely on management telling you that those numbers are right and the auditor confirms them. That is the assurance process on the underlying numbers... So now if the FRIP shows that the financial statements are wrong, that definitely stigmatises [the company] (R3)*

Respondents went on to explain that even if the company does not restate its financial statements, the likely outcome is a suspension of trading. In this way, that there is a problem in how the company has applied IFRS is still being communicated to stakeholders (R1; R3). Consequently, irrespective of whether or not there is a restatement, the company is 'exposed to bad press' and 'it doesn't smell very good' (R5). This results in investors no longer wanting to invest in the company, customers and suppliers no longer wanting to deal with the company and other stakeholders not wanting to be associated with the company (R5). In this way, the reputational implications of a negative FRIP finding, including the perception that the company is not complying with best practice designed to service the information needs of stakeholders, means that there are strong normative isomorphic pressures exerted on the organisation to ensure their financial statements are of a high quality. This is reinforced by similar isomorphic pressures working on the individuals responsible for those financial statements.

#### **4.2.2 Consequences for the preparers**

Interviewees pointed out that a preparer is unlikely to face criminal sanctions for non-compliance with IFRS or otherwise suffer direct personal financial cost. As explained in Section 2.2.2 and Section 4.2.1, the most important implication of an adverse report by the FRIP are the consequences for the professional reputation of the preparers and those charged with the organisation's governance.

The name of the individual responsible for the preparation of the company's financial statements is required to be published (Companies Act, 2008). One respondent suggested that this was important for "nailing the person" (R1). The individual responsible for the preparation of the financial statements is identified and becomes the object of regulation and prescription (see Maroun and Atkins, 2014). In the context of a FRIP review, this means that any adverse finding is quickly linked, not only with the identity of the respective firm, but also with the professional competency of the individual accountants tasked with

the preparation with the financial statements<sup>17</sup>. The finding of non-compliance also places strain on the employment relationship. A preparer may very well 'fall out of favour' with his employer and either lose his job or stunt his professional development (R1; R3; R5). As a result, that the financial statements may be subject to review by the FRIP operates as a subtle (but important) source of normative isomorphic pressure. Consider, for example, the following comment:

*[Preparers] will always have the **possibility** of being called by the FRIP at the back of their minds. From experience, people would rather have it right than even a **possibility** of incorrect or incomplete disclosure by the mere fact that they know there is a **possibility** that someone out there **could be looking** at the financial statements (sic) (R5, emphasis added).*

Most respondents shared this view. On one level, an actual review by the FRIP has a disciplinary effect, resulting in self-regulation and careful reflection on how IFRS is being applied at the respective organisation. In this way, the professional implications for the individual accountants involved (normative isomorphism) works hand-in-hand with sanctions by the JSE and relevant professional bodies for non-compliance (coercive isomorphism). Similar isomorphic pressures are, however, also felt even when the preparer was not subject to a FRIP review. Respondents were unanimous that the *potential for review* (and resulting reputational impact) is often sufficient to condition preparers to apply IFRS very conservatively (R2; R4; R5; R6).

As explained in Section 4.2.1, compliance with IFRS is part of a process of signalling an awareness of the need for high quality financial statements and users' expectations for transparent corporate reporting. This is a source of normative isomorphic pressure for companies. By the same token,

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<sup>17</sup> This is the case even if restatement does not result because, as explained by respondents, the FRIP findings become common knowledge among senior management, the Board of Directors and the independent committees of the Board

demonstrating a command of IFRS and a stakeholder-centric reporting model is a defining feature of a competent professional accountant (Fogarty, 1992; Maroun and van Zijl, 2015) . As a result, the possibility of a review by the FRIP and a negative finding, even if this is remote, is often sufficient to encourage preparers to review the application of IFRS to complex transactions, consult with peers, and seek the advice of their auditors.

*Most of us make sure that standards are being complied with. We consult [with the audit firm's technical department] and make sure that whatever comments come back from the technical department are looked at more closely than they would have been in the past because, in a way, the JSE would be looking as well (R5)*

FRIP reviews also affect how preparers interact with their auditors when the latter detect errors in the accounting records as part of the normal audit process. For example, one interviewee, explaining how a company's preparers respond to difference detected during an audit pointed out that:

*I think that [FRIP reviews] have made people a bit more aware in terms of the questions that could be asked and the level that people do go into when looking at the financials. So, I think that, any issue or debate that would've been an audit difference as a disclosure issue and would've been left unadjusted because it wasn't material is looked at more carefully. If it can be done right, rather do it as opposed to just leaving it unless it is really impossible. (R5)*

This comment suggests that preparers rely on materiality to justify not complying precisely with the requirements of IFRS (see Tremblay and Gendron, 2011; Maroun and van Zijl, 2015). FRIP reviews address this commonly used method of resisting corporate reporting prescriptions. Most interviewees agreed that the possibility of the FRIP questioning a company's application of IFRS is making preparers less likely to dismiss differences detected by auditors on the grounds that these are immaterial (R6).

Respondents also identified normative isomorphic pressure being exerted on those charged with governance, in particular, organisations' audit committee chairmen. The main reason for this is that communications between then JSE and the company are usually addressed to the chairman of the audit committee (R1; R3; R5; R6). This means that the reputational risks for preparers, as discussed earlier, apply equally to the Chairs of audit committees. That the Companies Act (2008) specifically requires the audit committee to accept responsibility for the preparation of financial statements in compliance with IFRS reinforces this sense of accountability. For example:

*[The chairman] is a bit more aware in terms of the questions that could be asked [by the FRIP] and the fact that a panel of experts will go through the financial statements in detail (R5)*

The result, according to all interviewees, is that the chairman places additional pressure on both management and the specific individual responsible for the financial statements to ensure they are compliant with the IFRS (R6). In other words, normative isomorphic pressure is reflexive. It not only makes the chairman more aware of his monitoring and quality control responsibilities but also results in his holding the organisation and individual preparers accountable.

In this way, the FRIP is part of a complex system characterised by the concurrent functioning of normative and coercive isomorphic pressure. Its review processes remind individual accountants of the importance of applying the IFRS with due care and skill. At the same time the professional implications of identified non-compliance promotes more active monitoring and review by those charged with an organisation's governance, something which is a source of normative and coercive isomorphic pressure in its own right. The final result is that the FRIP, even though it does not enjoy the direct force of law, encourages respondents to internalise the importance of high quality financial reporting and engage in active self-regulation to ensure compliance with IFRS (R1; R2; R3; R5; R6).

### 4.2.3 Consequences for the auditor

As auditors are reliant on their reputation for continued existence (Chandler et al, 1993; Agulhas, 2007) , the risk of having a restatement on a set of financial statements on which an unqualified opinion was issued cannot be ignored. Based on the new reporting standards and heightened awareness of high quality transparent corporate reporting (Section 4.2.1), there is an increased expectation that the auditors will ensure compliance. Respondents identified two areas of interest when considering the auditors. The first was the impact of the proactive review in which auditors are participating. The second were the implications of this review process yielding a result which is inconsistent with the auditors' opinion of the financial statements.

After the recent financial crises and corporate scandals, regulators have increased their scrutiny of the audit profession (Malsch and Gendron, 2011) . This has placed additional pressure on the firms to ensure that they discharge their fiduciary duties. Because these regulators often have the power to impose penalties, they operate as a source of coercive isomorphic pressure. At the same time, professional sanction, which calls into question the technical competency of the individual accountant is a source of normative isomorphic pressure (Malsch and Gendron, 2011) . Although the FRIP is not established specifically as an audit oversight body, its review processes can be viewed in a similar light.

According to all respondents, the FRIP can be viewed as another body scrutinising the application of IFRS by clients (see also Section 4.2.1) and, indirectly, the rigor of the procedures carried out by auditors to support their opinion that the respective financial statements achieve fair presentation. The effect on the auditor was explained as follows:

*Researcher: Does the effect of the FRIP review have implications for the auditor when the FRIP criticises the application of IFRS and the auditor has concluded that the financial statements comply in all material respects with IFRS?*



Respondent: *It is very uncomfortable for the auditor, very uncomfortable because not only do they have their own client turn on them, every client blames their auditor because they said the financial statements were okay. That's what happens. So this will definitely sour the relationship with the client... It is also a further matter of discomfort... When there are two audit firms because there is peer pressure... Then there is the third element in that, if there is a restatement, it is an automatic referral to the JSE, SIACA, and the IRBA and there will probably be a disciplinary hearing. (R3)*

Similar to the discussion in Section 4.2.2, normative isomorphic pressure works on the individual responsible for the audit engagement. A contradiction of the auditor's conclusion by the FRIP calls into question the practitioner's understanding and application of IFRS and the extent to which he has carried out the audit engagement in compliance with the relevant standards. In other words, an adverse FRIP review is an attack on each of the essential elements of professionalization: technical proficiency, due care and skill, and the sound application of professional judgement (Chandler et al, 1993; Maroun and Atkins, 2014) . Consequently, even though the FRIP does not hold the individual auditor directly responsible, its conclusions 'identify the auditor as possibly lacking ' (R7) and are, an important source of normative isomorphic pressure. The possibility of being judged by peers adds to this<sup>18</sup>.

As explained by Respondent 3 above, in multi-audit engagements, having a professional opinion disputed by the FRIP 'is especially embarrassing' because of peer pressure. To paraphrase Maroun and Atkins (2014, p. 848), there is a 'strong awareness of reputational risk' which is 'magnified by the fact that non-

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<sup>18</sup> As discussed in Section 4.2.2, it does not matter that the identity of the company/audit client is not made public. The critical review of the auditor's skills by those *within* the organization is a source of normative isomorphic pressure. This is simply amplified if results are restated.

compliance [with IFRS], if detected, would become common knowledge among the respective partner's peers and subordinates'.

As with preparers, respondents also felt that it was not necessary for the auditor to be involved in an actual FRIP review for this normative pressure to function. Several interviewees explained how, on listed engagements, auditors are aware of the possibility of a FRIP review and are taking this into account when designing their audit procedures and concluding on identified differences<sup>19</sup> (R5; R7). In addition, interviewees commented that FRIP reviews have the potential to erode confidence in the attest function as a whole:

*If you are saying that you need this [FRIP reviews] over and above what's in the audit opinion then that causes doubt about the audit opinion (R4)*

and

*If you're saying the FRIP process adds an additional level of confidence what does it say about your audit process? (R6)*

If a company's financial statements have been audited and an unqualified audit opinion has been issued on these financial statements, there is a reasonable assumption that the accounts correctly reflect the financial position and performance of the reporting entity in accordance with IFRS (R4; R5; R6). If the stakeholders believe an additional monitoring system is necessary, then there must be doubt regarding whether or not the auditors are able to discharge adequately their duties, leading to 'the opinion of the auditor being second guessed' (R6). In this way, the indirect effect of a FRIP review on the professional standing of the auditor in the eyes of the public, and the confidence that non-experts vest in the attest function, is a significant source of normative isomorphic pressure.

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<sup>19</sup> A specific analysis of how auditors are modifying the nature, timing and extent of audit procedures to take into account the increased professional risks associated with a FRIP review is beyond the scope of this research.

The proactive review provided a reminder to the audit profession, specifically the big four firms, that 'they are not above the law' (R1). This process itself could be seen as a normative force, reminding the firms that they cannot simply rely on their relative position in the market and also need to ensure they spend sufficient and appropriate time ensuring their clients' financial statements comply with the reporting framework (R3).

From a slightly different perspective while auditors are required to be independent of their clients (IAASB, 2009b), as in any business, they are economically dependant on their clients. Therefore, FRIP reviews can act as an additional regulatory mechanism which exerts indirect coercive and normative isomorphic pressure to safeguard against threats to independence which might compromise the quality of an audit engagement.

The proceeding discussion should not, however, be interpreted as implying that isomorphic pressures are only functioning on the auditor. Respondents explained that the proactive review by the FRIP can enhance auditors' ability to hold clients accountable for non-compliance with IFRS. For example the proactive review can be used to convince or persuade clients to adhere to IFRS:

*For me it makes it easier for the companies I work for to say 'look it's not just me you need to convince, there is another regulatory body that can ask questions', so we need to ensure that our disclosure is correct (R2)*

FRIP reviews may also be useful for managing the tension between economic dependence on a client and the regulatory function carried out by the auditor:

*It makes the auditors' job easier because they don't have to take up the cudgels against their own clients. They say 'look you could interpret it that way, but do you want to take a risk that the FRIP will take a different view, and then we have a fight with them, and you may have to restate' (R3)*

In other words, auditors can utilise the consequences of a negative FRIP finding to ensure that their clients are applying IFRS appropriately. This becomes

especially useful when the audit client considers the preparation of their financial statements as a 'tick box' exercise and are reluctant to adhere to the spirit of the accounting standards (R2). In this way, the normative and coercive isomorphic pressures resulting from FRIP reviews function in two ways. Firstly, they work on the individual auditor to ensure compliance with IFRS and are relevant in the context of demonstrating that confidence in the attest function remains valid. Secondly, the potential of the FRIP as a source of isomorphic pressure can be relied upon by the auditor to compel clients to adhere to IFRS.

### 4.3 Mimetic isomorphic pressures

Due to the evolution of reporting standards and the proliferation of codes of corporate governance (as discussed in Section 2), companies are under pressure to signal compliance to the market (see DiMaggio and Powell, 1983). This conformity assists organisations in either establishing or preserving their legitimacy. However, as these new standards and corporate governance requirements are not always explicit, organisations may be unsure of how best to apply them (Tremblay and Gendron, 2011). As explained by institutional theory, this uncertainty leads to replication of the practices or activities of those firms which are already accepted as a legitimate part of the capital market (DiMaggio and Powell, 1983). Although not a common finding, there was some evidence of the functioning of this mimetic isomorphic pressure as a result of FRIP reviews. For example, one preparer explained how his team reviews technical reports (published by the JSE) and summarises the main findings resulting from the proactive review process. The purpose was not to identify the offending organisation but to understand how the FRIP is interpreting relevant sections in the IFRS. This has a number of important implications.

Firstly, there is evidence of a type of inverse of mimetic isomorphism at work in that preparers are identifying those practices deemed inappropriate by the FRIP and avoiding them when preparing their financial statements (R5; R8; R9). Consider, for example, the following comment:

*[Published findings from FRIP reviews] are making the general public more aware of the good stuff and the bad stuff in terms of good financial reporting and bad examples [sic] and making them aware of what they [preparers] should not be doing. (R5)*

Secondly, preparers and auditors confirmed that they are actively reviewing financial statements. The purpose of these reviews is to ensure that all information required by the IFRS is being included in the financial statements in order to pre-empt interrogation by the FRIP (R5; R6; R8; R9). As explained by most interviewees, this is resulting in additional disclosure by most listed companies to ensure that their financial statements are consistent with those of their peers and the requirements of IFRS (R2; R5; R6; R9). Finally, there was some evidence to suggest that the FRIP has been elevated to the position of an interpretation committee, even though this is not part of the FRIP's mandate:

*I haven't heard of any cases where boundaries are being pushed. There haven't been big public debates or challenges of the FRIP's findings... You will only see the authority they have because people are not pushing the boundaries... People are doing what they are told and if the FRIP decides on something then that's the way it is. (R8)*

As discussed in Section 4.1 and 4.2 the technical standing of the FRIP has resulted in a cognitive legitimacy reserve. All respondents confirmed that the FIRP is constituted by some of the country's leading minds in corporate financial reporting and that this confers significant pragmatic legitimacy. At the same time, a rigorous review processes - coupled with a clear mandate from the Stock Exchange - has resulted in procedural legitimacy. This is complemented by structural legitimacy resulting from the fact that the purpose of the FRIP is to drive high quality financial reporting in the interest of the users of financial statements. This means that, in South Africa, the FRIP is generally accepted as a financial reporting authority capable of providing legitimate interpretations of

IFRS. Whether or not this was intended by the JSE was unclear but comments from most preparers and auditors revealed that findings from a FRIP review carry as much weight as interpretations issued by the IFRIC and, in some cases, are seen as an irrefutable extension of the IFRS's.

## 5. Conclusion

### 5.1 Summarising comments

This study examines the functioning of the FRIP as a mechanism of accountability. In particular, detailed interviews with a sample of technical experts reveal significant sources of coercive, normative and mimetic isomorphic pressures. These are relevant for organisations themselves, as well as for individual preparers and auditors.

Firstly, the FRIP does not enjoy the direct force of law and cannot pose statutory penalties. Nevertheless it works in conjunction with other regulatory measures to yield significant coercive isomorphic pressure to comply with IFRS. All respondents explained that the FRIP provides a means of testing whether or not companies are complying with the JSE Listing Requirements and Companies Act (2008) which specifically mandate preparation of financial statements in accordance with IFRS. In this way, the FRIP does not impose penalties directly but is an important technology of accountability. It provides the means for data collection and analysis necessary to render non-compliant companies visible to the relevant regulators who are able to impose fines, require restatement of results and suspend listings. This is complemented by the operation of societal expectations.

Numerous corporate scandals have made the need for transparent corporate reporting very clear. As a result, companies are under significant pressure from stakeholders to comply with IFRS and to demonstrate that they are preparing high quality financial statements. In this context, a negative finding by the FRIP acts as a signal that the organisation is failing to take this fiduciary duty seriously and this can have implications for the ability of the reporting entity to attract

new investors, raise new debt financing and remain in favour with counterparties who demand compliance with IFRS in their respective contractual undertakings.

In many instances, the monetary cost of an adverse FRIP finding is not the only consideration. Perhaps more relevant are reputational implications. For the organisation itself, highlighted instances of non-compliance with IFRS call into question its internal controls, governance structures, commitment to compliance with codes of best practice and the firm's legitimacy. In turn, this erodes the confidence which important stakeholders place in the organisation and, as with coercive isomorphism, can undermine the attractiveness of the organisation to investors. This is especially true when the company is required to restate results because non-compliance with IFRS is, indirectly, being reported to all relevant stakeholders.

Normative isomorphic pressures are also at work on individual preparers. As technical accounting experts, they should be preparing financial statements in compliance with IFRS. A negative finding by the FRIP calls into question professional competency and due care, effectively tarnishing the individual accountant's professional reputation. This goes hand-in-hand with coercive isomorphic pressure as the inference of professional misconduct can give rise to disciplinary enquiries by professional bodies and lead to the individual falling out of favour with the respective employer.

Respondents also identified normative isomorphic pressure being exerted on those charged with governance, in particular, organisations' audit committees. In light of the fact that the Companies Act (2008) vests responsibility for the quality of the financial statements with the audit committee, the reputational implications of a FRIP review for individual preparers apply equally to the chairmen of audit committees.

The effect of an adverse FRIP review for external auditors should also not be overlooked. Audit firms are heavily dependent on claims to professional

expertise and technical competency in order to command the confidence of non-expert users. Even though the FRIP does not hold the individual auditor accountable for the quality of a client's financial statements, its conclusions can suggest that 'the auditor [is] possibly lacking' (R7). In other words, the FRIP can be seen as another regulatory body reviewing financial statements and, indirectly, calling into question the quality of the audit procedures used to support the opinion on a client's financial statements. In this way, the FRIP is able to exert a significant normative isomorphic pressure on the individual audit partner and the professional firm which is almost entirely dependent on claims to technical expertise for continued existence.

It is important to note that these normative and coercive isomorphic pressures work concurrently. FRIP reviews remind individual accountants, auditors and those charged with governance of the importance of correct application of IFRS in terms of the Listing Requirements, statute and contractual provisions. At the same time the professional implications of identified non-compliance encourage respondents to internalise the importance of high quality financial reporting and engage in active self-regulation to ensure compliance with IFRS.

Finally, although not a recurring finding, some respondents pointed to the FRIP as a source of mimetic isomorphic pressure. This often takes the form of identifying those reporting practices deemed unacceptable by the FRIP and ensuring they are not repeated. Many preparers are also devoting considerable time and effort to ensuring that their financial statements include comparable disclosure to their peers and include all required disclosures prescribed by IFRS. Perhaps the most important finding is the expansion of the FRIP's jurisdiction to include interpretation of IFRS. This is not included in the Review Board's mandate but the cognitive legitimacy of the FRIP means that its findings are often undisputed and readily accepted as a valid basis for how particular requirements of IFRS must be applied by different sectors.



## 5.2 Contribution of the thesis

This thesis provides the first account of how the FRIP is capable of exerting coercive, normative and mimetic isomorphic pressure on organisations, those charged with their governance, individual preparers of financial statements and external auditors. In doing so, the research makes a number of important contributions.

Firstly, it adds to the limited body of interpretive corporate governance research in South Africa. Most local corporate governance and accounting research is descriptive and lacks the rigorous theoretical analysis necessary for explaining how regulatory bodies are functioning (see Brennan and Solomon, 2008; Maroun and van Zijl, 2015).

Secondly, the thesis offers evidence in support of the JSE's decision to establish a proactive monitoring review. This process appears to promote compliance with IFRS by listed companies. In particular, coercive and normative isomorphic pressure work on individual accountants and auditors and remind them of the importance of applying IFRS with due care and skill. In this way, the findings suggest that FRIP reviews are an important part of the corporate reporting quality system. At the same time, because these reviews can be used to hold individuals accountable, they assist in preserving confidence in the professional accounting and auditing function. This may be especially important given that, in the aftermath of multiple corporate failures, automatic trust in these expert systems can no longer be taken for granted.

Finally, from a practical point of view, the FRIP provides a means of enforcing the Listing Requirements and Companies Act (2008). As explained in Section 5.1, the FRIP offers a means of actively reviewing financial statements and interrogating instances of non-compliance. Resulting isomorphic pressure is, therefore, indicative of the fact that South Africa's corporate reporting requirements can be enforced and are not just symbolic. For a developing capital market – dependant on maintaining an image of good governance in order to attract foreign

investment – this might be the most important contribution made by FRIP reviews.

### **5.3 Limitations and areas for future research**

Additional research will be required to support these assertions. As discussed in Section 1.5 and 3.2.3, the thesis relies on a relatively small group of experts. It is recommended that future research engage a broader group of stakeholders to understand better the implications of FRIP reviews. For example, it would be interesting to explore the views of investors, analysts and other regulators to determine more clearly the contribution made by FRIP reviews. This should go hand-in-hand with additional theoretical development. This thesis has offered evidence of the FRIP as a source of coercive, normative and mimetic isomorphic pressure. Future research is needed to explain precisely how these contribute to the development of and confidence placed in the accounting and auditing profession in South Africa. As part of this process, the history of some form of monitoring activity by the South African Stock Market, including how this compares with other leading jurisdictions, should be taken into account. More specifically, it would be interesting to contrast FRIP reviews with the equivalent activities carried out by the SEC and FRC. This could include an examination of differences in the technical approaches employed by the monitoring bodies and the approach adopted regarding the identification of non-compliant companies.

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## Appendix 1: Interview agenda

### Questions:

- What is your understanding of the purpose of the FRIP?
- What do you believe the effect of the monitoring has been on the users of the financial statements and the company itself?
- Does review by the FRIP increase the confidence of stakeholders in financial reporting?
- Do you believe the FRIP has resulted in an improvement in the quality of financial statements issued by companies listed on the JSE
- Do you believe the FRIP has adequate authority, autonomy and power to enforce a higher quality of financial reporting?
- Does the FRIP, in your opinion, lead to improved corporate transparency?
- Do you believe the FRIP adds a dimension of legitimacy to the company's financial statements?
- Why do you think the FRIP uses a five-year rotation period?
- Overall, do you have any recommendations on how to ensure high quality financial reports in South Africa?

## **Appendix 2: Ethics clearance**

Ethics clearance was granted by the University of the Witwatersrand. The following is the Ethics Clearance reference: CACCN/1092

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