

# **ISA 510 and ISA 620: relevance of, and practical implications for South African external auditors**

**A research report submitted by**

**Marianne Kok**

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**Ethics Number: CACCN/1062**

**Student number: 349310**

**Tel: 071 688 1228**

**Supervisor: Professor W. Maroun**

## Contents

I	Declaration .....	1
II	Abstract .....	2
III	List of abbreviations, acronyms and useful definitions.....	3
1	Introduction .....	6
1.1	Purpose, context and significance .....	6
1.2	Assumptions .....	9
1.3	Limitations and delimitations .....	9
1.4.	Structure of the research report .....	10
2	Literature review .....	11
2.1	Development of the South African audit profession .....	11
2.1.1	A brief history of the South African auditing profession.....	11
2.1.2	The Independent Regulatory Board for Auditors (IRBA) .....	12
2.1.3	Codes of corporate governance .....	14
2.2	Prior academic research .....	14
2.3	Overview of relevant International Standards on Auditing (ISA) .....	16
2.3.1	Objective of the audit .....	16
2.3.2	ISA 510 – Initial audit engagements.....	17
2.3.3	ISA 620 – Using the work of an auditor’s expert.....	19
	<i>Overview of ISA 620.....</i>	19
	<i>Relevance of ISA 620 in practice.....</i>	21
2.3.4	Comparison of ISA 510 and ISA 620 in terms of audit activity and process .....	23
2.4	Understanding the inconsistencies between ISA 510 and ISA 620 .....	23
3.	Method .....	25
3.1	Research paradigm .....	26
3.2	Interviews.....	26
3.2.1	Developing the interview agenda.....	27
3.2.2	Sample .....	27
3.2.3	Design.....	28
3.2.3	Data collection.....	29
3.2.4	Data analysis .....	30
3.2.5	Validity and reliability.....	31

3.3	Ethical considerations.....	32
4.	Findings.....	33
4.1	ISA 510 .....	33
4.1.1	The relevance of ISA 510.....	33
4.1.2	Nature, timing and extent of procedures .....	36
4.1.2	The rationale for ISA 510.....	38
4.2	ISA 620 – Auditor’s expert.....	41
4.2.1	Relevance of ISA 620 .....	41
4.2.1	Nature, timing and extent of procedures .....	43
4.2.2	Rationale for ISA 620 .....	43
4.3	Similarities and tensions between ISA 510 and ISA 620 .....	45
5.	Conclusion .....	47
5.1	Summarising comments .....	47
	Research question 1: How is ISA 510 interpreted and applied by auditors when gaining sufficient appropriate evidence on opening balances tested by a predecessor auditor? 48	
	Research question 2: How is ISA 620 interpreted and applied by auditors when gaining sufficient appropriate evidence on the work performed by an auditor’s expert? .....	48
	Research question 3: Are there inconsistencies in the approach followed when applying ISA 510 and ISA 620 and what are the implications of any inconsistencies?.....	49
5.2	Contribution of the thesis.....	50
5.3	Limitations and areas for future research .....	51
III	List of references .....	52
IV	Interview Agenda .....	57
V	Ethical clearance.....	59

## I Declaration

I hereby declare that this research report is my own unaided work. It is submitted in partial fulfillment of the degree of Master of Commerce by Coursework and Research Report at the University of the Witwatersrand, Johannesburg. It has not been submitted elsewhere for the purpose of being awarded another degree or for examination purposes at any other university.

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Marianne Kok

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## II Abstract

**Purpose** - The objective of the IAASB's framework for audit quality is to raise awareness about the key elements, namely input, processing, output, interaction and contextual factors. Archival auditing research mainly focusses on input, interaction and contextual factors of the framework. This thesis focuses on the processing element of the audit quality framework. The purpose of this thesis is to explore the rationale for, practical implications and inconsistencies between the extent to which an auditor places reliance on the work of a predecessor auditor versus the work of an auditor's expert.

**Design/methodology/approach** - The research is exploratory / interpretive and qualitative in nature. It relies on detailed interviews with purposeful selected auditors who are involved in assurance engagements.

**Findings** – Both ISA 510 and ISA 620 require a high degree of professional judgement and skepticism from auditors. ISA 510 rules based approach is interpreted as a measure to reduce auditor's risk. Similarly compliance with procedures is seen as a source of normative isomorphic pressure similar to compliance with internal quality control processes established by audit firms. In comparison with ISA 510, ISA 620 poses a lesser audit risk as it is limited to a single transaction or balance. Mimetic isomorphic pressure has been noticed as this standard is continuously being used as part of an audit approach adopted in prior periods.

**Research limitations/implications** - The study is conducted in a South African setting. While limiting the study to ISA 510 and ISA 620 may be seen as a limitation, insight into the practical application of ISAs is limited in archival auditing research. The study also did not deal with audit failures or the loss of confidence in the auditing profession.

**Practical implications** - The introduction of mandatory audit firm rotation will highlight the importance of ISA 510. Change in auditors redirects focus to audit firms' risk assessment processes and the impact of a change in audit methodology.

**Originality/value** - The study contributes to the limited auditing research focusing on the processing phase of the IAASB's framework for audit quality in a South African context. Its practical contribution outlines how auditors apply their professional judgement when using ISA 510 and ISA 620. It can be useful for auditors seeking to improve audit quality and for standard-setters to ensure internal consistency of audit practice.

**Key words:** auditor's expert, audit quality, IAASB, predecessor auditor, isomorphism

### III List of abbreviations, acronyms and useful definitions

Abbreviation / Acronyms	Description
<b>APA</b>	Auditing Profession Act, 2005 (Act No. 26 of 2005)
<b>CPC</b>	Code of Professional Conduct of the South African Institute of Chartered Accountants (CPC, 2013)
<b>IAASB</b>	International Audit and Assurance Standards Board
<b>IRBA</b>	Independent Regulatory Board for Auditors
<b>ISA</b>	International Standards on Auditing
<b>PAAA</b>	Public Accountants' and Auditor's Act No. 80 of 1951
<b>PAAB</b>	Public Accountants' and Auditor's Board
<b>RA</b>	Registered auditor in South Africa with the Independent Regulatory Board for Auditors.
<b>RI</b>	Section 1 of the APA defines a reportable irregularity (RI) as follows: reportable irregularity means any unlawful act or omission committed by any person responsible for the management of an entity, which has caused or is likely to cause material financial loss to the entity.
<b>Big Four</b>	Refers to the 4 biggest auditing firms in South Africa, namely, Deloitte, EY, KPMG and PWC (in alphabetical order).
<b>Audit</b>	The examination of, in accordance with prescribed or applicable auditing standards: Financial statements with the objective of expressing an opinion about their fairness of or compliance with an identified financial reporting framework and any applicable statutory requirements or financial and other information, prepared in accordance with suitable criteria with the objective of expressing an opinion on the financial and other information.
<b>Auditee</b>	Means an institution or accounting entity referred to in section 4 of the Public Audit Act No.25 of 2004, and any group of such institutions or accounting entities whose financial statements are or are to be consolidated in terms of legislation referred to in section (4)(2) of the same Act.

Abbreviation / Acronyms	Description
<b>Audit documentation</b>	The record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached (terms such as 'working papers' or 'work papers' are also sometimes used) (ISA 230 <sup>1</sup> par 6(a)).
<b>Auditor's expert</b>	An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the auditor to assist in obtaining sufficient appropriate audit evidence. An auditor's expert may be either an auditor's internal expert (who is a partner or staff, including temporary staff, of the auditor's firm or a network firm), or an auditor's external expert (ISA 620 <sup>2</sup> , par 6(a)).
<b>Applicable financial framework</b>	The financial reporting framework adopted by management and, where appropriate, those charged with governance in the preparation of the financial statements which is acceptable in view of the nature of the entity and the objective of the financial statements or is required by law or regulation (ISA 200 <sup>3</sup> , par 13(a)).
<b>Audit evidence</b>	Information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information (ISA 500 <sup>4</sup> , par 5(c)).
<b>Firm</b>	A sole practitioner, partnership or corporation or entity of professional accountants.
<b>Client</b>	The person for whom a registered auditor or registered firm is performing or has performed an audit engagement.
<b>Management's expert</b>	An individual or organisation possessing expertise in a field other than accounting or auditing, whose work in that field is used by the entity to assist the entity in preparing the financial statements (ISA 500, par 5(d)).

<sup>1</sup> ISA 230 – Audit documentation

<sup>2</sup> ISA 620 - Using the work of an auditor's expert

<sup>3</sup> ISA 200 - Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing

<sup>4</sup> ISA 500 - Audit evidence

<b>Abbreviation / Acronyms</b>	<b>Description</b>
<b>Predecessor auditor</b>	The auditor from a different audit firm, who audited the financial statements of an entity in the prior period and who has been replaced by the current auditor (ISA 510, par 4(c)).
<b>Third party</b>	Any person who is not a client as defined.



# 1 Introduction

## 1.1 Purpose, context and significance

“Audit quality is much debated but little understood” (Knechel et al., 2012, p.1). Users, auditors, regulators and general society have different views on audit quality. Users may consider that high audit quality equals the absence of material misstatements in financial information. In turn the auditor may define high audit quality as completing all required tasks in conformance with the audit firm’s methodology. Regulators may view high audit quality as compliance with professional standards. Lastly society may view audit quality as a mean to avoid economic downturns in a company or market (Knechel et al., 2012). Knechel et al. (2012) concluded that a balanced scorecard approach to audit quality should facilitate the perceptions of all stakeholders (being the users, auditors, regulators and society). To put audit quality in motion audit firms develop audit approaches or audit methodologies.

Audit approaches evolve over time as society’s information needs change, amendments to regulatory requirements are introduced and client’s value creation processes evolve (Peecher et al., 2007). These attest technologies are a defining feature of the audit profession and contribute significantly to the trust vested in the audit profession by non-expert stakeholders (Kueppers and Sullivan, 2010).

When corporate failures occur, the trust in the audit profession is shaken. The quality and reliability of the audit report is questioned and regulatory measures are introduced to substitute for lost trust in order to ensure the continuing function of the audit system (Unerman and O’Dwyer, 2004). Unfortunately,

“discussions of audit quality tend to occur in the context of alleged audit failures, without recognition that the vast majority of audits stand the test of time” (Kueppers and Sullivan, 2010, p. 286).

One of the reasons for this resilience is the considerable time and effort invested in the development and improvement of technical auditing standards (Byington and Sutton, 1991). While these have not been able to prevent every corporate failure, the codification of acceptable audit practice has been important for ensuring consistent execution of audit engagements, monitoring and review of audit practice and minimum levels of audit quality (see also Power, 2003a; Humphrey et al., 2011; Maroun and Solomon, 2014). An excellent example is the framework on audit quality issued by the IAASB in 2014.

The objectives of the framework are to raise awareness about the key elements of audit quality, encouraging stakeholders to explore ways to improve this and facilitate dialogue among key stakeholders (IAASB, 2014). The framework consists of input, processing, output, interaction and contextual factors at various levels, such as engagement level, firm level, national level and global level. The framework is complemented by ISQC 1<sup>5</sup> which deals with the development and maintenance of quality designed to provide a governance schematic for audit firms and ISA 220<sup>6</sup> which provides guidance on quality control at the engagement level (Bedard et al., 2008). Collectively, these standards are designed to address each 'element' of the audit quality paradigm including<sup>7</sup>:

- inputs in the audit process,
- audit processes,
- outputs of an engagement,
- key interactions and
- contextual factors.

(adapted from IAASB, 2014)

The prior research on audit quality is, however, limited. The majority of international research focuses on inputs or variables which may affect audit quality such as the size of the audit firm (DeAngelo, 1981), length of audit tenure (Geiger and Raghunandan, 2002; Jackson et al., 2008), legislation (Kleinman et al., 2014), and different skills of engagement leaders (Martinov-Bennie and Pflugrath, 2009; Nelson, 2009). The outputs of the audit process have also been tested extensively. For example, there is a large body of work which deals with the effect of external audit on earnings quality (Becker et al., 1998; Piot and Janin, 2007), the accuracy of going concern reports (Geiger and Rama, 2006; Carson et al., 2012) and recommendations for changes in the content and structure of different audit reports (Turner et al., 2010; Mock et al., 2012). At the interactional and contextual level, the research deals extensively with how a client's corporate governance system or prevailing legal regulatory system affects audit quality (Francis, 2004; Holm and Zaman, 2012; Simnet et al., 2016). A technical analysis of audit processes appears to have been overlooked (Maroun and Jonker, 2014). This provides a basis for this research.

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<sup>5</sup> ISQC1 - International Standard on Quality Control 1 - Quality control for firms that perform audits and reviews of financial statements, and other assurance and related services engagements

<sup>6</sup> ISA 220 - Quality control for an audit of financial statements

<sup>7</sup> These elements are discussed in more detail in Section 2.1

The aim of this thesis is to provide an initial perspective of audit quality, using the application of ISA 510 and ISA 620 at a point in time as a type of case study to explore the rationale for and practical implications of inconsistencies between the extent to which an auditor may place reliance on the work of a predecessor auditor versus the work of an auditor's expert. The following sub-questions are addressed:

- How is ISA 510 interpreted and applied by auditors when gaining sufficient appropriate evidence on opening balances tested by a predecessor auditor?
- How is ISA 620 interpreted and applied by auditors when gaining sufficient appropriate evidence on the work performed by an auditor expert?
- Are there inconsistencies in the approach followed when applying ISA 510 and ISA 620 and what are the implications of any inconsistencies?

This thesis makes a number of important contributions:

- As discussed above, there is very little research dealing with audit quality at the technical level. Most of the prior research examines audit quality by testing for changes in inferential / proxy variables (Simnet et al., 2016). How auditing standards are interpreted and applied in a real setting is not dealt with (Humphrey et al., 2011). As a result, this thesis makes an important theoretical contribution by providing a perspective on audit quality grounded in a practical context.
- Related closely to the above, the prior auditing research adopts a positivist framework (Francis, 2004). This body of work has provided a number of important insights on audit quality but is also reductionist. This thesis makes an important methodological contribution by providing primary empirical evidence on how auditing standards are being interpreted and applied by practitioners. In doing so, it adds to the limited body of interpretive research on auditing (Power, 2003b) especially from a South African perspective (Maroun and Jonker, 2014).
- Most importantly, the thesis makes a key practical contribution. It outlines how practitioners apply their professional judgement when using ISA 510 and ISA 620. The research documents' key considerations (including key risk areas), challenges encountered and technical inconsistencies. These findings will be useful for auditors

seeking to improve audit quality and for standard-setters who need to ensure internal consistency of audit practice.

- The subject matter is relevant to all audit firms in light of IRBA's mandatory audit firm rotation movement to revisit current South African auditor legislation and to stay in step with global developments (Independent Regulatory Board for Auditors (IRBA), 2016).

## 1.2 Assumptions

This study assumes that modern society is not characterised by a unique 'truth'. It is a dynamic and subjective collection of competing values, beliefs and rituals which confer meaning to different stakeholders (Walsh and Stewart, 1993; Hopwood, 2000; Rodrigues and Craig, 2007; O'Dwyer et al., 2011). In this context, application of social practice is best understood using an interpretive epistemological perspective and methods which are sufficiently flexible to understand and document 'social dynamism' (Maroun and van Zijl, 2016).

## 1.3 Limitations and delimitations

This research report is subject to limitations and delimitations.

1. Firstly, the research examines the perceptions of a relatively small number of registered auditors (RAs) in South Africa. A small sample is an inherent restriction, given the limited number of individuals knowledgeable about technical audit practice and related legislation, ethics, and corporate governance practices. A small, purposefully selected group of experts (RAs) is also used to ensure that only informed responses are considered (Cohen et al., 2002; Creswell, 2005; Maroun et al., 2011), although this means that responses are not representative of the entire population of RAs (Azam et al., 2011; Collis and Hussey, 2013) (refer to Section 3.2.2 for more details).
2. Only ISA 510 and ISA 620 are considered in detail. A comprehensive review of tensions / inconsistencies between other standards issued by the IAASB or between professional practice guidance issued by other standard-setters is deferred for future research (refer Section 5.3).

3. The study focuses on a single jurisdiction only and concentrates on the application of select professional standards from 2014 to 2015. A longitudinal analysis covering more than one setting is not appropriate at this stage, given the limited body of prior research on audit quality at the technical level (see Section 2.2). The aim of this thesis is to provide an initial perspective of audit quality, using the application of ISA 510 and ISA 620 at a point in time as a type of case study. A more extensive review is a matter for future researchers (refer Section 5.3).

#### **1.4. Structure of the research report**

Section 2.1 provides an overview of the development of the South African audit profession from the 1950's leading to the current legislation and monitoring bodies (SAICA and IRBA) in place. Section 2.1 is further complimented by referring to the presence of prevailing codes of corporate governance in South Africa.

Section 2.2 provides detail of relevant prior academic research which is aligned with this thesis. Section 2.3 is an academic overview of applicable ISAs in the context of this thesis. Considering the topic of this thesis, ISA 510 and 620 will be the focal point, however, a number of other ISAs are relevant. Section 2.3 concludes to delineate an introductory academic comparison of ISA 510 and 620. Section 2.4 links ISA 510 and 620 to the presence of isomorphic pressures in the context of an accounting and auditing environment.

Section 3 deals with the method followed in this thesis. Section 3.1 explains the rationale for using a exploratory / interpretive research paradigm. Section 3.2 explains the reason for the use of interviews, the selection of a sample, data analysis and the measures taken to enhance validity and reliability of the selected method. Section 3.3 closes the chapter with reference to ethical considerations applied.

The findings are discussed in Chapter 4. Distinction in terms of the findings is made between ISA 510 (Section 4.1) and ISA 620 (Section 4.2). Section 4.3 illustrates the interconnectivity between ISA 510 and ISA 620 in terms of the identification of tensions and similarities in audit approach.

Section 5.1 summarises the objectives, key findings and closing remarks of this thesis. Section 5.2 provides the research contribution and Section 5.3 concludes this research report with research limitations and areas for additional research.

## **2 Literature review**

The objective of this literature review is to provide a framework for this research. Section 2.1 provides a summary of the development of the South African audit profession. Section 2.2 considers the status of international auditing-related research. Section 2.3 discusses the applicable ISAs (mainly ISA 510 and ISA 620). The focus is on identifying key technical provisions and the similarities and differences between the standards in order to provide a basis for exploring the application of these standards in a real world setting. Section 2.4 addresses inconsistencies between ISA 510 and ISA 620 by considering DiMaggio and Powell (1983a) model of isomorphism.

### **2.1 Development of the South African audit profession**

Worldwide corporate failures have caused public confidence in the auditing profession to dwindle (Francis, 2004). Globally, the question of whether or not self-regulation is sufficient to ensure minimum levels of audit quality are being hotly debated (Hilary and Lennox, 2005). In response to these failures, South Africa made changes to its own regulatory mechanisms. This section will focus on the changes made to the South African auditing arena, namely, legislative changes and the establishment of IRBA. A brief overview is provided of the history of the South African auditing profession, introduction of an independent regulatory body and the monitoring mechanisms of this body.

#### **2.1.1 A brief history of the South African auditing profession**

The auditing profession in South Africa has been subjected to legislation since the 1950's. The Public Accountants' and Auditor's Act, 51 of 1951 (PAAA) came into operation in November 1951 in an attempt to combine the four already established provincial accountant societies in South Africa (The Republic of South Africa, 1951). The Public Accountants' and Auditor's Board (PAAB) was a direct result of the PAAA and was responsible for the management of the auditing profession, including the registration and control of articled clerks. The PAAB administered the qualifying examinations from 1957 to 1998. The PAAA was updated in 1991 and 1993 to consolidate amendments made since its promulgation. This attests to a commitment to maintaining the auditing profession's standards (The Republic of South Africa, 1951; Puttick et al., 2008).

Up to 2008 South Africa's independent auditing function was mainly a self-regulated function (Odendaal and De Jager, 2008). With the turn of the century and the demise of

multinational corporates, South Africa followed the global trend to overhaul its auditor-related legislation (Puttick et al., 2008). Issues such as auditor independence, partner rotation, segregation of duties, the delivery of non-audit services and inadequate governance structures were specifically considered. Even though some issues had been addressed prior to 2008 in the King Code for Governance in South Africa<sup>8</sup>, this was not legislated (Institute of Directors Southern Africa (IoD), 2002; Institute of Directors Southern Africa (IoD), 2009).

### 2.1.2 The Independent Regulatory Board for Auditors (IRBA)

The PAAA was replaced with The Auditing Profession Act No. 26 of 2005 (the APA). Under Section 3 of the APA, the Independent Board for Registered Accountants (IRBA) was established. IRBA<sup>9</sup> is responsible for the regulation of the auditing profession (The Republic of South Africa, 2005).

#### *Objectives of the APA and the IRBA*

IRBA's priority is to protect the South African public by improving and implementing internationally comparable ethics and auditing standards (Independent Board for Registered Auditors, 2013). The objectives of the APA (2005) are to:

- protect the public by regulating audits performed by RAs,
- establish the IRBA as a truly regulatory body to monitor audit conduct,
- the development and maintain internationally comparable ethical and auditing standards,
- prescribe of measures to advance the implementation of appropriate standards of competence and good ethics in the auditing profession and
- to provide for disciplinary action against RAs with regards to improper conduct.

(The Republic of South Africa, 2005)

#### *Membership of the IRBA*

IRBA's membership is at the discretion of the Minister of Finance (The Republic of South Africa, 2005). IRBA established the Standards Committee for Auditor Ethics and the Standards Committee for Auditing Standards. Appointment to these two committees is at the discretion of IRBA (see Section 22, Auditing Profession Act, 2005). The IRBA also

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<sup>8</sup> King I was issued in 1994 and King II was released in 2002. Both addressed the need for high standards of governance and were broadly applicable to all types of organisations (Solomon, 2010). A detailed analysis of how the King Codes can be applied by the South African Auditing Profession is beyond the scope of this thesis.

<sup>9</sup> IRBA is financed by the auditing profession by means of registration, licence and practice review fees for auditors and government (ODENDAAL, E. M. & DE JAGER, H. 2008. Regulation of the auditing profession in South Africa. *Southern African Journal of Accountability and Auditing Research*, 8, 1-13.

established a disciplinary committee and its disciplinary rules were implemented in June 2007. The supervision of IRBA is within the ambit of the Minister of Finance (Odendaal and De Jager, 2008).

### *Functioning of the IRBA*

The IRBA's processes can be classified as follows: (1) evaluation; (2) standards; (3) practice reviews and (4) registration and disciplinary.

- Evaluation involves IRBA's accreditation model for institutional and programme accreditation. This entails that professional bodies apply for accreditation to serve as RAs or training providers.
- Standards involved the update to the Code of Professional Conduct where the International Federation of Accountants' code was taken into consideration.
- Practice reviews consist of an inspection committee which carries out independent reviews of individual practitioners and firms.
- Registration and disciplinary functions include the minimum qualifications and competencies for auditors. Disciplinary committee hearings are open to the public to promote transparency. As shown in Table 1, the IRBA has in excess of 4 000 registered members and has completed multiple inspections and disciplinary processes from 2014 to 2016.

<b>Table 1: Overview of disciplinary matters handled by IRBA</b>			
	<b>As at 31 December 2016</b>	<b>As at 31 December 2015</b>	<b>As at 31 December 2014</b>
<b>RAs registered with IRBA</b>	4 359	4 311	4 281
<b>Inspections performed</b>			
• Firm inspections	20	37	34
• Engagements	237	384	348
<b>Disciplinary matters</b>			
• Disciplinary initiated	192	100	68
• Disciplinary hearings	6	4	11

(Independent Regulatory Board for Registered Auditors (IRBA), 2016)



### 2.1.3 Codes of corporate governance

Turning to the codes of governance, auditor's actions are monitored by their clients. The King Code of Governance Principles and the King Report on Governance assigns specific responsibilities to audit committees with reference to the functioning of external auditors and its relationship with the entity (King IV adopts a similar approach<sup>10</sup>). This governance responsibility includes the appointment approval of engagements, approval of remuneration, monitoring of reportable irregularities submitted by external auditors, report on independence of external auditors and review of quality and effectiveness of the external auditors (Institute of Directors Southern Africa (IoD), 2009).

In addition to the monitoring functions performed by IRBA (Section 2.1.2) and review processes provided for by King I-III and King IV (Section 2.1.3), the South African auditing profession relies on self-regulatory measures to ensure high quality audit engagements. These internal practices or processes are informed primarily by ISQC 1 and ISA 220. These are discussed in more detail in Section 2.2, followed by a review of the prior academic research on audit quality.

## 2.2 Prior academic research

Table 2 provides an overview of the IAASB's Framework for Audit Quality.

	<b>Engagement level</b>
<b>Inputs (values, ethics, attitude)</b>	<ul style="list-style-type: none"><li>• The values, ethics and attitudes of auditors which in turn, are influenced by the culture prevailing within the audit firm.</li><li>• The knowledge, skills, and experience of auditors and the time allocated for them to perform the audit.</li><li>• The input level is further expanded between audit engagement level, audit firm and national jurisdiction.</li></ul>
<b>Process</b>	<ul style="list-style-type: none"><li>• The rigour of the audit process and quality control procedures impact audit quality.</li><li>• For example, laws and regulations (context) may require specific reports (output) which influence the skills (input) utilised.</li><li>• The process level is expanded for audit engagement, audit firm and national jurisdiction.</li></ul>

<sup>10</sup> At the time of collecting data and preparing this report, King IV was not yet effective. As a result, a detailed examination of King IV and how it differs from King III is not within the scope of this thesis.

<b>Table 2: Audit quality framework</b>	
<b>Outputs</b>	<ul style="list-style-type: none"> <li>• Reports and information which are formally prepared and presented by one party to another, as well as outputs arising from the auditing process that are generally not visible to those outside the audited organisation.</li> <li>• For example, these may include improvements to the entity's financial reporting practices and internal control over financial reporting, which may result from auditor findings.</li> <li>• The outputs from the audit are often determined by the context, including legislative requirements.</li> </ul>
<b>Key interactions in the financial reporting supply chain</b>	<ul style="list-style-type: none"> <li>• While each separate stakeholder in the financial reporting supply chain plays an important role in supporting high-quality financial reporting, the way in which the stakeholders interact can have a particular impact on audit quality.</li> <li>• Can be both formal and informal which will be influenced by the context in which the audit is performed and allow a dynamic relationship to exist between inputs and outputs.</li> </ul>
<b>Contextual matters</b>	<ul style="list-style-type: none"> <li>• There are a number of environmental – or contextual – factors, such as laws and regulations and corporate governance which have the potential to impact the nature and quality of financial reporting and, directly or indirectly, audit quality.</li> <li>• Where appropriate, auditors respond to these factors when determining how best to obtain sufficient appropriate audit evidence.</li> </ul>

(IAASB, 2014)

There is only limited research on South African assurance practice (Maroun and Jonker, 2014). In contrast, from an international perspective, for the period 1995 to 2014, 130 auditing and assurance-based articles were published in leading accredited journals<sup>11</sup>. Six of the 130 articles dealt with assurance services related to matters other than financial statement audits. The remaining 124 articles were classified by Simnet et al. (2016) using a schematic adapted from the IAASB's Framework for Audit Quality (Table 2 above).

<sup>11</sup> Accounting, Organizations and Society; Auditing: A Journal of Practice & Theory; Contemporary Accounting Research; Journal of Accounting & Economics; Journal of Accounting and Public Policy; Journal of Accounting Research; Review of Accounting Studies and The Accounting Review.

Simnet et al. (2016) found that archival research centred on input values and knowledge, key interactions regarding those charged with governance, auditor-regulator relationships, laws and regulations and the audit industry. The process stage of the audit has not been topical in archival research. This is because of the difficulty in gaining access to appropriate data to interpret the quality of certain stages of the audit.

## 2.3 Overview of relevant International Standards on Auditing (ISA)

Research indicates that RAs perform extensive risk assessment as part of the audit process and consider a wide range of risks including business and fraud risks (Paape and van Buuren, 2011). The industry in which an entity operates predicts potential business risks which, in turn, impacts audit risk (Peecher et al., 2007). The applied risk assessment process will lead the auditor to determine the required audit effort (activity and processes involved) necessary for a particular account or assertion. Professional skepticism applied during the risk assessment stage should be constantly reassessed and challenged based on the appropriate audit evidence gathered (Glover and Prawitt, 2013).

Standard-setters and regulatory bodies issue guidance and standards on how auditors should assess and respond to risks associated with potential and current clients. The relevant standards for South Africa are the ISAs (issued by the IAASB). These ISAs prescribe the responsibilities and overall objectives of an auditor when conducting an audit. Five of these standards are reviewed to provide context.

### 2.3.1 Objective of the audit

ISA 200<sup>12</sup> requires an auditor to:

*obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error*  
(par 5).

Reasonable assurance is a high level of assurance which is obtained when the auditor has obtained sufficient audit evidence to reduce the risk of expressing an inappropriate audit opinion. It is important to note that absolute assurance is not required (par 13(m)).

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<sup>12</sup> ISA 200 – Overall objectives of the independent auditor and the conduct of an audit in accordance with International Standards on Auditing

In order to obtain reasonable assurance, the auditor must, according to ISA 315<sup>13</sup>, gain an understanding of the client, its business environment and relevant internal controls (Bentley et al., 2013). This will entail performing risk assessment procedures in the audit planning phase to assess the risk of material misstatement at the overall and assertion level (ISA 330<sup>14</sup>) following which, the auditor designs suitable test procedures to reduce audit risk to an acceptably low level (Hogan and Wilkins, 2008). Of particular interest for the purpose of this thesis is the application of ISA 510 and ISA 620 as part of the process of reducing the level of audit risk.

### **2.3.2 ISA 510 – Initial audit engagements**

ISA 510 addresses the auditor's responsibility relating to opening balances during an initial audit engagement. Initial audit engagement refers to an engagement where the prior period was audited by a predecessor auditor. The incoming auditor has two clear responsibilities relating to the opening balances. The first is to identify any misstatements in the opening balances and the second is to be satisfied that accounting policies have been applied consistently (par 3).

ISA 510 is not the only standard supporting a new audit engagement. ISA 510 should be read with ISA 300<sup>15</sup>. The latter refers to two specific additional procedures in initial audit engagements: quality control for an audit of financial statements and communicating with the predecessor auditor when there has been a change of auditors (ISA 300, par 13). In this way, the extent of the work required when dealing with a new audit engagement is more onerous than a continuing engagement. This is because the RA needs to obtain an understanding of the preceding year's engagement which was performed by a different audit firm (International Federation of Accountants (IFAC), 2008).

It is interesting to note that the Auditing Standards Committee in the U.S.A was of the opinion that, if the predecessor auditor's working papers on its own provide sufficient audit evidence to support the issued auditor's conclusion, no other audit procedures need to be performed (Elder et al., 2009). This is not the case with ISAs. ISA 510 contains prescriptive audit procedures for opening balances and for the consistency of accounting policies. The audit procedures relating to opening balances are as follows:

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<sup>13</sup> ISA 315 - Identifying and assessing the risks of material misstatement through understanding the entity and its environment

<sup>14</sup> ISA 330 -The auditor's responses to assessed risks

<sup>15</sup> ISA 300 – Planning of an audit of financial statements

- The auditor must read the most recent financial statements and previous RAs report, specifically focusing on information relevant to opening balances and disclosures (par 5).
- Thereafter, sufficient audit evidence relating to whether or not opening balances contain misstatements which materially affect the current period's financial statements must be obtained. The auditor must also consider whether or not appropriate accounting policies were adopted to determine the opening balances and if these accounting policies have been applied consistently in the current period's financial statements (par 6).
- In addition to the above, one or more of the following procedures should be executed:
  - review of the predecessor auditor's working papers to obtain evidence regarding the opening balances,
  - evaluate whether audit procedures performed in the current period provide evidence relevant to opening balances or
  - perform specific audit procedures to obtain evidence regarding opening balances (par 6(c)(i)-(iii)).

In the execution of its duties, the auditor applies professional judgement and professional skepticism to certain aspects of the audit. Professional judgement stems from the application of rigorous formal training, knowledge and experience (Jones et al., 2003; Nelson, 2009). Both the incoming and predecessor auditor's ethical standards filter through in the application of professional judgement.

The review of the predecessor auditor's working papers is influenced by the professional competence and independence of the predecessor auditor (ISA 510, par A4; International Federation of Accountants (IFAC), 2008). Considerations of independence and competence of the predecessor auditor appear to be similar to those considerations in ISA 600<sup>16</sup>. However, the IAASB is of the opinion that an incoming auditor is not placing reliance on the work of a predecessor auditor where in ISA 600 an auditor may place reliance on the work of a component auditor (International Federation of Accountants (IFAC), 2008). In the event that the incoming RA could not obtain sufficient appropriate

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<sup>16</sup> ISA 600 – Special Considerations – Audits of group financial statements (including the work of component auditors)

audit evidence regarding opening balances, the auditor will modify the audit opinion (ISA 510, par 10).

### 2.3.3 ISA 620 – Using the work of an auditor’s expert

In 1998 the PAAB introduced *SAAS 620: Using the work of an expert*<sup>17</sup>. Subsequently SAAS 620 was replaced with ISA 620 which requires the RA to evaluate formally the expert’s competence, capabilities and objectivity relating to the specified assignment<sup>18</sup>.

The nature, scope, timing and responsibilities of the auditor’s expert employed may vary and is determined by the auditor. In the event an auditor has limited expert knowledge to gain sufficient and appropriate audit evidence, the assistance of an auditor’s expert will be considered. Once the auditor’s expert completes her assignment, the RA will evaluate the adequacy of work and either place reliance on it or perform additional audit procedures (ISA 620, par 8).

#### *Overview of ISA 620*

In terms of ISA 620 the objectives of an auditor are to determine:

- a) whether to *use* the work of an auditor’s expert and
- b) when using the work of an auditor’s expert, whether that work is adequate for the auditor’s purposes (par 5).

To achieve these objectives, firstly, the auditor is required to assess whether expertise in fields other than accounting or auditing is required. If so, then the auditor will determine whether to use the work of an auditor’s expert (par 7).

Secondly, when the need for an auditor’s expert has been determined, the nature, timing and extent of audit procedures should consider matters including the following:

- the nature of the matter to which that expert’s work relates,
- the risks of material misstatement in the matter to which that expert’s work relates,
- the significance of that expert’s work in the context of the audit,

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<sup>17</sup> SAAS 620 has material implications for the audit of an insurance provider. Prior to 1998 auditors of long-term insurers could exclude from their audit opinions an opinion relating to the actuarially determined policy liabilities and related items. However, since the introduction of SAAS 620 auditors of South African long-term insurers are required to express a statutory audit opinion on the financial statements of the insurer as a whole. The audit opinion expressed will extend to all actuarial related items VON WIELLIGH, S. 2005. Materiality in audits of listed South African long-term insurers. *Meditari: Research Journal of the School of Accounting Sciences*, 13, 189-201.

<sup>18</sup> For example, expertise in the valuation of financial instruments, intangible assets or plant and equipment would need to be considered.

- the auditor's knowledge of and experience with previous work performed by that expert and
- whether that expert is subject to the auditor's firm's quality control policies and procedures.

(par 8 (a) to (e))

Thirdly, the auditor will evaluate whether the auditor's expert has the necessary competence, capabilities and objectivity for the auditor's purposes. In the case of an auditor's external expert, an evaluation of objectivity will include inquiry regarding interests and relationships which may create a threat to that expert's objectivity (par 9).

Fourthly, the auditor will obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:

- determine the nature, scope and objectives of that expert's work and
- evaluate the adequacy of work performed.

(par 10 (a) and (b))

Fifthly the auditor will agree in writing when appropriate, on the following matters with the auditor's expert:

- the nature, scope and objectives of that expert's work,
- the respective roles and responsibilities of the auditor and that expert,
- the nature, timing and extent of communication between the auditor and that expert, including the form of any report to be provided and
- the need for the auditor's expert to observe confidentiality requirements.

(par 11 (a) to (d))

Lastly the auditor will evaluate the adequacy of the auditor's expert's work, including:

- the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence,
- if that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances and
- if that expert's work involves the use of source data that is significant to that expert's work, the relevance, completeness, and accuracy of that source data.

(par 13 & par A38–A39)

In the event that the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor will agree with that expert on the nature and extent of further work to be performed by that expert or perform additional audit procedures appropriate to the circumstances (par 13).

In conclusion, the auditor will not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor will indicate in the auditor's report that the reference does not reduce the auditor's responsibility. If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor will indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion (par 15 & par A42).

### *Relevance of ISA 620 in practice*

ISA 620 is typically applied in the context of testing financial estimates which require mathematical / valuation methodologies not within the scope of an auditor's expertise (Botez, 2008; Glover et al., 2014). As a result, ISA 620 can be read with ISA 540<sup>19</sup> and ISA 545<sup>20</sup>.

ISA 540 deals with the auditor's responsibilities relating to accounting estimates, including fair value estimates, and related disclosures in financial statements (par 1). When a financial statement element cannot be accurately measured, preparers of financial statements are required to use information available to make an accounting estimation. Elements of financial statements where estimates can be expected are allowance for doubtful debts, inventory obsolescence, outcome of long-term contracts, costs arising from litigation settlements and judgements (Botez, 2008). Fair value accounting estimates can include, for example, the following:

- complex financial instruments not traded in an active and open market,
- share-based payments,
- property, plant and equipment held for disposal or
- certain assets or liabilities in a business combination.

(Glover et al., 2014)

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<sup>19</sup> ISA 540 – Accounting estimates

<sup>20</sup> ISA 545 – Auditing fair value measurement and disclosures



The degree and availability of market related information of the element can affect the risk of material misstatement of accounting estimates due to intentional or unintentional bias from the preparers of financial statements (ISA 540, par 8 – 11).

The auditor is required to evaluate the assumptions applied by management in deriving at the estimate, as part of the normal audit procedures (Botez, 2008; Glover et al., 2014). The auditor's evaluation will extend to the reasonable, consistent with market practice or observable. These assumptions are considered in the context of prevailing economic circumstances, plans of the reporting entity and relevance of assumptions made in prior years (ISA 510, par A79).

Auditing of fair value measurements requires considerable judgement. This could be a difficult task as estimates are characterised by subjectivity and future uncertainty. As a result, a number of deficiencies have been noted when testing material estimates (and, as part of this, relying on the work of an expert).

Mauldin and Wolfe (2014) focus on whether or not auditors recognise the insufficiency of reviewing the biased estimation process applied by reporting entities and alternative tests are selected to replace or supplement such a review. They concluded the following:

- only a minority of senior auditors attempted to identify bias in an accounting estimate with increased sampling from the biased estimation process,
- senior managers with strong task and test planning experience make judgements similar to senior auditors,
- regardless of years of experience, some auditors have a flawed perception about the quality of audit evidence,
- auditors often choose inefficient or ineffective tests,
- fifty percent of the sample selected prefer confirmation as an audit procedure opposed to more efficient alternative procedures and
- consultation between members of an audit team may affect judgement, more specifically senior members of an audit team may carry more authority.

The Public Accounting Oversight Board's (PCAOB) view is that practitioners fail to evaluate the reasonableness of management's underlying assumptions and methods (Church and Shefchik, 2011). A body of auditors surveyed responded that PCAOB inspectors did not consider the risk of misstatement and totality of audit evidence

gathered. This disagreement results in a possible inspection risk as auditors may be more focused on managing their inspection risk than on high audit risk areas (Glover and Prawitt, 2013).

#### **2.3.4 Comparison of ISA 510 and ISA 620 in terms of audit activity and process**

When comparing ISA 510 and ISA 620 in terms of audit activity and process, the following differences were noted:

- the field of expertise is not necessarily accounting or auditing when dealing with ISA 620,
- ISA 510 refers to the auditor's responsibility whilst ISA 620 refers to the responsibility of the current RA to obtain sufficient audit evidence,
- ISA 510 makes specific reference to *appropriate audit evidence* versus ISA 620 referring to an assessment of adequacy of the work performed by an auditor's expert,
- ISA 510 review includes historic information, whilst ISA 620 focuses on current information,
- ISA 510 prescribes audit procedures versus ISA 620's matters for consideration,
- ISA 620 requirements may vary depending on the circumstances,
- ISA 510 refers to a predecessor auditor as an *external party* to the current appointed RA, whilst ISA 620 caters for an expert being either an external party or an employee of the same assurance firm,
- ISA 620 has no specific reference to independence of an auditor's expert, whereas the CPC is centred around independent of an auditor or accounting practitioner,
- in terms of ISA 620 an expert will communicate scope limitations and / or period validity of issued report whereas ISA 510 assumes predecessor auditor to attest to previous reported financial information in the current year and
- there appears to be less of a audit activity and processes involved with ISA 620 than with ISA 510.

#### **2.4 Understanding the inconsistencies between ISA 510 and ISA 620**

The thesis assumes that audit is a socially constructed phenomenon (Section 1.2). As a result, understanding the tensions between technical standards requires an appreciation of the institutional context in which auditing has developed and specific standards are applied. For the purpose of thesis, Dimaggio and Powell (1983b) model of isomorphism is used to shed light on why ISA 510 and ISA 620 create different audit approaches

DiMaggio and Powell (1983b) define three types of isomorphic pressure: coercive, normative and mimetic.

### ***Coercive isomorphism***

Coercive isomorphism is often explained in terms of external force exerted on an organisation by a person, entity or institution in a position of relative power (DiMaggio and Powell, 1983a). For example, laws and regulations can be imposed by the state or regulator, affecting how an organisation operates or prohibiting certain types of behaviour. In an auditing context, the operation of the APA is an excellent illustration. As explained in Section 2.1, this legislation defines certain duties in relation to an audit (such as the responsibility to report reportable irregularities to the IRBA). Similarly, the inspection process carried out by the IRBA can reveal non-compliance with auditing standards and result in sanctions for the respective audit firm (refer Section 2.1.2).

It is also possible for coercive isomorphism to operate more subtly. For example, Maroun and van Zijl (2016) explain how public expectation can be a source of indirect (but powerful) isomorphic pressure which drives compliance with generally accepted standards, even in the absence of direct legal authority. Similarly, Louw and Maroun (2017) demonstrate how the possibility of having non-compliance with accounting standards reported publically can work on the minds of individual accountants and auditors, even if there are no direct legal sanctions. The same may apply, by analogy, to the application of auditing standards. Individual auditors may be adhering to prescriptions set by the IAASB, not only because of a statutory duty to comply with ISAs but because of the consequences of being labelled as a poor professional if incorrect application of standards is detected by regulators, peers or clients.

### ***Normative isomorphism***

This type of isomorphic pressure is the result of the professionalisation of the accounting and auditing space. For example, companies seek to comply with codes of best practice, industry standards and the latest governance developments because these are 'external definitions of authority and competency' (Suchman, 1995, p. 589). Demonstrating that a company has aligned with prevailing practices becomes an important means of gaining or maintaining legitimacy. This is especially relevant in an institutionalised accounting environment. Claims to compliance with IFRS and ISAs are a means of demonstrating the credibility and that the organisation is in control of its financial reporting processes and systems (Louw and Maroun, 2017). The same applies in an auditing environment.

The ISAs constitute the dominant discourse for describing the objective of external audit and what constitutes an audit performed with sufficient care and skill (Holm and Zaman, 2012). As a result, audit firms need to demonstrate that they have a thorough understanding of the technical requirements of each standard and that they are applying the relevant prescriptions correctly and consistently. This is not only because of the risk of sanction for non-compliance with ISAs (coercive isomorphism) but because non-compliance strikes at the very heart of professional identity.

### *Mimetic isomorphism*

Finally, when institutional environments characterised by uncertainty, companies can secure legitimacy by copying the actions, processes, systems and outputs of the most prominent entities or those which have already attained status. This is referred to as mimetic isomorphism (DiMaggio and Powell, 1983b). For example, de Villiers and Alexander (2014) show how companies replicate social and environmental disclosures in the annual or sustainability reports of industry leaders to convince users that their reports are of a high quality. Maroun and van Zijl (2016) reveal a similar process at work in the financial reporting setting where the decision to adopt accounting standards early appears to be influenced by the actions of competitors. The same logic can be applied to the way in which auditing standards are interpreted and applied. Specific provisions in the ISAs may be operationalised or the decision to apply a specific ISA may be informed by comparable practices within an audit firm or by its peers.

To test the application of coercive, normative and mimetic isomorphic pressures, the remainder of this thesis examines ISA 510 and 620. The emphasis is on identifying how these standards are being applied, differences in application and whether or not these differences suggests the operation of isomorphic pressures.

## **3. Method**

This section explains the chosen research method. Section 3.1 discusses the difference between positivist and interpretive research and argues the case for the application of interpretive research otherwise known as qualitative research. Section 3.2 explains the reasons for the selection of detailed interviews in the execution of this research, the design of the research questionnaire and the advantages of idiographic research. Section 3.3 to 3.5 details the use of prior literature, data collection, data analysis processes and

limitations respectively. This chapter concludes on the selected research approach in section 3.6.

### **3.1 Research paradigm**

Exploratory research is suitable as a suitable method for exploring little-studied areas (Creswell, 2009). Positivist research usually applies empirical techniques to study a phenomenon in an objective way which results in generalisation of findings (Leedy and Ormrod, 2015). Interpretive research may be considered to be more subjective, as the researcher forms an integral part of the data handling in terms of collection, analysis and interpretation (Creswell, 2009; Leedy and Ormrod, 2015). With interpretive research the researcher attempts to integrate more exploratory techniques to consider any social aspects which may not be measured in a positivist research study. This may result in the validity and reliability of data being questioned when compared to an empirical research method. Nevertheless, interpretive methods can be used to provide a detailed account of findings and an in-depth analysis of the subject matter which positivist approaches cannot achieve (Creswell and Clark, 2007).

This thesis is grounded in an interpretive framework. Historically, auditing research focused on audit quality and its role in the financial reporting process (Simnet et al., 2016). As discussed in Section 1.1, this usually involves testing quality surrogates in keeping with a positivist approach. The technical application of the ISAs during the execution of an audit by individual auditors has not been researched in detail (Section 1.1). In the absence of a substantial body of research dealing with auditing at a technical level, a qualitative approach is suitable. This allows for the generation of detailed findings, taking into account the practical realities of auditing fieldwork practices (Maroun, 2011).

### **3.2 Interviews**

Interviews are a suitable method for exploring little-studied areas (Creswell, 2009; Rowley, 2012). Questionnaires have not been considered as the aim of the research is to gain an understanding of the interviewees' evaluation and application of the ISAs (see Section 1.1). At the outset, it was anticipated that interviews would provide meaningful insights to understand the opinions of respondents on the subject matter, coupled with the limited or related prior research in auditing.

### 3.2.1 Developing the interview agenda

ISA 510 and ISA 620 were used to develop a semi-structured interview agenda. Well-chosen questions dealing with the execution of ISA 510 and ISA 620 in a chronological order were developed, followed by open-ended questions dealing with the interviewees' views on the similarities and differences of these two standards (Rowley, 2012). The questions were divided into three parts: (1) relating to ISA 510; (2) relating to ISA 620 and (3) general questions focusing on independence and competence in comparing the two standards.

The interview agenda was subjected for review by the researcher's supervisor and a visiting professor at the University of the Witwatersrand. It was also piloted with a registered auditor at one of the Big 4 to ensure that it covered the relevant provisions of ISA 510 and ISA 620; is accurate and focuses on the research questions. The pilot interview resulted in no significant adjustments to the interview questionnaire as no material issues were noted<sup>21</sup>.

### 3.2.2 Sample

Purposeful sampling<sup>22</sup> was utilised (Patton, 2002, p. 230). It was a requirement that the interviewees are RAs who are involved in assurance engagements so that they will have an in-depth understanding of the ISAs. The participants' audit clients represented various industry sectors, namely banking, mining, industrial, retail, public sector and SME markets. Participants were chosen from registered audit firms. The sample consisted of audit partners from the Big 4 (4 respondents); second tier firms (3 respondents) and small firms (3 respondents). All respondents are engagement leaders.

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<sup>21</sup> The pilot study took place in Johannesburg during November 2014. Interviews lasted for approximately 55 minutes and were transcribed as detailed in Section 3.3. The pilot interview was included in Chapter 4 as the agenda design was adequate to result in detailed findings.

<sup>22</sup> Purposeful sampling represents intentional selection of participants who have experience in the key concept explored in the study CRESWELL, J. W. & CLARK, V. L. P. 2007. Designing and conducting mixed methods research.

Table 3: Respondents					
#	Firm category	Year's experience	Registered with IRBA?	Experience with Engagement quality control?	Duration of interview
1	Big 4	6 years	✓	✓	55 minutes
2	Big 4	14 years	✓	✓	57 minutes
3	Big 4	10 years	✓	✓	53 minutes
4	Big 4	14 years	✓	✓	65 minutes
5	Second tier	12 years	✓	✓	40 minutes
6	Second tier	4 years	✓	✓	42 minutes
7	Second tier	8 years	✓	✓	49 minutes
8	Small firm	6 years	✓	✓	40 minutes
9	Small firm	18 years	✓	✓	42 minutes
10	Small firm	15 years	✓	✓	52 minutes

### 3.2.3 Design

All interviews were semi-structured to ensure a thorough examination of the subject matter while retaining focus on the research question (Holland and Campbell, 2005; O'Dwyer et al., 2011; Rowley, 2012; Leedy and Ormrod, 2015). As recommended by Rowley (2012), a total of 10 interviews averaging between 40 and 70 minutes were conducted. The aim with a small sample size is to obtain detail and insightful data and not to extrapolate or generalise findings by means of statistical consensus.

The researcher acknowledges that there is a trade-off between sample size and the level of detail obtained from the data collected (Creswell and Clark, 2007; Maroun, 2012). A smaller sample size is an inherent characteristic of qualitative research (Rowley, 2012). The aim is not to generalise findings, extrapolate results or achieve a measure of statistical consensus (Creswell and Clark, 2007). Rather, detailed accounts result which means that, although fewer respondents were involved, the data collected is more extensive and insightful than from with quantitative research (Maroun, 2012; Leedy and Ormrod, 2015). The number of interviews conducted was also informed by the point at

which 'saturation' was achieved. This was achieved after 4 interviews<sup>23</sup> were complete. This was confirmed by completing an additional 6 interviews.

It should be noted that no effort is made to consider the effect of experience, specific industry expertise or other variables (such as cultural background) on the responses received. This is because of the inherently small sample and the initial exploratory aim of this research (see Section 1.4).

### **3.2.3 Data collection**

Interviewees were provided with an overview of the nature and purpose of the research and invited to participate in the study. Confidentiality was guaranteed and participants were offered a copy of the final report on request. Interviews were conducted in person with the exception of one telephonic interview (Respondent 5).

The interview agenda was made available to respondents before the start of the interviews to ensure that respondents were fully aware of the purpose and nature of the interview. This aided in detailed and complete accounts from respondents (Ryan et al., 2002; Creswell and Clark, 2007; Rowley, 2012; Leedy and Ormrod, 2015). As the questions were open-ended, the risk of 'rehearsed' responses is regarded as low (Holland and Campbell, 2005; Rowley, 2012): this contributes further to the validity and reliability of the study.

At the start of each interview, interviewees were asked for permission to record the interview. This assisted with the generation of accurate transcripts as the researcher was not required to make detailed notes of. In addition, recording of interviews allows for unlimited review of recordings to ascertain non-verbal clues and tone of interviews (Holland and Campbell, 2005; O'Dwyer et al., 2011). As per Rowley (2012), the result is the incorporation of a procedurally rigorous method of collecting and processing interview data and improving the quality of findings. The interviewees were allowed to discontinue recordings or withdraw from the study at any stage but none did so. The interviews were recorded with an Olympus 'Voice Tracer' MP3 Dictaphone and subsequently manually transcribed. All voice recordings and transcripts were kept logically and physically secure.

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<sup>23</sup> This was probably due to the fact that the researcher engaged only with very experienced practitioners with a thorough understanding of the technical provisions of the applicable ISAs.



The first few minutes of each interview were spent establishing a rapport with the interviewee who was reminded of confidentiality and there being no 'correct' or 'incorrect' responses. The interviews were then guided by introducing the objectives of ISA 620 and ISA 510. The sequence of questions varied slightly although consistent themes were addressed in each interview (Alvesson, 2003; Rowley, 2012). Albeit the 'academic' nature of the questions, open-ended questions provided an opportunity to explore respondent's answers in more detail. For example respondents supported their responses by practical examples or experiences with audit clients.

Interviews were between 40 and 70 minutes long which allowed sufficient time for themes to be fully explored (O'Dwyer et al., 2011). Interviews took place between November 2014 and March 2015 in Johannesburg and Pretoria at respondents' offices. As all the interviewees are located locally, access to respondents did not pose a threat to the mortality rate of interviews (Creswell, 2005).

#### **3.2.4 Data analysis**

Digitally recorded interviews were transcribed. A general inductive approach was selected for data analysis (Thomas, 2006).

The first step involved multiple readings of the transcriptions. The researcher focused on how the requirements of ISAs were explained by the respondents and how these provisions were being applied. No detailed coding was done at this stage as the aim was to gain a general sense of how respondents were operationalising the professional standards.

The second step focused on the development of categories or emerging themes (open codes). Examples included reasons for changing auditors, technical disagreements among auditors, different views on the technical requirements of the standards and procedures performed when accepting new clients or using the work of experts. These themes were aggregated under axial codes. The axial coding was based on the following data features:

- (1) a category label,
- (2) a category description which includes key characteristics, scope and limitations,
- (3) text or data associated with the category which refers to meanings, associations or perspectives contained within the data and

- (4) linking of categories where a relationship may exist between one or more categories (Thomas, 2006).

This process allowed the researcher to identify different assurance practices and the reasons for these differences. The data were grouped under the different levels/types of isomorphic pressure (coercive, normative or mimetic). These axial codes were also used to organise the findings (see Section 4).

### **3.2.5 Validity and reliability**

Validity and reliability are important considerations for quantitative research (Patton, 2002). In essence, validity and reliability represents trustworthiness, rigor and quality (Golafshani, 2003). Qualitative research is inherently subjective as the researcher has been inextricably involved in the data collection and analysis processes. This is a defining characteristic of qualitative research and not, in itself, a threat to validity and reliability (Creswell and Clark, 2007). However, using detailed interviews has resulted in the research questions being explored in detailed and attempt to avoid reductionist trappings of positive techniques (O'Dwyer et al., 2011). This approach contributed to detailed first-hand accounts of practical difficulties and interpretation encountered in the technical application of ISA 510 and ISA 620 (Creswell and Clark, 2007; Leedy and Ormrod, 2015).

Nevertheless, steps to safeguard validity and reliability of the research were taken.

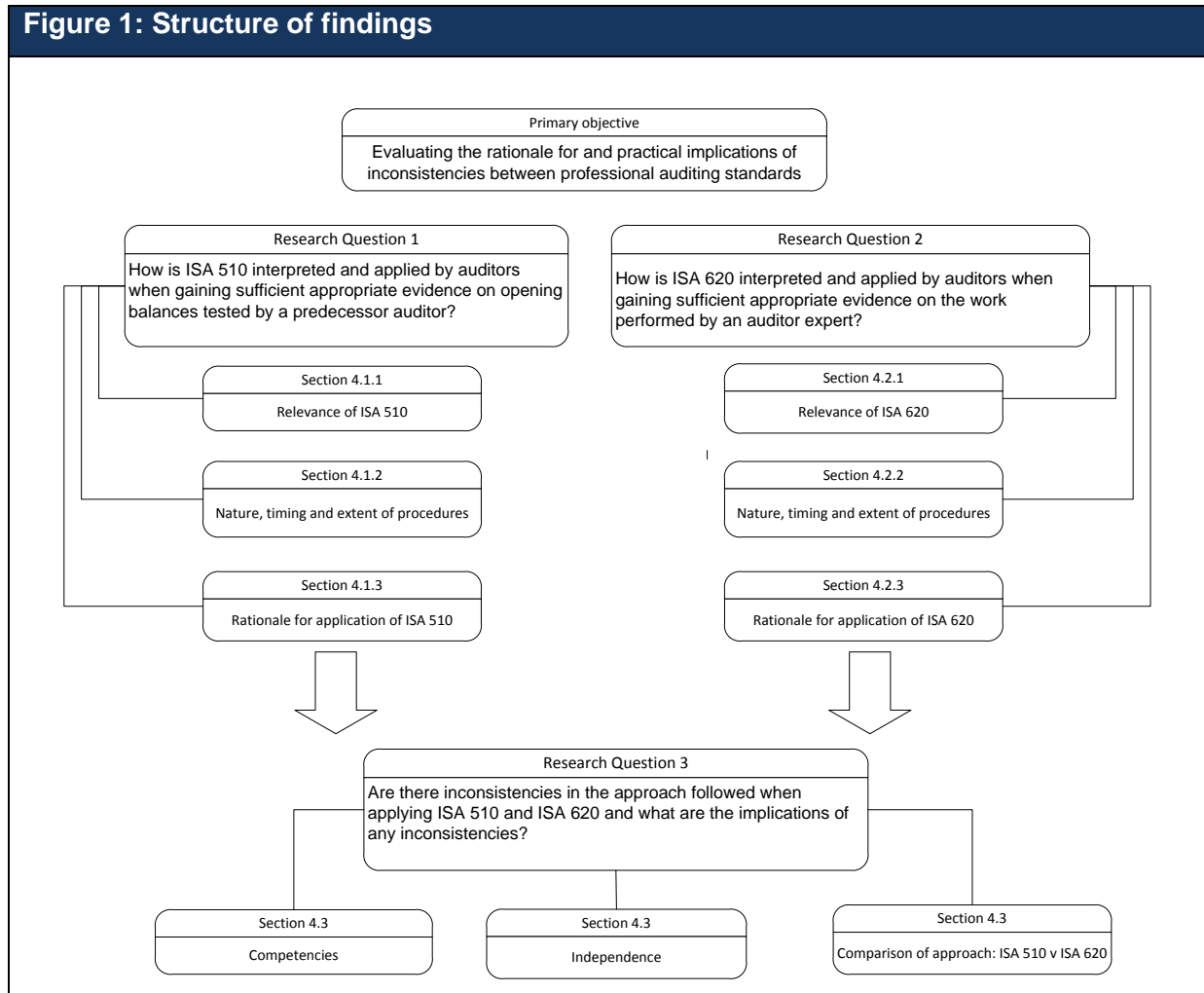
- As explained in Section 3.2.2, only subject experts were engaged to ensure that findings were detailed and accurate.
- The interview agenda was grounded in the professional literature and piloted with two colleagues at the researcher's host university (Creswell, 2009; Rowley, 2012). Each interview started with an explanation of the purpose of the interview and the researcher explained that the results were to be used only in the compilation of academic research (Vaivio, 2006, in Lukka and Modell, 2010). Respondents were told that there were no correct or incorrect responses and were guaranteed confidentiality (see Section 3.2.3). This was designed to prevent respondents providing rehearsed responses or responses based only on what technical standards require them to do.
- As a final safeguard, this research report has disclosed inherent delimitations and limitations (Section 1.3) as recommended by Creswell (2009).

### 3.3 Ethical considerations

- Interviewees were guaranteed complete anonymity. In addition, the data collected by the researcher has not been made available to third parties. The data will be kept for a period of 2 years from the date of the completion of this research report and then destroyed.
- Any quotations which may result in the identification of respondents has been paraphrased or amended with changes clearly indicated.
- Participants were interviewed at their choice of location in order to for them to feel comfortable. Interviewees could also discontinue the interview at any time (Creswell, 2009).
- All respondents were offered a copy of the final report.
- Finally, as interviews can be classified as moral enquiry, the required ethics clearance was obtained from the University of the Witwatersrand (Annexure V).

## 4. Findings

This chapter documents the findings from the detailed interviews. Figure 1 shows how the results are structured.



### 4.1 ISA 510

#### 4.1.1 The relevance of ISA 510

ISA 510 is applicable where an audit client changes its appointed audit firm<sup>24</sup>. The reason for change plays a role in the audit procedures of the incoming auditor. The noted reasons for change in auditors are as follow:

- disagreement or difference in opinion between client and predecessor auditor (R2, R5),
- auditor rotation policy initiated by the entity's audit committee<sup>25</sup> (R1),

<sup>24</sup> Audit partner rotation or change of engagement partner within an audit firm is not subject to the application of ISA 510.

- difference in interpretation and application of IFRS (R2),
- smaller firms do not have the capacity or technical ability to service an expanding client (R3),
- perception of value gained from external audit provider decreases (R5) and
- breakdown in relationship between audit firm staff and audit client (R5).

Respondents indicated that the adherence to the CPC (in terms of conflict of interest, independence and competence requirements) is a primary consideration for accepting a new audit engagement (R2, R3, R4, R5, R6,). The Big Four firms have developed policies and procedures to address requirements in the CPC. Furthermore, the reputation, type of industry and products of the potential client should not negatively impact the audit firm (R2, R3).

The client's governance structure is considered. For example, auditors take into account who the members of a client's board of directors in order to assess the managerial tone (R3, R4). From a general risk assessment perspective, the timing and any delays with the previous year's audits are also considered as there is a difference between an audit completed shortly after year end and an audit which is only finalised long after year-end. The latter is indicative of a 'messy client' and, as a result, a greater level of audit risk (R3).

Once the assessment of ethical considerations (per the CPC) is complete, auditors apply ISA 510. Respondents discussed a number of instances where ISA 510 is relevant. Each is discussed below.

### ***Risk assessment – review of financial statements***

The risk assessment for listed entities differs from privately owned entities as the needs of the stakeholders are different (R1, R3, R8, R9). For example, consideration is given to what management wishes to overstate and the potential fraud areas (R1). A common departure point for performing the risk assessment is a review of the most recent financial statements in order to determine the materiality and potential future impact of each financial statement line item (R1, R2, R3, R4). Basic analytical review of the previous year's financial statements is used to 'understand the numbers', the 'history of movement in account balances' and 'types of audit reports issued' (R3). In addition the status of the

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<sup>25</sup> Data collection predated the introduction of firm rotation rules released by the IRBA in 2017. An analysis of the impact of mandatory audit firm rotation on the application of ISAs is beyond the scope of this thesis.

previous audit report and the presence of any possible reportable irregularity<sup>26</sup> are considered (R1, R2, R3, R4, R5, R6, R7).

### ***Compliance with IFRS***

The review of financial statements involves taking into account whether or not there are complex balances and transactions. The aim is to assess the risk of a disagreement between the incoming auditor and the client because of differences in the interpretation of accounting standards. One expert explained as follows:

‘...the last thing you want to identify is the previous auditor had a disagreement on a technical matter that the client is shopping around to get the right opinion and that you then accept the client and challenged with a similar view’ (R2).

Review of the financial statements provides a sense of whether the accounting framework and selected accounting policies have been complied with or not (R1, R2, R3, R4, R5, R6 and R7). R1 and R2 commented explicitly on the difference in interpretation on the application of IAS 39 and IFRS 9 between the Big Four relating to areas of judgement. Areas of possible restatement due to a difference in interpretation of IFRS need to be raised early in the new client-auditor relationship (R1, R2, R3, R4).

### ***Review of predecessor auditor’s working papers***

Compliance with selected accounting policies will be further validated when reviewing the predecessor auditor’s working papers (Section 3.1.2). Analytical review of financial performance is key, with special attention given to areas where management judgement is present and how these areas have been disclosed in the financial statements (R2, R4, R5). Attention is given to previous year’s issues reported in the external audit management letter and the schedule of unadjusted audit differences (R5). The accounting framework adopted and the application of certain IFRS’s are considered, specifically where there may be a difference in interpretation among the Big Four.

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<sup>26</sup> Section 1 of the APA defines a reportable irregularity as follows: reportable irregularity means any unlawful act or omission committed by any person responsible for the management of an entity, which — (a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or (b) is fraudulent or amounts to theft; or (c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof.

Where the opening balances have not been subjected to an audit in the prior year or the predecessor auditor is not willing to have a discussion with the incoming auditor, the opening balances will be subjected to a full audit to ensure that they do not have a material impact on the current year's results (R4).

A determining factor noted by all respondents is whether or not access to the predecessor auditor's working papers can be established (R1, R2, R3, R4, R5, R6, R7, R8). Access to predecessor auditor's working papers is more dependent on *who* the predecessor audit partner was and not so much the firm' (R5). More reliance or comfort is gained from an audit firm with international alliance (R5). Access to the predecessor auditor's working papers influences the nature, extent and timing of the audit procedures for opening balances (discussed in more detail in Section 3.1.2).

#### **4.1.2 Nature, timing and extent of procedures**

The nature, timing and extent of audit procedures is dependent on whether or not access to the predecessor auditor's working papers can be achieved. If not the auditor is required to perform alternate procedures in order to gain comfort over opening balances. This section will focus on the nature, timing and extent of procedures employed by the incoming auditor.

In some instances a verbal discussion with the predecessor auditor could suffice if the initial risk assessment of the entity is perceived to be low. The Big Four firms seldom obtain clients from smaller audit firms while there is moderate client movement between the Big Four and the Second Tier firms (R1, R2, R3).

The Big Four firms were in agreement about the level of staff who will address ISA 510. For a listed entity, the initial review will be performed by a partner and, for smaller entities, by a competent manager with partner oversight (R1, R2, R3 and R4).

Access to the predecessor auditor's working papers is the easiest and the preferred procedure. If access to the predecessor auditor's working papers or a discussion can take place, the main consideration is to understand the predecessor auditor's assessment of materiality and errors found. If available, the schedule of adjusted and unadjusted audit differences will be reviewed or discussed with the predecessor auditor (R1, R2, R3, R4). The schedule of unadjusted differences assists with 'the identification of a possible trend for misstatements' (R4). Prior year's management letter, if made available, will also be

scrutinised to establish the risk of misstatement in opening balances. If possible a review of the main assertions will be helpful to understand the scope of the prior year's work (R3).

The discussion or meeting with the predecessor partner provides further information. The objective is to identify areas of concern noted by the previous auditor and gain a sense of skill/competency of the previous audit team. This can take into account, not only the work done at the current client, but also the outgoing partners' portfolio and how long she has been in practice:

'You ask: "what other clients are you doing?" "How long have you been the auditor of this one" and "how long have you been an auditor?" Those basic things – to understand independence and to understand competency – are an integral part of the nature, timing and extent of the procedures carried out under ISA 510 (R3).

If access to the working papers of a predecessor auditors and contact cannot be established, alternate procedures on opening balances are performed. Examples provided by the respondents here included walk through procedures or test of detail. In most cases 'substantive testing of the statement of financial position and an analytical review of the statement of profit or loss be the solution' (R4). The application of accounting policies is also reviewed. For example, the process of testing debtor balances for impairments (R1).

#### ***Movement between audit partners within the same firm***

Planned rotation of auditor partners (within the same firm) is different from a sudden change in auditor. In most cases the incoming auditor will shadow the exiting auditor in the final year (R2, R3). This provides comfort and the necessary supporting evidence to opening balances for the incoming audit partner. The audit team and, in most instances, the audit manager are still allocated to the audit client (R1, R2, R3, R4, R5).

The procedures performed on opening balances will be less cumbersome than an in-depth review of the previous year's file. A mere roll forward of balances and a conversation will take place between the outgoing and incoming auditors (R3, R4, R5). However, competence of the previous auditor will still be considered (R3, R4). For the Big Four Firms and the Second Tier firms, the prior year's audit files would have been



subjected to internal quality reviews providing a basis for assessing the rigour of procedures performed on the prior period's balances and transactions (R3).

#### 4.1.2 The rationale for ISA 510

The ISA 510 audit procedures are divided into three areas: opening balances (par 5-7); consistency of accounting policies (par 8) and relevant information in the predecessor auditor's report (par 9).

Respondents had different views on inclusion of specific procedures in ISA 510 (outlined in Section 2.3.2). The most repeated response was that these procedures are common procedures of the Big Four and Second Tier firms' risk management processes (R1, R2, R3, R4, R5, R6, R7). The standard does stipulate minimum procedures but, based on the risk associated with the audit client, the depth and audit work will vary (R4, R5).

All of the respondents felt that ISA 510 is about reducing the auditor's risk. As a result, there was a sense that the ISA 510 procedures had developed over time in response to specific facts or circumstances encountered in practice. Over time, these procedures have become generally accepted. The result is a subtle (but important) source of normative isomorphic pressure to comply with ISA 510.

Whether intended by the IAASB or otherwise, the principles in ISA 510 are being interpreted as rules. Respondents agreed that there were no laws or regulations which directly mandated the application of the procedures in ISA 510. Nevertheless, they felt that they were expected to comply with *all* of the procedures. For example, irrespective of differences in facts or circumstances, all respondents indicated that they will review any available financial information to determine what was and what was not included in the prior period's financial statements, review accounting policy choices made by management and the concerns the audit firm may have with either the industry of the auditee or its accounts (R2). Similarly, while auditors may be able to justify excluding clearly immaterial balances from the scope of ISA 510 testing, 'there are certain minimums' (R4) and '[ISA 510] is one of the standards that you can't bypass so you can't say, "Well, there is no risk in opening balances: I am doing nothing"' (R4).

Respondents justified the strict adherence to ISA 510 on the ground that access to the previous auditor's working papers may not be available. In these cases, ISA 510 provides a practical solution for reaching a conclusion on opening balances. Similarly, the procedures prescribed by ISA 510 are useful if the previous auditor has not divulged

all of the relevant information relating to the opening balances. In this instance, ISA 510 is useful for providing a basis for reaching a conclusion on opening balances and demonstrating that the incoming auditor has obtained sufficient appropriate evidence over the opening balances (R5). From a more critical perspective: 'If the opening balances are wrong you are going to get a wrong end result. It also provides you with an opportunity to gain knowledge of the client's business and it enables you to get some indication of how the client operates especially with small businesses' (R8).

Interestingly, there was also a view that having too much discretion to determine the nature, timing and extent of procedures for opening balances would lower audit quality. This is predicated on the view that, given the increased focus on external regulation of the profession as a whole, specific audit procedures should also become more prescriptive:

"The auditing profession is **fairly regulated** and risk focused. Auditors have an **accustomed mind-set** to pre-engagement activities as part of planning. I think the problem with standards is that they **become too vague so that you allow for too much judgement which means that there is potentially too much room for error**" (R3, emphasis added).

Importantly, the quality of the audit evidence provided by prescriptive procedures was not discussed or referred to. In addition, respondents could not give examples of exactly *how* the use of prescriptive procedures improved audit quality. Normative pressures to demonstrate compliance with the standards means that the technical rationality of the approach for auditing opening balances does not need to be defined or justified. It is sufficient for practitioners to conclude that the nature, timing and extent of their approach for testing opening balances is sufficient because it covers each of the recommended procedures in ISA 510 (R1, R4).

Other ISA standards contain a fair amount of professional judgement on part of the auditor in terms of "you assess a risk and respond to it" (R4). The auditor's response to the level of risk is based on knowledge, experience and competencies (R4). When dealing with opening balances, the incoming auditor is not privy to information relating to the prior period. As a result, respondents feel that ISA 510 'forces the auditor by mandating procedures to ensure that the incoming auditor is covering something' (R4). For this purpose, all of the respondents felt that the detailed procedures listed in ISA 510 'make logical sense without considering access to the predecessor auditor' (R4).

This finding can probably be attributed to the appearance of a *quasi*-scientific approach to testing opening balances which, on the surface, appear to be objective and rigorous (see

Humphrey, 1991). ISA 510 defines specific procedures which needs to be performed in order to demonstrate that sufficient appropriate evidence has been collected. There is little judgement being applied when determining which of these procedures need to be applied and the extent to which they are being relied on. The procedures are also applied without having to place significant reliance on judgements by the predecessor auditor. As a result, respondents suggest that ISA 510 is a useful risk management tool because it creates a clear distinction between audit work performed by the predecessor and incoming auditor. By virtue of the fact that the incoming auditor has 'objectively' tested opening balances, any errors or omissions of the predecessor auditor are, in essence, 'quarantined' (R3, R4).

Ironically, while the user of the audit report is able to rely on the opinion of the predecessor auditor, the same is not the case for one auditor seeking to rely on the work of another (R10). In other words, non-expert users are able to place reliance on claims to professional expertise and independence of the predecessor auditor but, within the profession, professional appearance alone is not enough. This is because the credibility of work performed is being defined on the basis of adherence to formalised test procedures in ISA 510 and not the good faith assumption that all auditors are equally competent (R10):

“Auditors are just human beings, an honest mistake can be made or a deliberate mistake can be made. Not all auditors are professional” (R9).

In this context, normative pressures to perform procedures required by ISA 510 has encouraged the development of internal / firm-level policies which take a procedural approach to testing opening balances. For individual members of the firm, the result is coercive pressure to comply with internal policy and, by default, ISA 510.

For example, respondents explained that pre-emptive electronic working papers are utilised by the Big Four. Their audit software is designed to generate pre-determined procedures based on ISA and other regulatory requirements (R1, R2, R3, R4). These procedures can be mandatory and the individual auditor cannot proceed to the next working paper or online screen unless the procedure has been considered. Alternately, approval from senior partners or representatives from technical departments is required if an auditor attempts to ignore one of the ISA 510 procedures. This is designed to ensure that, at minimum, risk areas and materiality relative to the current year financial statements have been addressed and that the firm can claim compliance with the ISAs (R1, R2, R3, R4).

## 4.2 ISA 620 – Auditor’s expert

### 4.2.1 Relevance of ISA 620

ISA 620 is applicable in an audit where the auditor makes use of ‘an individual or organisation in a field of expertise other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence’ (ISA 620, par 1). The auditor retains responsibility for the opinion expressed. In other words, respondents confirm that an expert cannot not be used as a substitute for the auditor’s own judgement or understanding of the client, its environment and internal controls (R4). Respondents outlined two broad instances when ISA 620 is applicable: when the audit team does not have sufficient skills to test a balance / transaction and when the use of an expert provides complementary audit evidence. Each is discussed below.

#### *Availability of skills*

Respondents agreed that, as client’s business models become more complex, multi-disciplinary skills become essential for understanding audit risks and designing audit procedure to obtain sufficient, appropriate audit evidence (R1, R2, R5). ISA 620 is applicable when required skills are clearly outside the scope of the professional accountant’s expertise (par 2(b)). Examples provided by respondents included:

- Determination of the operating life of a mine – this requires an operating and geological analysis, independent of the accounting for the mine assets and determining monetary values (R3).
- Similarly, the determination of the costs included in an environmental rehabilitation assessment. The auditor would have the expertise to conclude on, for example, the appropriateness and application of the discount rate and subsequent accounting for any changes in estimate. However, the determination of the rehabilitation work which needs to be completed, the timing of those activities and the estimated costs involved require specialised skills unrelated to accounting, finance and auditing (R3).
- Assessments of legal liability which is based on an understanding of the prevailing common law and statutory environment (R1).
- The use of quantity surveyors to determine the stage of completion of construction projects based on surveys of physical work completed to date (R6, R8).

There were also instances where experts were being used to complement the audit team's skills. These typically involved the use of actuaries or qualified valuers to assist with complex mathematical models needed for valuing assets and liabilities such as defined benefit obligations, pension plan assets, credit loss models under IFRS 9 and sensitivity analyses under IFRS 7 (R2, R3).

In most instances, these experts were engaged when the applicable accounting standards required the use of a fair value measurement or disclosure. Respondents confirmed that most cost-based accounting standards (such as IAS 2, IAS 16 and IAS 38) seldom require the use of an expert. In contrast, accountants and auditors appeared to be less comfortable with the methods used to determine fair values (see IFRS 13) and the assumptions of different valuation models. In these cases, an expert is used to provide the necessary assistance, even though, on strict reading of ISA 620, the auditor should be in a position to test these fair values without having to rely on an expert (R8, R9, R10).

#### ***Sufficiency and appropriateness of audit evidence***

Audit clients frequently rely on experts to assist with the measurement of different assets and liabilities. Examples are similar to those referred to above. Respondents all pointed out that, when a client makes use of a management expert, the auditor will typically use her own expert to verify the work performed by the management expert (R1, R3, R7). This was justified on the grounds that the use of an auditor's expert is the most efficient and appropriate approach for confirming complex judgements and estimates made by the audit client's expert (being the management expert) (R1, R2, R5).

As a result, a primary objective of ISA 620 is to draw a distinction between the sufficiency and appropriateness of evidence provided by a client's and an auditor's expert. While these experts may be similar in most respects, the former may lack the same level of independence and objectivity of the audit expert due to a close working relationship with the client (R1, R3, R4, R6). As a result, an auditor cannot, ordinarily, rely exclusively on the work of a management expert (see also ISA 500). Additional audit procedures are required to confirm that key assumptions, chosen methods and the scope of any work performed are sufficient to address the relevant audit risk and to support a conclusion on the respective balance/transaction (R1, R3, R4, R7).

Even in cases when a management expert is not used, some respondents felt that an audit expert could be used to complement procedures performed by the audit team on different balances/transactions, especially when such balances/transactions have the

potential to become material in future periods (R4). For these interviewees, ISA 620 provided a framework for using a form of third party verification usually for the purpose of providing confirmatory evidence of the results of the auditor's own test procedures.

#### **4.2.1 Nature, timing and extent of procedures**

The nature, timing and extent of audit procedures consist of the following:

- assessment of auditor's expert's competence (par 9),
- communication of scope of work and format of deliverable (report) (par 11) and
- testing of auditor's expert's findings or report (par 12).

The assessment of competence, where the auditor's expert is not employed by an audit firm, is based on the person's qualification and experience (R3). Scope of work to be performed, due date and the format of the deliverable are agreed in writing with the auditor's expert (R1, R2, R3, R4).

Where an auditor's expert is already in the employment of an audit firm, the scope of work is also communicated with the auditor's expert. However, the format of the deliverable is known to the auditor's expert as she has been trained in the audit methodology of the respective audit firm (R1, R2, R3, R4). In this case, the auditor's expert is seen as another member of the audit team and is familiar with her firm's quality control policies and procedures (R3, R4).

Once the deliverable is received from the audit expert, detailed testing of the report or findings takes place. This involves the testing of assumptions or estimates applied. Assumptions or estimates are tested or verified, usually by the audit supervisor / manager. Any input data, for example, interest rates or statistical data, is verified against available market data. If a certain methodology was used, the applied methodology will be tested against other available methodology to determine the reasonableness of the methodology applied (R3, R6).

#### **4.2.2 Rationale for ISA 620**

The two technical reasons for the application of ISA 620 were the lack of skills by the engagement team to test certain balances and transactions or the need to obtain complementary audit evidence (Section 2.3.3). In addition to these technical justifications for using ISA 620, respondents suggested that the standard can be used (in some cases)

to limit the auditor's legal liability. It is also possible that the application of ISA 620 is affected by the institutionalisation of the audit environment.

### *Legal liability*

Respondents feel that the audit evidence provided by ISA 620 may be more persuasive than the result of test procedures completed by an audit team. This is because the work has been prepared by individual additional skills / experience. As a result, some respondents feel that using the work of an expert could be useful if balance or transaction was associated with a high level of legal liability risk (R1, R7, R8).

### *Relevance of isomorphic pressure*

There are cases where the use of an expert is required to provide skills which are beyond the competency of a professional accountant. Examples are provided in section 4.2.1). There were, however, instances of auditors applying ISA 620 by default. Instead of considering the nature of the respective balances and transactions, including inherent risk, some respondents automatically concluded that an expert would be required to provide sufficient appropriate audit evidence for material balances (R6, R7, R10).

One respondent provided an example concerning a non-monetary asset which was valued by an expert in prior years. Despite the fact that the state of the asset and applicable market had not changed, the asset was re-assessed each year by an independent expert (R7). Similarly, even in instances where fair value measures were being computed under IFRS 13, experts were engaged to support the work of the audit team on the grounds that this had become standard firm procedure (R10). This suggests that mimetic isomorphic pressures are at work.

As the use of an expert becomes more common on audit engagements, the application of ISA 620 becomes a basis for demonstrating that sufficiently rigorous procedures have been applied to support an opinion on complex balances and transactions. The standard is not being used as part of a rational response to an assessed risk of misstatement but part of a symbolic demonstration that the approach followed for the current audit engagement is consistent with that used in prior periods or by other professional firms (R7, R10). Interestingly, the same claim to technical expertise which has contributed to the legitimacy of the audit profession (Shaked and Sutton, 1981) is at work when it comes to the auditor's decision to place reliance on an expert.

Under ISA 620, the individual engaged to assist the auditor must be a recognised subject expert. The standard also refers to the importance of formal training and membership of recognised professional bodies (par A9 & A15). This is complemented by an assessment of the appropriateness of the methods applied by the expert, any assumptions used and the scope of the work performed (par A33). Similarly, the confidence which non-expert users place in the audit opinion is based on codification of audit methodology, the appearance of rational technical audit procedures and the competency of the independent practitioner (Shaked and Sutton, 1981; Humphrey et al., 2011). In other words, ISA 620 does more than articulate technical processes which are followed when an auditor engages an expert to assist with testing balances and transactions. It provides the discourse for articulating the features of expertise which the layman values in the auditor and which, by analogy, the auditor identifies in her duly appointed expert.

### 4.3 Similarities and tensions between ISA 510 and ISA 620

**Table 4: Similarities and tensions between ISA 510 and ISA 620**

Area	ISA 510	ISA 620
<b>Competency</b>	<p>ISA 510 does not contain an explicit requirement to test the competency of the predecessor auditor (ISA 510, para 5-6). In practice, however, practitioners are taking factors which point to the competency of the predecessor auditor into account (see Section 4.1.2). This process is an informal one and is normally based on word of mouth or past experiences dealing with the predecessor auditor (R3, R9).</p> <p>Assessment of competence for a predecessor auditor is</p>	<p>The auditor is specifically required to consider the competency of the expert (par 9). In practice, this takes into account the following:</p> <ul style="list-style-type: none"> <li>• qualifications,</li> <li>• prior experience (usually in terms of the expert's CV),</li> <li>• evidence of other high profile clients and</li> <li>• academic publications (where applicable).</li> </ul> <p style="text-align: right;">(R3, R7)</p>



**Table 4: Similarities and tensions between ISA 510 and ISA 620**

Area	ISA 510	ISA 620
	dependent on the results of the review of the working papers by an incoming auditor as part of the incoming firm's risk assessment process (R1, R3, R4).	
<b>Independence</b>	Is not required explicitly required in the ISA as independence is embedded in the CPC.	<p>Verification of an auditor's expert form part of the auditing firm's quality control governance processes for:</p> <ul style="list-style-type: none"> <li>• experts in the employment of the auditing firm or</li> <li>• strategic alliance between the auditing firm and a third party firm of specialists (R1, R2, R3, R4).</li> </ul> <p>When an auditor's expert is considered for an assignment with whom the auditing firm has no previous dealing with, independence will be reviewed prior to the assignment (R1, R2, R3, R4, R5, R7).</p> <p>A management expert is not considered to be independent (R1 – R10).</p>
<b>Audit staff used for testing</b>	A mixture of staff may be used. Partner and manager level will be involved with the initial risk assessment, review of the financial statements and interaction with predecessor auditors. Lower levels of staff within the audit team will be involved in detailed substantive testing	Because of the highly technical or complex nature of areas requiring the need of an expert, more senior staff will be involved (R1, R4, R3). However, the verification of input data against market related data can be performed by lower levels of staff within the audit team (R4, R6, R8).

**Table 4: Similarities and tensions between ISA 510 and ISA 620**

Area	ISA 510	ISA 620
	when required (R1, R2, R4, R7, R8).	
<b>Audit approach being applied</b>	The incoming auditor will review the opening balances addressing all assertions because the incoming auditor's audit opinion is applicable to both the current and prior financial year (R2, R4) so the scope of the audit approach will be broader in relation to ISA 620.	The auditor's expert is responsible for a specific ring-fenced area, addressing a single assertion focussing on a limited number of financial statement line items (R2, R3, R4, R7). The auditor is responsible for reviewing the work of the auditor's expert in order to obtain sufficient appropriate audit evidence.

## 5. Conclusion

This chapter summarises the key findings from the detailed interviews and presents closing remarks for each of the research questions (Section 5.1). The contribution to the professional and academic literature is highlighted (Section 5.2) and inherent limitations and areas for additional research suggested (Section 5.3).

### 5.1 Summarising comments

This thesis attempts to address how ISA 510 and 620 are interpreted and applied by auditors in terms of execution of audit approach, gathering sufficient appropriate audit evidence and an understanding of any similarities and inconsistencies on the application of these standards from the perspective of a small sample of auditors. The findings have been interpreted, using DiMaggio and Powell's (1983) model of isomorphism. The three types of isomorphism are coercive, normative and mimetic, are used to identify how ISA 510 and ISA 620 are operationally applied by external auditors.

### **Research question 1: How is ISA 510 interpreted and applied by auditors when gaining sufficient appropriate evidence on opening balances tested by a predecessor auditor?**

ISA 510 contains specific procedures pertaining to the audit of opening balances. The findings detail a definite structured risk assessment process applied by auditors to evaluate the reason for change in auditors. Changes as a result from dispute between the client and the predecessor auditor and different interpretation of IFRSs are considered 'red flag' concerns. Underlying adherence to CPC, ISQC1 are evaluated in line with the client's industry, products and potential client clientele and the strength of governance structures are considered.

ISA 510 is seen as reducing the auditor's risk. Respondents view ISA 510's stated minimum procedures (see Section 4.1.1) developed over time as a response to specific facts or circumstances encountered audit practice. However, these minimum procedures are not seen as enough so all procedures are complied with. These procedures (interpreted as rules) can be seen as a source of normative isomorphic pressure. Normative isomorphic pressure is also evident in the development of internal quality control processes by audit firms and, in turn, coercive pressure is evident where individual auditors (staff) comply with internal policy by default.

### **Research question 2: How is ISA 620 interpreted and applied by auditors when gaining sufficient appropriate evidence on the work performed by an auditor's expert?**

The underlying theme of ISA 620 is where the auditor needs to address an area outside her expertise. The decision to use an expert is that of the engagement auditor and is dependent on the complexity, current materiality and future materiality of a financial statement line item. Respondents agree that, as client's business models become more complex, multi-disciplinary skills become essential for understanding audit risks and designing audit procedures to obtain sufficient, appropriate audit evidence. The use of an expert is useful when the transaction or financial statement line item is associated with a high level of legal liability risk.

An expert can be sourced either from an in-house resource employed by the audit firm or via a strategic alliance with an external firm. For both these two eventualities firm based

quality control measures are in place. In the event of a completely independent expert used, independence and skills verification take place. Sufficient and appropriateness of audit evidence is dependent on the type of expert employed. An expert employed by an audit firm is already trained in the firm's methodology and practices. An expert sourced from a strategic alliance agreement with an external firm would be guided in terms of an agreed upon procedures supported by predefined output requirements. More supervision and guidance is required where dealing with an independent auditor's expert.

The application of ISA 620 is also affected by institutionalism. Mimetic isomorphic pressure have been noticed as the standard is not being used as part of a rational response to an assessed risk of misstatement but part of a demonstration followed by an audit approach adopted in prior years. Mimetic isomorphic pressure is also present in the selection of an ISA 620 expert in terms of formal training, expertise and membership of recognised bodies. ISA 620 does more than articulate technical processes which are followed when an auditor adopts a layman approach and relies on the 'need' to use an expert.

### **Research question 3: Are there inconsistencies in the approach followed when applying ISA 510 and ISA 620 and what are the implications of any inconsistencies?**

At the outset, the following differences are noted between ISA 510 and ISA 620 in that:

- the field of expertise may differ in ISA 620, when dealing with an area which is not within the ambit of the professional accountant,
- ISA 510 tends to focus on appropriate audit evidence in the execution of stipulated audit procedures, whereas ISA 620 entails an assessment of adequacy for the auditor's overall audit opinion,
- ISA 510 classifies a predecessor auditor as an external party to the current year audit engagement, whereas ISA 620 caters for an expert who can be either part of an audit firm, through employment or strategic alliance agreements, or an external party,
- ISA 510 does not consider the independence of the predecessor auditor, where ISA 620 specifically calls for an assessment surrounding independence and
- less audit effort is involved when dealing with ISA 620 compared to ISA 510.

(Section 2.3.4)

Similarities and tensions between ISA 510 and ISA 620 have been assessed in terms of independence, competence and audit approach applied in execution of these two standards.

Independence of the predecessor auditor is not considered when the incoming auditor is reviewing opening balances, while ISA 620 application places significant concentration on the independence of an auditor's expert. An assessment of competence is considered to be a significant matter for both standards, even though ISA 510 does not call for an assessment of competence of the predecessor auditor. All respondents highlight competence (who, firm related, experience, reputation) as an indicator of the risk of misstatement in opening balances. Competence with regards to ISA 620 can be managed by either firms employing either various specialists or having strategic alliance agreements with certain fields of expertise. In the case of the latter, independence confirmation will be called for on an annual basis.

Both ISA 510 and ISA 620, when applicable during an audit, are considered important standards. Coupled with execution and the risk of misstatement attached to balances or transactions, the application of these standards is within the responsibility of a manager or partner level within the audit team. This allocation of responsibility illustrates the extent of judgement and professional skepticism which may be required.

In conclusion when comparing ISA 510 and 620 in terms of audit approach and effort, ISA 510 requires an extensive approach as the auditor is required to address all assertions relating to the opening balances as her current year audit opinion includes both the current and prior financial year. ISA 620, on the other hand, only addresses possibly one or two assertions represented in specific account balance(s), so ISA 620 audit approach can be 'ring-fenced' from other areas within the audit.

## **5.2 Contribution of the thesis**

Simnet et al. (2016) finds that archival research centred on input values and knowledge, key interactions regarding those charged with governance, auditor-regulator relationships, laws and regulations and the audit industry. The process stage of the audit has not been topical in archival research. This is because of the difficulty in gaining access to appropriate data to interpret the quality of certain stages of the audit. This thesis adds to the scant body of research classified as the 'process' in the auditing cycle.

This thesis makes a key practical contribution. It outlines how practitioners apply their professional judgement when using ISA 510 and ISA 620. The research documents key considerations (including key risk areas), challenges encountered and technical inconsistencies. These findings will be useful for auditors seeking to improve audit quality and for standard-setters who need to ensure internal consistency of audit practice.

Taking into account the current developments of mandatory audit firm rotation (Independent Regulatory Board for Auditors (IRBA), 2016), the execution of ISA 510 will be a more than sporadic occurrence for audit firms.

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

This thesis focuses on ISA 510 and ISA 620 in an attempt to demonstrate legitimacy through the presence of isomorphic pressures as defined by (DiMaggio and Powell, 1983b).

This thesis does not deal with audit failures stemming from the application of either ISA 510 or 620, nor the loss of confidence in the auditing profession. Furthermore, the viewpoints of the standard-setters or IRBA have not been incorporated or assessed.

Areas of further research on ISA 510 can be extended to mandatory audit firm rotation and engagement audit partner rotation. The differentiation in the risk assessment process as a result of the impact of a change in audit methodology (firm rotation) in comparison with no change in audit methodology.

The differences in application of certain ISAs, not limited to ISA 510 and 620, between the different size of audit firms can highlight tensions in terms of expertise, resources and interpretation.

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## IV Interview Agenda

### ISA 510 – Initial audit engagements

#### “Objective

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (a) opening balances contain misstatements that materially affect the current period’s financial statements and
- (b) appropriate accounting policies reflected in the opening balances have been consistently applied in the current period’s financial statements, or changes thereto are appropriately accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework” (IAASB, 2008, ISA 510, par 3).

#### Questions:

1. What factors would influence the selection and extent of audit procedures?
2. Based on your experience, what audit procedures do you consider to be most suitable for mitigating the risk of misstatement in opening balances?
3. What audit evidence will you obtain to comply with ISA 510?
4. Why do you think certain audit procedures are stipulated in ISA 510? (E.g. read of recent financial statements and audit reports, review of previous auditor’s working papers, obtain audit evidence whether opening balances contain misstatements that materially affect current period’s financial statements (ISA 510, par 5-9).
5. Is there a difference in the audit procedures when dealing with a predecessor auditor from a different audit firm as opposed to a predecessor auditor from the same firm?

## **ISA 620 – Using work of an auditor’s expert**

### “Objectives

The objectives of the auditor are:

- (a) To determine whether to use the work of an auditor's expert and
- (b) If using the work of an auditor's expert, to determine whether that work is adequate for the auditor's purposes (IAASB, 2008, ISA 620, par 5).

### **Questions:**

6. What factors would influence the selection and extent of audit procedures to conclude that the work of an expert is adequate for the purpose of an audit.
7. Typically what type of audit procedures will you perform when using the work of an auditor’s expert?
8. What audit evidence will you obtain to comply with ISA 620?

### **General questions**

9. In your opinion, is there a difference when assessing the competence of a predecessor auditor (ISA 510) or an auditor’s expert (ISA 620)?
10. Is there a difference when assessing the independence of a predecessor auditor or an auditor’s expert?
11. In your experience, is there a difference in the audit approach when dealing with a predecessor auditor and or auditor’s expert?
12. Do you think there are any similarities or differences between the dealing with a predecessor auditor and or auditor’s expert?

## **V Ethical clearance**

Ethics Clearance was granted by the University of the Witwatersrand. The following is the Ethics Clearance reference: CACCN/1062.