

THE IMPACT OF MANDATORY AUDIT RELIEF ON THE AUDIT PRACTICE

by

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DECLARATION

I, Carla Coetzee (Student no: 23210452), hereby declare that the dissertation

The impact of mandatory audit relief on the audit practice

submitted for the degree of MCom in Auditing at the University of Pretoria, is my own work and has not previously been submitted by me for a degree at another university. Where secondary material is used, this has been carefully acknowledged and referenced in accordance with university requirements.

C Coetzee

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“Thank you God for the wisdom, the strength, the perseverance and the ability”

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ABSTRACT

THE IMPACT OF MANDATORY AUDIT RELIEF ON THE AUDIT PRACTICE

The South African Companies Act 71 of 2008, which came into effect on 1 May 2011, legislated that the financial statements of all public companies and state-owned companies should be audited annually but stipulated that the financial statements of private companies and personal liability companies are only subject to audit if an audit is in the public interest. As a result, certain companies are relieved from mandatory annual audits. This change in regulation had a direct impact on the audit practice, in particular on small and medium-sized audit practices since many of their clients no longer required an audit.

This study determined the impact of mandatory audit relief on small and medium-sized audit practices in South Africa with reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance, and sustainability. A qualitative research approach was used in this study with constructivism as a philosophical worldview. For the purpose of this descriptive research a multiple-case study strategy was followed.

The findings of the study showed a need for the audit of financial statements where an audit was in the public interest. Small and medium-sized audit practices participating in this study changed their goals and strategies as a result of mandatory audit relief with specific reference to a shift from audit services to other service offerings. As a result of the change in service offerings, the small audit practices and medium audit practices that participated in this study experienced an increase in staff with a lower level of qualification than in the past. Although several small and medium-sized audit practices experienced a decrease in the income from audit engagements, there was an increase in practice income from service offerings other than audits. It is clear that small and medium-sized audit practices participating in this study were challenged in their role as training offices for the South African Institute of Chartered Accountants and/or the South African Institute of Professional Accountants. Sole practitioners

participating in this study were mostly concerned about the sustainability of their practices in future. However, the majority of the participants from sole proprietors and small and medium-sized audit practices were of the opinion that the future role of auditors will continue to be important. Overall, in this study the unfavourable consequences of the mandatory audit relief impacted most significantly on sole proprietors, and to a lesser extent on small audit practices, in comparison to the impact of the positive consequences in the case of medium audit practices.

The findings of this study contribute to the existing body of knowledge and provided valuable information to the following role-players in the field of auditing: small and medium-sized audit practitioners, the Department of Trade and Industry, the Independent Regulatory Board for Auditors, the South African Institute of Chartered Accountants, universities and educators of prospective Chartered Accountants (South Africa) and prospective audit trainees.

Key terms: audit deregulation, mandatory audit relief, regulatory reform, small and medium-sized audit practices, SMPs, organisational change.

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LIST OF ABBREVIATIONS

AAA	American Accounting Association
AICPA	American Institute of Certified Public Accountants
APA	Auditing Profession Act No. 26 of 2005
APB	Accountancy Professional Bill
ATC	Approved Training Centre
BEE	Black Economic Empowerment
BN	Board Notice
CAATs	Computer-assisted audit techniques
CAQDAS	Computer aided qualitative data analysis software
CAs	Chartered Accountants
CA(SA)	Chartered Accountant (South Africa)
DTI	Department of Trade and Industry
EME	Exempt Micro Enterprise
EU	European Union
GAA	Global Accounting Alliance
IAASB	International Auditing and Accounting Standards Board
ICAEW	Institute of Chartered Accountants in England and Wales
IFAC	International Federation of Accountants
IAPC	International Auditing Practices Committee
IRBA	Independent Regulatory Board for Auditors
ISA	International Standard on Auditing
ISRE	International Standard on Review Engagements
JSE	Johannesburg Stock Exchange
MAP	Medium Audit Practice
MOI	Memorandum of Incorporation
PAAB	Public Accountants' and Auditors' Board
PAYE	Pay As You Earn
PIS	Public Interest Score
POB	Professional Oversight Board
RA	Registered Auditor
RBA	Regulatory Board for Auditors
RCA	Representative Council of Accountants
RSA	Republic of South Africa

SAICA	South African Institute of Chartered Accountants
SAIPA	South African Institute of Professional Accountants
SAP	Small Audit Practice
SARS	South African Revenue Service
SAS	Statement on Auditing Standards
SMEs	Small and Medium-sized Enterprises
SP	Sole proprietor
UK	United Kingdom
USA	United States of America
VAT	Value-Added Tax

CHAPTER 1

THE IMPACT OF MANDATORY AUDIT RELIEF ON THE AUDIT PRACTICE

1.1 INTRODUCTION

Over the past two decades the South African economy and its legislative framework have undergone immense reform. Many feel that it was almost too momentous while others are of the opinion that change is important to fuel economic growth (Harvie, 2009:1). However, this reform has been fundamental to the future of the country and is driven both by the new democratic dispensation and the pace of change in the global economy (RSA, 2004a).

Changes to a country's company law and audit requirements from time to time are not an uncommon phenomenon (Hevlund, Krijestorac & Roslin, 2010). The United Kingdom (UK) was the first country to provide relief from the statutory audit for Small and Medium-sized Enterprises (SMEs) (Hevlund *et al.*, 2010:13). In the UK legislation, the concept of audit exemption was introduced in the 1994 Regulations to the Companies Act 1985; since then the UK legislation concerning small companies has been amended at various intervals (UK, 1994; UK, 1997; UK, 2000; UK, 2004; UK, 2012; UK, 2015). With each amendment, the scope of the audit exemption was broadened, allowing more SMEs mandatory audit relief.

One of the most significant consequences of the various amendments to the UK legislation from 1994 to 2015, which introduced and expanded the scope of audit exemption, was the fall in the number of audit firms registered with the Institute of Chartered Accountants in England and Wales (ICAEW) (Quick, 2006b). This has had far-reaching implications; audit firms gave up their right to train auditors as a result of forgoing registration (Fearnley, Hines, McBride & Brandt, 2000:305); their offerings changed to focusing on services other than audits (Grant, 2006) and the quality of professional service to SMEs has decreased according to a study by Woolf (2007) who found errors in financial statements where balance

sheets did not balance, as well as issued share capital exceeding authorised share capital.

Until the 20th century, the framework of company law in South Africa was essentially built on foundations put in place by British law in Victorian England in the mid-19th century (Gloeck, 2004). The Companies Act 46 of 1926 was the first act in South Africa that made statutory annual audits compulsory for all registered companies (Union of South Africa, 1926). A major review of the company law was initiated in 1963, which resulted in the establishment of the Companies Act 61 of 1973 (RSA, 2004a).

During the early part of the 21st century, a decision to review and modernise company law was taken by the Department of Trade and Industry (DTI) in South Africa. In its publication entitled *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (RSA, 2004a) the DTI explains the reason for such reform by stating that it was based on the need to bring South African law in line with international trends and to reflect and accommodate the changing environment for business, both in South Africa and internationally. The result of the reform process was the promulgation of the South African Companies Act 71 of 2008 which, in contrast to the mandatory audit requirement in the previous Act, allows for mandatory audit relief (RSA, 2009).

Based on the UK experience resulting from the change in the UK audit regulation as mentioned above, it is of interest whether or not mandatory audit relief for specific enterprises, as implemented in South Africa in 2011, tips the scale favourably towards small¹ and medium-sized audit practices.

A former Project Director: Assurance and Members' Advice of the South African Institute of Chartered Accountants (SAICA) points out that SMEs which are no longer required to have audits, will save money (SAICA, 2012). Those in favour of audit exemption argue that although an audit provides much value to any

¹ For the purpose of this study a sole proprietor is considered as one form of a small audit practice, unless the distinction between a sole proprietor and other small audit practices is evident from the context.

entity, the cost of performing audits for SMEs exceeds the benefits in most instances, while others maintain that the decision not to have an audit may impair an entity's ability to obtain external funding (SAICA, 2012). This is due to financial institutions requiring applications by companies for financial assistance to be accompanied by audited financial statements (SAICA, 2012). The relaxation of the audit requirement for SMEs also affects the capacity of audit practices to train new accountants (Stainbank, 2008:13). Valuable training ground could be lost because, according to a 2006 SAICA survey, respondents were of the opinion that prospective Chartered Accountants (CAs) in small practices then received better training when compared to prospective CAs being trained in large firms (Stainbank, 2008:13). Smaller audit firms that continue to serve as training offices for prospective CAs may experience some challenges complying with the requirement of the Independent Regulatory Board of Auditors (IRBA): that a trainee accountant must receive at least 40% of all training in auditing (Stainbank, 2008:13).

Although some of the consequences of the regulatory reform with regard to mandatory audits in South Africa were mentioned above, little research exists into the impact of mandatory audit relief on small and medium-sized audit practices (Stainbank, 2008; SAICA, 2012, 2013). The Stainbank study (2008) focused on the development of financial reporting for SMEs in South Africa and the implications of recent and impending changes. In 2013, SAICA performed a survey among small and medium-sized accounting practices, but the objective was merely to determine if businesses still prefer audits, which resulted in SAICA advising SMEs "to know where they stand" pertaining to the change in the Companies Act of 2008 (SAICA, 2013).

The purpose of this study is to provide a broader perspective. It aims to determine the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. A qualitative research approach was used in this study, underpinned by constructivism as a philosophical worldview. For the purpose of this research, a multiple-case study strategy was followed (Yin, 2014).

The population comprised small and medium-sized audit practices registered with the IRBA in the Pretoria region (IRBA, 2015e). The researcher used the IRBA classification (IRBA, 2015b) as a guideline and reclassified the sizes of audit practices to focus on the lower end of the audit landscape. Requests were made for interviews to a total of 14 participants who were practicing as sole proprietors and small audit practices as well as medium-sized audit practices; all of them participated in the study.

1.2 DEFINITIONS OF IMPORTANT TERMS

The intention of a definition is to provide as concise a description of a phenomenon or object as possible, but it presupposes an adequate understanding of the totality of the phenomenon. Definitions provide guidance and articulate de facto boundaries for conceptualisation and operational interpretation but definitions are by their very nature defining and limiting (Van Tonder, 2014:14). The concepts for clarification on which this study elaborated are discussed below.

1.2.1 Audit

The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework (IAASB, 2009: ISA 200).

1.2.2 Audit practice

The practice of a registered auditor who places professional services at the disposal of the public for reward (RSA, 2005).

1.2.3 Registered auditor

An individual registered as an auditor with the IRBA, the regulatory board for the auditing profession in South Africa (RSA, 2005).

1.2.4 Professional services

These are services requiring accountancy or related skills performed by a registered auditor including accounting, auditing, review, other assurance and related services, taxation, management consulting and financial management services (IFAC, 2012).

1.2.5 Sole proprietor

For the purpose of this study a sole proprietor is one form of a small audit practice, unless the distinction between a sole proprietor and other small audit practices is evident from the context.

1.2.6 Organisation

A complex entity that is unique and purposeful and guided by leadership. It is constantly evolving and therefore stands in a change relationship with the environment (Van Tonder, 2014:51). For the purpose of this study, an organisation is viewed as a unit of analysis. Terms such as: practice, business, firm, company and corporation, may be regarded as synonyms.

1.3 PRELIMINARY LITERATURE REVIEW

According to Creswell (2014:25) a literature review assists in determining whether the topic is worth studying and provides insight into ways in which the researcher can limit the scope to a required area of inquiry. The literature review also shares with the reader the results of other related studies and links a study to the larger, ongoing dialogue in the literature, filling the gaps and extending prior studies (Creswell, 2014).

As an introduction to the detailed literature review chapters of this study (Chapters 2 and 3), a preliminary review is included in Chapter 1. The literature reviewed for this study is categorised into two sections (chapters). The first

section (Chapter 2) focuses on the origin, regulation and deregulation² of auditing, containing the following sub-sections:

- *Origin of and need for auditing*

The auditing concept, as explained by several definitions, is a process of independent examination with the intention to express an opinion based on a set of criteria to enhance the credibility of financial statements (Anderson, 1977; Flint, 1988; AAA, 1973; IFAC Guideline, 1980; Mautz, 1975; ICAEW, 1980; AICPA, 1973; SAS 1; IAASB, 2009 ISA 200). By studying the history of auditing from before 1840 until recent times, it is clear that historical events, the verdicts of the courts and technological developments have contributed to the constant shifts in the objective of auditing and the role of the auditor (Teck-Heang & Ali, 2008). Even though these have evolved over time, the need for the audit function is still supported by theories, such as shareholder and stakeholder theories. The expansion of owner-managed businesses into entities, where there was a split between ownership and management, resulted in agency theory (Jensen & Meckling, 1976). Stakeholder theory supported the concept of wider accountability (Freeman, 1984). Information asymmetry and the demand for monitoring are among the reasons for undertaking external audits (Andersen, Francis & Stokes, 1993). Where there is a separation of ownership and control, the principal (the shareholder) is willing to incur a financial cost to monitor the activities of the agent (the director) (Adams, 1994:8). The agent is responsible for producing most of the financial information required by the principal. The basic principles of enhancing credibility and reliability of information and increasing the confidence of users underlie the need for the auditing profession (Mentz, 2014:52).

- *Audit regulation*

As the need for auditing increased, the corresponding need for the regulation of the auditing mechanism evolved from nascence to full development. The legal requirements governing the professional auditor were introduced in the UK during 1948 (UK, 1948) and in the United States of America (USA) during 1934

² For the purpose of this study, the term “deregulation” refers only to the audits of smaller companies.

(Defliese, Jaenicke, O'Reilly & Hirsch, 1990). Statutory audits have been compulsory in South Africa since 1926 (Union of South Africa, 1926). In 1963, a major review of the company law in South Africa was initiated which resulted in the establishment of the Companies Act 61 of 1973, which replaced the 1926 Act (RSA, 2004a:5). Although many of the principles and provisions of the 1926 Act were adopted in the 1973 Act (RSA, 2004a:14), the 1973 Act was hailed as "...cutting the umbilical cord" between South African and English company law (RSA, 2004a:14). However, it was still based on the framework and general principles of the English law (RSA, 2004a:14) and still required all registered companies in South Africa to be audited (RSA, 1973).

- *Regulation of the auditing profession in South Africa*

In order to better understand the current state of the auditing profession in South Africa, which relates to the focus of this study, the regulation of this profession in South Africa should be considered. It was first recognised through statute by way of The Public Accountants' and Auditors' Act 51 of 1951 (Puttick & van Esch, 2007:6; RSA, 1951). The Public Accountants' and Auditors' Board (PAAB) was established in terms of this Act, exercising disciplinary powers over the control of the profession, the registration and control of articled clerks and the conduct of examinations (RSA, 1951: section 2, section 23). On 1 January 1980, the SAICA was established. A decade later, in 1991, PAAB consolidated amendments made over the previous few years and updated the terminology owing to the introduction of the Public Accountants' and Auditors' Act No. 80 of 1991 (Puttick & Van Esch, 2007:7; RSA, 1991). In 1997, the Accountancy Profession Bill (the APB) was drafted, which introduced the first model for recognition and accreditation of institutes such as SAICA that was later adopted by PAAB in 1999 (Puttick & Van Esch, 2007:9).

In the early years of this millennium questions were raised internationally regarding audit regulation. This occurred as a result of the collapse of Enron and WorldCom in the USA, and Parmalat in the UK (Teck-Heang & Ali, 2008:6; Khalifa, Sharma, Humphrey & Robson, 2007:837). The focus shifted from self-regulation towards independent regulation of the auditing profession, which resulted in the approval of the Auditing Profession Act No. 26 of 2005 (APA) in

2006. The APA, which revoked the Public Accountants' and Auditors' Act No. 80 of 1991 (RSA, 2005), is still currently the regulation relevant to the auditing profession in South Africa. The statutory body, the IRBA, which was established by means of the APA, controls the auditing profession (also referred to as public accountancy) in South Africa (IRBA, 2015c). Even although self-regulation of the auditing profession was replaced with regulation by a statutory independent regulatory body, the IRBA, in 2006, at that time the financial statements of all companies, regardless of their size and the public interest in them, had to be audited by auditors registered with the IRBA. This requirement changed in 2008 with the introduction of audit deregulation.

- *Regulatory reform*

The UK was the first country to remove mandatory audits for SMEs (Hevlund *et al.*, 2010:13) and developments in corporate law in South Africa have been influenced largely by the UK (West, 2009:15). Various arguments in favour of and against small company audit exemption were raised before and after the legislation on audit regulation was introduced in 1994 (UK, 1994). The regulation, which should be read in conjunction with the criteria for qualification as a small company, uses indicators (turnover, balance sheet total and number of employees) to determine whether a company could be exempt from a mandatory audit (UK, 1992, 1994).

South Africa has undergone fundamental changes since the review of its company law that was initiated in 1963 and which resulted in the Companies Act 61 of 1973 (RSA, 1973). This Act still required a compulsory statutory annual audit for all registered companies in South Africa (RSA, 1973). The first democratic election held in South Africa, in 1994, paved the way towards a new democratic dispensation and a new constitution for South Africa (SA Info, 2015). The reform of corporate law in South Africa became a priority since the 1973 Companies Act was seen as unnecessarily inflexible and a more business-friendly approach was demanded (RSA, 2004a). The South African Companies Act 61 of 1973 (RSA, 1973) was replaced by the Companies Act 71 of 2008 (RSA, 2009). The Companies Act of 2008, which allows for audit exemption of specified companies, was signed into law in 2009 and came into effect on 1 May

2011 (Shev, 2011). The audit exemption regulations of the Companies Act 71 of 2008 (RSA, 2009) could be regarded as a catalyst for change in small and medium-sized audit practices in South Africa.

The second section of the literature study (Chapter 3) focuses on organisational change and audit practices, with the following sub-sections:

- *The organisation concept*

The nature of the organisation has been researched from almost every possible perspective and in multiple disciplines (Shenhav, 1995; Rozman, 2012). Various scholars have defined an organisation (George & Jones, 1996; Wilson & Rosenfeld, 1990; Daft, Murphy & Willmott, 2010; Robbins & Coulter, 2009; Pfeffer, 1997:7; Robey & Sales, 1994; Greenwood & Empson, 2003). As remarked by Van Tonder (2014:14), it is unlikely that agreement will be reached on the definition of the term “organisation”. For the purpose of this study, organisations are defined as complex entities that are unique and purposeful and guided by leadership.

Audit firms are considered to be organisations. In line with the aim of the study, to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa, the literature review focuses on these practices as organisations. Research done on such audit practices by authors such as Goyal (2007), Greenwood and Empson (2003), Ramirez (2009), Jeppesen (2007), Bröcheler, Maijor and Van Witteloostuijn (2004) provides guidelines to gain a better understanding of these kinds of organisations. Apart from the literature as referred to above, regulations and guidelines laid down by governing bodies (IRBA, SAICA, and the South African Institute of Professional Accountants (SAIPA)) have revealed valuable information on the classification, registration and functioning of small and medium-sized audit practices.

A small or medium-sized audit practice is a type of organisation which functions as a proprietorship or small partnership, mostly at a single location relying on traditional services provided to SMEs, with negligible expenditure on human resources and research (Goyal, 2007). They are traditionally organised as

partnerships and do not form part of a national or international network (Jeppesen, 2007; Goyal, 2007). Such practices exhibit homogeneity, allow partners the responsibility for decision-making, allow for customisation to solutions of client problems, are vulnerable to litigation of partners and motivate staff using admission to the partnership as a lure (Greenwood & Empson, 2003). The human capital of these practices (measured by the education and experience of staff members) is an important determinant of the firm's performance (Bröcheler *et al.*, 2004). Auditors can practice in South Africa as partnerships, sole proprietors or companies (where all shareholders are registered auditors and directors of the company) (RSA, 2005).

- *Organisational change*

Korten (1995) and Van Tonder (2014:4) refer to organisational change as one of the most salient features of the last decade. This concept has been defined by various scholars such as Burnes (2004), Van Tonder (2014), and Senior (2002). Based on their views, organisational change is a process with wide implications for an organisation's strategy, processes, people and structure. A framework for such change as put forward by Porras and Silvers (1991) is appreciated because this study focuses on the effect of change. The objective of this study, referred to earlier, may lead to changes in organisations. Such changes need to be managed; therefore change management approaches are needed (Senior, 2002). Such approaches depend on the rate of occurrence of change, the manner in which it arises and its scale (Grundy, 1993; Luecke, 2003; Burnes, 1996, 2004; Bamford & Forrester, 2003; Wilson, 1992; Dunphy & Stace, 1993; Senior, 2002). Different views exist concerning the types of change. For the purpose of this study *Type I* (incremental or step-by-step change over an extended period of time) and *Type II* (disruptive, unpredictable change) as explained by Van Tonder (2014) have been recognised.

- *Process-orientated change theory at organisational level*

Porras (1987:52) identifies four dimensions which define change that will ultimately alter the expectations of people and their on-the-job behaviours. The four dimensions, foundational areas, or streams, of the organisation according to the Stream Organisation Model are organising arrangements, social factors,

technology, and physical setting. These components strongly affect and influence one another and must be designed in line with the environmental demands placed on the organisation while, at the same time, creating work settings and conditions that support members of the organisation (Porras, 1987:70).

Relationships between organisations and their external stakeholders determine internal organisational changes. Adaptation is therefore an ongoing process of adjustment in response to environmental change (Van Tonder, 2014:112). Once it is acknowledged that change is an integral component of the organisation, the need for the management of change will diminish. Change will become as much a common feature of daily functioning as leadership and reward structures (Van Tonder, 2014:52). If this is the case with reference to the impact of mandatory audit relief on small and medium-sized audit practices, the mindsets of auditors will also change and lead to altered forms of practice.

The Stream Organisation Model (Porras, 1987:52), which identifies the four foundational areas as mentioned above, forms the basis of the semi-structured interviews used for data collection purposes in this study.

- *Organisational change in audit practices*

Change is a recurring theme of this dissertation and its application to the auditing profession requires consideration of professionalization. Although there is no fixed set of characteristics that can be recognised for a profession, Defliese *et al.* (1990:52) argue that at least the following characteristics must be present: The formal recognition of professional status by a government body by way of issuing a licence; acquiring specialised knowledge through formal learning; implementing and monitoring a code of ethics to be complied with; recognition and acceptance by the public of the work performed by the member as well as the professional status used, and having a social responsibility towards a client, aside from the work that was performed. In the fifties some of these attributes (systematic theory, authority, community sanction, ethical codes and culture) were already being acknowledged by Greenwood (1957:45-53). Various scholars identified factors that drive change in audit practices. These include factors such as technology developments, globalisation, competition, increased regulation and

focus on commercialisation due to the expansion of services (Lander, Koene & Linssen, 2013; Brock, 2006; Ahroni 1999; Nachum, 1996; Botzem & Quack, 2009; Arnold, 2009; Hart, Schlesinger & Maher, 1992; Gray, 1999; Greenwood & Suddaby, 2006; Ramirez, 2009; Romanelli & Tushman, 1994; Meyer, 1982; Greenwood & Hinings, 1996; Brock, Powell & Hinings, 2007). Change is also evident in small and medium-sized audit practices. One such change event is the relief from mandatory audits introduced by regulatory reform, the focus of this study.

The literature study, as reflected upon above, serves as an introduction to a more comprehensive literature review (refer to Chapters 2 and 3).

1.4 STATEMENT OF THE PROBLEM

The 1973 Companies Act (RSA, 1973) subjected the financial statements of all companies to annual statutory audits. As part of the corporate law reform in South Africa, this Act was replaced by the 2008 Companies Act (RSA, 2009) which came into effect on 1 May 2011. The 2008 Companies Act, read together with the 2011 Companies Regulations and the Close Corporations Act, state that the financial statements of all public companies, state-owned companies and any profit company or close corporation that hold assets in a fiduciary capacity which exceed R5 million in value during the year, should be audited annually (RSA, 2009, 2011, 1984). This legislation furthermore stipulates that the financial statements of private companies, personal liability companies or close corporations, in which there is a public interest, are required to be subjected to annual audits (RSA, 2009, 2011, 1984). As a result of this amendment, specific companies are exempt from mandatory annual audits, which could have an impact on small and medium-sized audit practices. As indicated in section 1.1 little research exists into the impact of mandatory audit relief on small and medium-sized audit practices (Stainbank, 2008; SAICA, 2012, 2013), a gap which this study intends to fill.

1.5 RESEARCH QUESTION

Hoberg (1999:36) indicates that the research problem/question controls the study, sets the limits of the problem(s) concerned, circumscribes procedures that are to be followed, governs the kind of data that may be required and directs the interpretation of the findings. The research question regarding this research topic was:

How did mandatory audit relief impact on small and medium-sized audit practices in South Africa?

1.6 OBJECTIVES OF THE STUDY

The core objective of the study is to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa.

The sub-objectives of the study are intended to:

- Determine the need for a statutory audit and regulatory reform in relation to mandatory audit relief (Chapters 2 and 5).
- Determine the nature of small and medium-sized audit practices (Chapter 3).
- Examine organisational change at an organisational level as well as in audit practices (Chapters 3 and 5).
- Investigate how mandatory audit relief impacts on small and medium-sized audit practices with reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance, and sustainability (Chapter 5).

1.7 RESEARCH METHODOLOGY

1.7.1 Research approach

The researcher made use of a qualitative approach in this study through which she sought a deeper understanding of the views and experiences of audit

partners in small and medium audit practices on this topic.

According to Creswell (1994:162) such an approach is suitable:

- for research on a small and medium scale;
- where the researcher is the primary instrument in the data collection;
- when the data that emerges from a qualitative study is descriptive; and
- when the focus is on the participants' perceptions and experiences.

In this study, the cases identified are small and medium-sized audit practices. The data was collected only by the researcher through semi-structured interviews. The data that has been collected is descriptive and reflects the perceptions and experiences of the participants.

1.7.2 Research design

The research design comprises four distinct components: A paradigm, the strategy, the method and the analysis (Voce, 2005). A paradigm, according to Joubish, Khurram, Ahmed, Fatima and Haider (2011) is fundamentally a worldview, a whole framework of beliefs, values and methods within which research takes place. They note that the research conducted in the decade preceding their study was characterised by a distinct turn towards more interpretive, postmodern and critical practices (Joubish *et al.*, 2011).

Guba and Lincoln (1994:105) argue that the questions concerning research methods are of secondary importance to questions regarding which paradigm is applicable to the research. These authors define the latter "as the basic belief system or world view that guides the investigation, not only in the choices of method but in ontologically and epistemologically fundamental ways." The ontological and epistemological views on which this study is based are discussed in Chapter 4.

The research philosophy that a researcher adopts contains important assumptions about the way in which one views the world. These assumptions underpin the research strategy and the research methods as part of the strategy. The research philosophy therefore relates to the development of knowledge and the nature of knowledge (Saunders, Lewis & Thornhill, 2012:127). Creswell (2014:6) identifies four worldviews: postpositivist, constructivist, transformative and pragmatic. For the purpose of this study, a constructivist philosophical worldview (also referred to as social constructivism) is applicable, which is usually seen as a qualitative research approach (Creswell, 2014:8).

The way in which a researcher asks the research questions inevitably involves him/her in exploratory, descriptive or explanatory research, leading to an answer that is exploratory, descriptive, explanatory, or a combination thereof (Saunders *et al.*, 2012:170). The overall research design of this study is descriptive because the purpose of descriptive research is to gain an accurate profile of events, persons or situations (Saunders *et al.*, 2012:171).

In this study the researcher is concerned with practices that prevail; points of view, or attitudes that are held; processes that are occurring; effects that are being felt or trends that are developing (White, 2005:98). In other words, the researcher intends to determine how mandatory audit relief as stipulated by the Act (“preceding event”) has influenced practices and structures (“*what is or what exists*”) in small and medium-sized audit firms in South Africa.

A research strategy is the methodological link between the philosophy (paradigm) and subsequent choice of methods to collect and analyse data (Denzin & Lincoln, 2005). In choosing a suitable strategy a reasonable level of coherence must be achieved throughout the research design that will enable the researcher to answer the research question and meet the objectives (Saunders *et al.*, 2012:173). A case study strategy was decided upon as this allows researchers to focus on (a) case(s) in order to retain a holistic and real-world perspective (Yin, 2014:4). According to Yin (2014:18) case study research includes both single- and multiple-case studies. For the purpose of this descriptive research, a multiple-case study strategy was followed where results were reported in a

descriptive way. Schramm (1971) believes that the crux of a case study is that it tries to illuminate a decision or set of decisions: why they were taken, how they were implemented, and with what result.

The interview, which is one of the most important sources of case study evidence (Yin, 2014:110), was chosen as the method to collect evidence of this kind in this study. Creswell (2014:194) states that the discussion method also needs to include detail on how the data in the study will be analysed and interpreted, ultimately to make sense of the data in order to report on the findings. A detailed description of the research design is presented in Chapter 4.

1.7.3 Population and sampling

Population can be defined as the entire group of persons or set of objects and events the researcher wants to study (Collins, Du Plooy & Grobbelaar, 2000:147; Roscoe, 1969 as cited in Mouton, 1996:134).

The population for this study comprised all the small and medium-sized audit practices registered with the IRBA in the Pretoria region.

The unit of analysis is a selected audit practice, while the managing audit partner is the participant. For the purpose of this study, using the IRBA's list of audit practices as a guideline, the researcher reclassified the sizes of audit practices as follows:

- Sole proprietors: 1 audit partner.
- Small audit practices: 2-3 audit partners.
- Medium-sized audit practices: 4-5 audit partners.

These three groups were identified as the cases for this multiple-case study. The following number of audit practices for each case was selected: Case 1 (sole proprietors): 7 audit practices with 1 participant each; Case 2 (small audit practices): 4 audit practices with 1 participant each; Case 3 (medium-sized audit practices): 3 audit practices with 1 participant each. Therefore a total of 14

participants who are practicing as audit partners in sole proprietorships, small audit practices and medium-sized audit practices were selected as interviewees and participated in the study.

1.7.4 Data collection

Data was collected by means of personal interviews. These are conversations between the researcher and participants in which the researcher poses questions to the participant. Interviews are typically classified as being structured, semi-structured, or open-ended (Leedy & Ormrod, 2005:184; Mertler, 2009:109; Walliman, 2005:284) and are the principal means of understanding people's experiences and perspectives (Stringer, 2004:64). For the purpose of this study the researcher made use of semi-structured interviews which provided the opportunity to probe areas where she wanted the interviewees to explain, or build on, their responses.

An audio recorder was used during the interviews to record responses rather than a tape-recorder as suggested by Creswell (2014:194). The recordings were externally transcribed for analysis at a later stage.

1.7.5 Trustworthiness of the data

To ensure reliability in qualitative research, an understanding and examination of trustworthiness are essential. Seale (1999:266) states that the "trustworthiness of a research report lies at the heart of issues conventionally discussed as validity and reliability".

Trustworthiness is therefore a matter of concern to readers. Lincoln and Guba (1985:289-329) identify four criteria that must be met to generate that confidence: credibility, transferability, dependability, and confirmability. Each of these criteria is discussed in Chapter 4.

1.7.6 Data analysis

According to Marshall and Rossman (1995:133) and De Vos, Strydom, Fouché and Delpont (2002:339) data analysis refers to the process of organising the data in a creative way for comparison and interpretation. Kumar (2005:240) points out that analysing qualitative data demands the application of content analysis, which refers to analysing the contents of the interviews in order to identify the main themes emerging from the responses.

In the data analysis approaches presented by De Vos *et al.* (2002:339), Terre Blanche, Durrheim and Painter (2006:321-340), Kumar (2005:240) and Miles and Huberman (1994:9), the following steps, as discussed in more detail in Chapter 4, appeared essential and were applied as steps to analyse the data collected for this study:

- preparing data for analysis;
- identification of themes;
- assigning codes to main themes;
- categorising or classifying responses under a main theme; and
- integrating the themes and responses into the text of the report.

Apart from a manual data analysis process as mentioned above, the researcher primarily made use of ATLAS.ti™ as a computer aided qualitative data analysis software (CAQDAS) programme. This software, when used systematically, can aid continuity and increase both transparency and methodological rigour (Saunders *et al.*, 2012:581).

1.7.7 Ethical aspects

Resnik (2011:1) defines ethics as norms for conduct that distinguish between acceptable and unacceptable behaviour. He adds that another way of defining ethics focuses on the disciplines that study standards of conduct, which then leads to a specialised discipline: research ethics, which studies behaviour norms (Resnik, 2011:1).

There are four categories of ethical issues relevant to the respondents in this study: seeking permission to conduct the study, the right to self-determination and justice, the right to informed consent and the right to privacy (Mkhize, 2009:20). More information on these four categories is available in Chapter 4.

1.8 SIGNIFICANCE OF THE STUDY

From the preliminary literature review, the researcher identified the lack of research with reference to the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. Therefore, she is of the opinion that the findings of this study may provide valuable information to various role-players in the auditing profession.

Examples of role-players are inter alia:

- *Current and potential small and medium-sized audit practitioners:*
From the data collected and interpreted in this study, valuable information, specific to the said audit practices, became available regarding various organisational components, which these abovementioned practitioners could consider to ensure their practices are well positioned in an environment influenced by regulations allowing mandatory audit relief.
- *DTI, as the South African regulator for corporate law:*
Responses from participants in this study revealed the practical impact and possible benefits and/or challenges experienced by the given practices as a result of the implementation of mandatory audit relief as introduced by the Companies Act 71 of 2008. Such information could inform future regulatory change.
- *The IRBA, as the regulatory body responsible for regulations and standards in the auditing profession in South Africa:*
The research results reflect how the IRBA requirements impact on small and medium-sized audit practices. This information could assist the IRBA, as the South African regulatory body, in making future amendments regarding the auditing profession. Furthermore the findings could also positively contribute to the IRBA competency framework.

- *SAICA, which is responsible for determining competencies and training of Chartered Accountants (South Africa) (CAs(SA)):*
Audit partners of the selected audit practices, which are accredited and practice as training offices, reflected on the impact of mandatory audit relief. Such information could assist SAICA to evaluate the current training requirements and consider amendments if necessary. SAICA could also adapt its continuing professional development offerings for small and medium-sized audit practitioners accordingly. Findings of this study could also provide valuable input for the SAICA competency framework.
- *Educators, who need to ensure that students obtain the necessary knowledge to qualify as CAs(SA) and registered auditors:*
This research provides insight into the practical application of knowledge content and assists with curriculum changes if needed.
- *Trainees, who must select an audit practice for the required practical training:*
The study clarifies concerns and uncertainties of prospective trainees regarding the impact of mandatory audit relief on small and medium-sized audit practices that will enable them to make informed decisions relating to their practical training.

1.9 LIMITATIONS AND DELIMITATIONS OF THE STUDY

For the purpose of this study, seven sole proprietors, four small audit practices, and three medium-sized audit practices in the Pretoria region have been identified as cases. Although some non-profit companies are also subject to audits, they have been excluded from the scope of this study. None of the Big 4 or any other large audit practices formed part of the sample. The complexity of the research topic may mean that the choice of the number of cases does not adequately represent the population (all the small and medium-sized audit practices registered with the IRBA in South Africa). Critics using a sampling logic might therefore question the acceptability of the study. However, if replication logic rather than sampling logic is used, the study is eminently feasible (Yin, 2014:59).

While the given cases were selected based on specific criteria as identified by the researcher and explained in Chapter 4, there might be other relevant criteria which have not been considered and applied.

The study concentrated only on the views expressed by partners in specific small and medium-sized audit practices. The views of other staff members of these practices were not considered. Other role-players, such as clients, financial institutions, investors, creditors and so forth, were not included in the sample as their views were not part of the objectives of the study.

Lastly, this study is limited in scope to the financial statement audits of profit companies. No consideration was given to the audits of the annual financial statements of non-profit companies.

1.10 CHAPTER DIVISION AND SUMMARY

The study has been introduced in this chapter. Various concepts have been explained, followed by a preliminary literature study. The problem, research questions and objectives of the study were stated. The research methodology was briefly discussed and attention was paid to ethical considerations. The significance of the study was explained while lastly, the limitations and delimitations of the study were mentioned.

Chapter 2 deals with the origin, regulation and deregulation of auditing. The history of auditing prior to 1840 until the present time is reviewed. Attention is given to agency and stakeholder theories which are regarded as the theoretical underpinnings of the need for an audit. Regulation of auditing in the UK, USA and South Africa is studied. In addition, the regulation of the auditing profession in South Africa is elaborated on. Ultimately, this chapter addresses audit deregulation in the UK and South Africa.

In Chapter 3, the literature review continues, with an emphasis on organisational change and audit practices. The organisation concept is reviewed and small and medium-sized audit practices are described, the focus falling specifically on

South Africa. Organisational change and the management thereof are discussed. The organisational components in the Stream Organisation Model are reflected upon as part of process-orientated change theory at organisational level. Finally, organisational change, with specific reference to the factors driving change in audit practices, is examined.

Chapter 4 commences with a statement that this study follows a qualitative research approach. Thereafter the research design is discussed focusing on the paradigm, strategy and philosophy, research method and analysis. Small and medium-sized audit practices, registered with the IRBA in the Pretoria region, have been identified as the population for the study; three groups of these were selected as the cases for this multiple-case study. This is followed by a discussion on semi-structured interviews as the method of data collection. Trustworthiness and analysis of data are explained and reference to ethical considerations concludes this chapter.

Chapter 5 deals with the analysis, findings and interpretation of the data collected. After the cases and participants are presented, the data analysis method is explained. This includes allocating themes and sub-themes, as identified from the responses. The findings and interpretation of each case are presented, followed by a cross-case analysis.

Conclusions and recommendations of the study are included in Chapter 6, with topics proposed for further research.

1.11 CONCLUSION

This chapter has introduced the study and its topic.

It is presented in interrelated parts. Definitions of important terms were presented as well as an overview of the literature. Thereafter, the problem was stated followed by the research question which informed the main objective of the study; to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. This was followed with a presentation of the sub-

objectives of the study: to determine the need for a statutory audit and regulatory reform in relation to mandatory audit relief; to determine the nature of small and medium-sized audit practices; to examine organisational change at an organisational level as well as in audit practices, and to investigate how mandatory audit relief impacts on small and medium-sized audit practices with reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance and sustainability.

The research methodology used to achieve these objectives consists of a literature review to discuss the origin, regulation and deregulation of auditing as well as organisational change and audit practices. This was supported by a multiple-case study based on sole proprietors, small audit practices and medium-sized audit practices, as distinguished by the number of audit partners.

The study has limitations in the sense that a limited number (14) of small and medium-sized audit practices, registered with the IRBA in the Pretoria region, was identified as units of analysis although the population comprised all the small and medium-sized audit practices registered with the IRBA in South Africa. However, as pointed out above, if replication logic rather than sampling logic is used when the findings are evaluated, the study is feasible (Yin, 2014:59). Specific criteria were identified and applied in selecting the cases while there might have been other relevant criteria which were not considered. The study concentrated only on the views of partners in the units of analysis whereas the views of other external role-players or internal role-players were not considered in the study. Furthermore, the scope of this study was limited to financial statement audits of profit companies.

Various stakeholders that could benefit from the study have been identified: current and potential small and medium-sized audit practitioners; the DTI; the IRBA; SAICA; educators and trainees.

The following chapter (Chapter 2) pays attention to the origin, regulation and deregulation of auditing which comprises the first part of the literature review in this study.

CHAPTER 2

ORIGIN, REGULATION AND DEREGULATION OF AUDITING

2.1 INTRODUCTION

The preceding chapter introduced the study by *inter alia*, stating the problem, the research question and objectives of the study. This chapter presents the first part of the literature review, which according to De Vos, Strydom, Fouché and Delpont (2011:134-135) has several goals, such as to assist the researcher in conceptualising the problem, refining it and reducing it to a feasible scope. Creswell (2014:27-28) states that a literature review provides the researcher with a useful background for the problem and knowledge of issues previously researched and discussed by scholars in the selected field of study.

In this chapter, the concept of auditing is reflected upon and the definition of auditing, as applied by the researcher, is highlighted. The history of auditing in the UK dates from medieval times (Matthews, 2013:6) and is reviewed over the period beginning from 1840 to the present time. Following this, agency and stakeholder theories are explained with the aim of providing the theoretical foundation to the study. The origin and development of audit regulation in the UK and USA, as well as a historical review on audit regulation in South Africa, are also examined. This is followed by an appraisal of the audit deregulation as it took place in the UK and South Africa.

The focus was placed on the history of the UK because not only were the South African developments in formal corporate structures largely influenced by the UK (West, 2009:11,15) but the UK removed the statutory audit for small companies more than two decades ago (UK, 1994). As audit deregulation is the concern of this study and since the said deregulation became a reality in South Africa only in 2011, the UK experience provides an interesting context for this study. It casts some light on the impact of audit deregulation on small companies over a considerable period: insights which contribute towards the understanding of this

phenomenon in a South African context. The next section, on the origin of and need for auditing, provides a departure point.

2.2 THE ORIGIN OF AND NEED FOR AUDITING

In the section below, the auditing concept is clarified as described and defined by various authors and ultimately defined for the purpose of this study. This is followed by a discussion on the audit history of the UK and the USA as part of the historical review of auditing. Agency and stakeholder theories are identified as the theoretical underpinning of the need for an audit. The rationale for this decision is explained in the subsequent discussions on the theories.

2.2.1 The auditing concept

Anderson (1977:6) clarifies the origin of the word “audit” by stating that the ancient records of auditing were mostly restricted to public accounts. Those accountable for their handling of public funds presented themselves before a responsible official, “known as the auditor, who listened to their accounting”.

In general, definitions of the term “audit” relate to a specific situation; they identify the particular objectives of an audit and responsibilities of the auditor in that situation (Flint, 1988:5). One of the more widely used definitions is that of the American Accounting Association (AAA) Committee on Basic Auditing Concepts (AAA, 1973:2) which states that: “...auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users”.

The International Federation of Accountants (IFAC) Guideline (1980:9), issued by the first International Auditing Practices Committee (IAPC) of IFAC, mentions that: “The objective of an audit of financial statements prepared within a framework of recognised accounting policies, is to enable an auditor to express an opinion on such financial statements. The auditor’s opinion helps establish the

credibility of the financial statements”. Mautz (1975:17) puts this in very simple terms, saying that audits “...add credibility to financial statements”.

The foreword to the Professional Auditing Standards and Guidelines in the UK asserts that, “An audit is the independent examination of, and expression of an opinion on, the financial statements of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with any relevant statutory obligation” (ICAEW, 1980).

In the USA, the American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 1 declares: “...the objective of the ordinary examination of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles” (AICPA, 1973: SAS 1).

Despite it being evident that various definitions of the concept of auditing have been used worldwide, some particular similarities can be identified, which define an audit as:

- a process of independent examination;
- whereafter an opinion is expressed;
- based on a set of criteria; and
- which provides credibility to financial statements.

These elements are included in the current definition of an audit as set out in the International Standard on Auditing (ISA) 200, applicable in South Africa and which is therefore applied in this study: “...the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material aspects, in accordance with an applicable financial reporting framework” (IAASB, 2009: ISA 200).

Although the above definition provides the exact meaning of the auditing concept, in order to gain a holistic perspective on the origin and need for an audit, it is necessary to focus on the history of auditing as well as agency and stakeholder theories as theoretical underpinnings. These topics are discussed in the following sections.

2.2.2 History of auditing

In 1988, Lee in his introduction to his collected edition of previous writings on the history of auditing makes the point: “As a subject, the history of auditing has received little attention” (Lee, 1988). A few years later he again recognised that the early historical development of auditing had not been well documented (Lee, 1993). Two decades later, Matthews (2013) added to Lee’s statement by observing that little had changed since then. He found that the general histories of accounting; for example, Brown (1968), Woolf (1912), Littleton (1981) and Stacey (1954) contain due reference to the auditing function but not in proportion to the extent to which the auditing profession earned its living (Matthews, 2013:1).

Although the history of auditing is not well documented, Brown (1962) emphasises that the objective and techniques of auditing have changed during the four hundred years of its recognisable existence. This could be ascribed to the changes in economic, political and sociological environments which influenced the needs and expectations of society (Teck-Heang & Ali, 2008:1). Flint (1988) rightly states that the aim of an audit has always been dynamic rather than static. Therefore, a review of the history of auditing enables one to understand, analyse and interpret the development and evolution of auditing as a result of the changes in contextual factors that influence the expectations of society.

2.2.2.1 Prior to 1840

The audit in the UK dates from medieval times, when the auditor on landed estates literally heard the accounts read out and checked on the lord’s behalf that

his steward had not been negligent or fraudulent (Matthews, 2013:6). The term “auditing” originated from the Latin word *audire* which literally means “to listen” (Morwood, 2005:221).

Defliese *et al.* (1990:8) agree that the literal interpretation of the word audit was initially applied by reference to audits that were already being conducted in 1200 in the City of London and executed in the presence of inhabitants of the city and members of government. The accounts so dealt with were read out by the treasurer for the attention of the auditor (Defliese *et al.*, 1990:8). The auditors in this period (the 1200s), also referred to as audit officers, were appointed to make sure that the state revenue and expenditure transactions were properly accounted for (Gul, Teoh, Andrew & Schelluch, 1994:1). Therefore, such examination of accounts by the auditor was to prevent fraudulent actions (Abdel-Qader, 2002). Up to this point in time, auditing had little commercial application since industries during this period were mainly individually owned and managed (Porter, Simon & Hatherly, 2008:26). Business managers had no need to report to owners on their supervision of resources, which resulted in minimal use of auditing.

In the second part of the 16th century, another form of corporate firm appeared in England, known as the joint stock company (Watts & Zimmerman, 1983:622). In these companies, the officers of the company traded on behalf of all the members or shareholders and, consequently, the first joint stock companies were annually audited (Watts & Zimmerman, 1983:624). These accounts were still voluntarily audited by a committee of members (shareholders) and/or directors and this practice continued into the eighteenth and nineteenth centuries.

As trading and manufacturing companies multiplied in the eighteenth century, accountants were commonly employed as auditors to check that all was in order with the investments of partners or shareholders (Edwards 1989:37). During this period, auditing was restricted to performing detailed verification of every transaction. The use of sampling testing during the audit was an unknown practice, as was the existence of internal control. The audit objective was

primarily to confirm the honesty of those charged with fiscal responsibilities (Teck-Heang & Ali, 2008:3-4).

The most significant enhancement of the audit process was brought about by industrialisation, which changed the economic environment in the nineteenth century: "...developments in the economic structure of civilizations caused audit needs. Industrialization created the need for financing. This created, in turn, the need for incorporation. And this created the need for financial reporting of audited information" (Lee, 1988:xvii).

2.2.2.2 1840-1900

The practice of auditing became firmly established only at the beginning of the industrial revolution during the period 1840-1900 in the UK (Gill & Cosserat, 1996:9; Ricchiute, 1989:9). The rise of a "middle class" during this period provided the funds for the establishment of large industrial and commercial undertakings although the share market was unregulated and vastly speculative (Porter *et al.*, 2008:27). This resulted in a high financial failure rate and unlimited liability for innocent investors. It was therefore apparent that the increasing number of small investors was seriously in need of protection (Porter *et al.*, 2008:27). Therefore, as stated by Brown (1962:698), "... the time was ripe for a profession of auditing to emerge".

During this period, the Joint Stock Companies Act was passed in 1844 in the UK, which stipulated that: "Directors shall cause the Books of the Company to be balanced, and a full and fair Balance Sheet to be made up" (Watts & Zimmerman, 1983:626). The Act also provided for the appointment of auditors (persons other than directors) to check the accounts of the company (Watts & Zimmerman, 1983:626). This Act, which required accounts to be audited, was merely incorporated into the law, a version of a practice that had already existed for 600 years. As indicated in section 2.2.2.1, joint stock companies were formed from the time of the latter half of the 16th century (Watts & Zimmerman, 1983:626). Leung, Coram and Cooper (2007) clarify that the statutory audit as well as the annual presentation of the balance sheet to the shareholders were only made

compulsory in 1900 under the Companies Act of 1862 (UK, 1908). Auditors during this period were mostly chartered accountants (Watts & Zimmerman, 1983:628) and were required to perform comprehensive checking of transactions and the preparation of correct accounts and financial statements. Not much attention was paid to the internal control of the company (Brown, 1962:698).

From the discussion above it is clear that the role of auditors during the period of 1840-1900 was focused mainly on fraud detection and the accurate interpretation of the company's balance sheet.

2.2.2.3 1900-1960

At the turn of the twentieth century, the auditing objectives and techniques of the UK (as discussed above) formed the basis for the development of the USA auditing profession in its early years. However, within twenty years the USA auditing profession had progressed independent of its origins (Brown, 1962:699).

Montgomery (1912:10) believes that auditors in the USA favoured the more progressive "balance sheet audit" over the traditional UK "bookkeeper audits". He defines the balance sheet audit as the internal check, which required the auditor "to verify the assets and liabilities, and to make such analysis of the Profit and Loss Account as will enable him to certify that it has been properly stated". According to Matthews (2013:33) the bookkeeping audit, which was the rule from the start of the professional audit in the UK from the early nineteenth century until the 1960s, typically also included doing the client's accounting, since the typically amateurish family firms in the UK did not have the personnel able to produce a set of final accounts themselves. The audit was strongly focused on the verification of transactions and their arithmetical accuracy as well as ensuring that the books balanced (Matthews, 2013:33). During this type of audit, the balance sheet attracted much less attention, which was far less time consuming than checking transactions.

Due to the growth of the USA economy in the 1920s-1960s, auditing development shifted from the UK to the USA. After the 1929 Wall Street Crash

and subsequent depression, investment in business entities grew rapidly in the following years of recovery (Teck-Heang & Ali, 2008:2). Apart from this, the progression of the securities markets and credit-granting institutions also expedited the development of the capital market in this period (Teck-Heang & Ali, 2008:2). The separation of the ownership and management functions became more evident as companies grew in size (Teck-Heang & Ali, 2008:2). There was a need to persuade the participants in the financial markets that the company's financial statement provided a true and fair representation of the relevant company's financial position and performance (Porter *et al.*, 2008:34-35). This ensures that funds continued to flow from investors to companies and that the financial markets functioned smoothly (Brown, 1962:699). The audit function was therefore mainly to provide credibility and trustworthiness to the financial statements prepared by company managers for their shareholders (Brown, 1962:699). As a result, the UK auditing objectives and approach were found to be unsuitable for the USA business during this time (Brown, 1962:699).

It has been argued by scholars like Moyer (1951), Lee (1972) and Chandler, Edwards and Anderson (1993) that the USA audit took a different direction from the UK audit for three main reasons:

- First, according to Moyer (1951), in the USA, accountants were less concerned with the bookkeeping audit because they faced a different legal framework. The USA had no equivalent to the UK 1900 Companies Act; therefore the USA auditor did not have clients who had a legal obligation to be audited (Moyer, 1951:7; Matthews, 2013:145).
- The second explanation for the contrast between the UK and USA audits, it has been argued, was the nature of their respective capital markets (Moyer, 1951:7-8). In Britain, even relatively small companies sought outside non-bank finance, and approximately 13,000 companies were quoted on the London Stock Exchange in 1900 (Edwards, 1989:201-202). In the USA, bank finance was the rule, so that before the First World War relatively few of even the largest manufacturing companies were quoted on Wall Street (Edwards, 1989:201-202). Therefore, according to Littleton (1981:24-25), in the USA: "...the strongest motivating factor [for the external audit] seems to have been

the need of creditors, particularly banks, for dependable financial information as a basis for their extension of credit.”

- The third and probably most significant reason for transatlantic divergence in audit practice was the greater size of the respective clients in the USA (Lee, 1972:24; Chandler *et al.*, 1993:456). Not only were USA audit clients bigger, they were, as Keeble (1992) has documented, also more professionally managed than in the UK. As Matthews (2013:147) stated, in the first half of the twentieth century the large UK companies were often still essentially “federations of old family firms”, whereas [the] “...American giants had a unified and centralised structure where management was departmentalised and professional”.

From the middle of the twentieth century, consensus was generally achieved (in both the UK and the USA) that the primary objective of an audit function is adding credibility to the financial statement rather than the detection of fraud and errors (Teck-Heang & Ali, 2008:4). A change in audit objective during this period was nonetheless emphasised by Montgomery (1934:26): “An incidental, but nevertheless important, object of an audit is detection of fraud”.

Accompanying this change in objective was a rather substantial alteration in techniques. In this period, the shift from the UK style of audit to the USA style of audit was characterised by a shift from detailed verification to sampling techniques. At this point auditors started to realise the importance of internal controls and the relation of strengths and weaknesses therein to sampling testing (Teck-Heang & Ali, 2008:4). Some major auditing cases during this time led to verdicts which resulted in emphasising physical observation of assets as well as the use of external evidence. These also had a direct impact on the fundamental principles of auditing (Teck-Heang & Ali, 2008:4).

In a nutshell, the development of auditing during the first half of the twentieth century was greatly influenced by the social-economic conditions of this period. The major characteristics of the audit approach during this time, as highlighted by Porter *et al.* (2008:33-36) included, among others:

- making use of sampling techniques based on the amount of reliance placed on the internal control of the company;
- gathering audit evidence through both internal and external sources;
- emphasis on the truth and fairness of financial statements rather than detecting fraud and errors;
- gradually moving to the audit of the profit and loss statement, despite the balance sheet remaining important; and
- physical observation of assets.

2.2.2.4 1960-1990

The bookkeeping audit was transformed from the 1960s onwards, and the major changes may be summarised as follows (Matthews, 2013:134-135):

- The practice of preparing the books and drawing up the client's accounts declined. Although auditors might still have had a significant say in the form and presentation of their clients' accounts, for the most part audits were 'pure' audits.
- From the 1960s the checking of accounting transactions was proportionately considerably reduced. The auditor now increasingly had to resort to testing a small sample, using relatively sophisticated statistical techniques, so-called substantive testing.
- Audit evidence was also likely to originate not from checking actual transactions but from testing the client's own internal system for controlling the business, so-called compliance testing; often involving the use of questionnaires and the construction of flow charts.
- The focus of the audit investigation shifted from the profit and loss account to the balance sheet; from verifying transactions to verifying assets and liabilities.
- More work, particularly the testing of transactions and systems, was now likely to be conducted in interim audits during the financial year, leaving the year end for balance sheet verifications.

- More planning went into an audit and the relatively strict following of audit programmes and manuals became the norm.
- The amount of permanent documentation associated with the audit increased, including in addition to programmes, questionnaires and flow charts, the formal accumulation of working papers.
- Just as the bookkeeping audit was closely associated with an unofficial aspect of the audit, namely accountancy, so the audit also acquired a role outside its statutory function, concerned with helping the client improve the business and embodied in the management letter.
- By far the biggest change in the audit process was the use of computers, which became an essential aspect of almost every audit, including the smallest of engagements.

During the period 1960-1990 the world economy continued to grow. Companies increased in size and complexity and this period marked an important progression in technological development. In the 1970s auditors played an important role in augmenting the credibility of financial information and expanding the operations of an effective capital market (Porter *et al.*, 2008). Leung, Coram, Cooper, Cosserat and Gill (2004:10) highlight the fact that an important duty of auditors was to affirm the truthfulness of financial statements. Teck-Heang and Ali (2008:5) mention that auditing had undergone some critical developments in this period. The number of transactions increased as a result of the continued growth in size and complexity of companies and the audit approach altered from verifying transactions in the books to relying on systems (Teck-Heang & Ali, 2008:5). During this period, auditors placed much higher reliance on companies' systems of internal control in their audit procedures, and were required to establish and document the accounting systems, with specific consideration of information flows and identification of internal controls (Teck-Heang & Ali, 2008:5).

By the 1980s, knowledge of the industry and the client's business as well as related risks became important considerations in the audit process (Matthews, 2013:135). Auditors spent more time before and after the gathering of audit

evidence in understanding the client's business and the markets they operated in and in assessing the company's comparative performance, in a process known as an analytical review (Matthews, 2013:135).

This also enabled the auditors to follow a more risk-based audit approach where an auditor is able to focus on those areas more likely to contain errors (Teck-Heang & Ali, 2008:5). Since the assessment of internal control systems was also found to be an expensive process, these factors once again led to a readjustment in the auditor's approach (Teck-Heang & Ali, 2008:5).

According to Woolf (1997:171), the factors mentioned above allowed an auditor to select a combination of three important auditor's tools in the audit process which contributed to the assurance sought. He describes the three tools as:

- Internal control that is sound (an internal system that is working effectively).
- Analytical review (assuming that these demonstrate the draft accounts to be reasonable).
- Lastly, in all cases, substantive testing of transactions and balances.

2.2.2.5 1990-present

In 1994, audit deregulation was introduced in the UK (UK, 1994). At that time there remained a large constituency of small concerns that from 1994 onwards had no legal obligation to be audited but that might have opted for an independent professional review (Woolf, 1997:338; Matthews, 2013:138). The auditors then still "did the books"; but the focus was on the transactions in the profit and loss account, and elements of the old bookkeeping audit were still very much alive (Woolf, 1997:338; Matthews, 2013:138).

According to Matthews (2013:142), the most significant change to the audit process was the introduction of the computer. He refers to this as "...an exogenous technological change which the auditors simply eventually had to come to terms with as best they could." Some of the "spin-off effects" of this technological change, as identified by Matthews (2013:143), are as follows:

- It became easier for clients to do their own accounting and the need for an auditor to do a client's accounting was significantly reduced.
- Because computers are more difficult to check and interrogate than manual systems, this reinforced the change in audit emphasis towards assessing the client's own internal controls.
- Computers also reduced the need for arithmetical precision by the auditor. It eliminated the skill of casting columns of figures and generally took the boring work out of audit.
- Auditors had to make use of computer tools as part of the audit process. This was done through the introduction of computer-assisted audit techniques (CAATs), a term which refers to certain software used by the auditor in performing audits to achieve the goals of auditing (Sayana, 2003).

It is clear that the considerable and fast paced change in the auditing profession since the 1990s is a result of the accelerating growth in the world economies. According to Porter *et al.* (2008:40) present-day auditing has developed into new processes that build on a business risk viewpoint of audit clients. This viewpoint pronounces that many business risks, if not controlled, will eventually affect the financial statements. Teck-Heang and Ali (2008:7) remark that over the past 30 years, the auditor played an "enhancing role" by enhancing the integrity and credibility of financial information. Nowadays, auditors are also expected to provide value-added services, such as reporting on irregularities, identifying business risks and advising management on the internal control environment (Cosserat, 2004). The establishment of multi-disciplinary practices by the Big 4 audit firms enabled auditors to provide consulting services, and such expertise has led to increased business risk focus in audit methodologies (Robson, Humphrey, Khalifa & Jones, 2007:411-412, 421-422). Corporate failures and the recent financial crisis are now turning the focus toward audit quality (Teck-Heang & Ali, 2008:6; Khalifa *et al.*, 2007:837). Teck-Heang and Ali (2008:7) mention that it can be expected that the role of auditors will converge due to reforms that were implemented in various countries as a result of the collapse of large corporations. Currently, the ultimate objective of auditing is to lend credibility to financial and non-financial information provided by management in annual reports (Teck-

Heang & Ali, 2008:6). Developments in integrated reporting demonstrated that in future auditors will be expected to provide wider assurances, not only on financial information but also on non-financial information (IRC, 2014). The paradigm of independent auditing has shifted over the years and may continue to shift in future.

2.2.2.6 Summary

From the above discussion it may be deduced that over the years, alterations in contextual factors, such as the critical historical events (e.g. the collapse of large corporations), the verdict of the courts, and technological developments (e.g. advancement of computing systems and CAATs) have contributed to the constant changes in the objective of auditing and the role of the auditor. However, it is just as important to note that the changes in society's expectations and the response of the auditing profession towards these do not always occur at the same pace, which causes a natural gap between the shifting expectation of the users and the response by the profession (Teck-Heang & Ali, 2008:7).

Despite the objective of auditing and the role of the auditor having evolved over time, the need for the audit function is still supported by theories, such as the shareholder and stakeholder theories, addressed in the next section.

2.2.3 Agency and stakeholder theory

This study focuses on small and medium-sized audit practices which are mostly responsible for small company audits with limited public interest (Stainbank, 2008:13); hence the starting point on a discussion of the theoretical foundations of the study lies in agency theory and is the focus of the discussion below.

2.2.3.1 Agency theory

The evolution of an audit, from a bookkeeping audit to a much wider process as described in section 2.2.2, was explained to provide the background and context for this study. It is clear that originally most organisations were owner-managed,

but as time passed there was a clear shift away from owner-managed companies. This tendency created a split between ownership and management, where the owner (the principal) entrusts his/her welfare and delegates his/her decision-making authority to the manager (the agent) who then makes decisions and takes actions on the principal's behalf. This is also defined as an agency relationship, upon which agency theory is based (Tiessen & Waterhouse, 1983:254; Jensen & Meckling, 1976:308).

Jensen and Meckling's publication (1976:308) was instrumental in the development of agency theory: they define the agency relationship as "a contract under which one or more (principals) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent." However, they mention that this contract does not have to be in writing; it may simply constitute implicit terms about how the principal expects the manager to behave.

Eisenhardt (1989:58) refers to the "ubiquitous relationship" at which agency theory is directed, where one party (the principal) delegates work to another (the agent), who performs that work. She therefore supports the statement of Jensen and Meckling (1976) that this theory attempts to describe this relationship using the metaphor of a contract.

Perhaps the simpler, but more practical, definition of the relationship may be found in the interpretation of Kerr (1991:3) when he states that "...the aim of the appointment of an agent is the performance of a service for the principal: what the principal finds is impracticable, inconvenient, or difficult to do for himself he proposes to do through another." In a legal context the word "agent" is most commonly used to describe a person whose activities are concerned with the formation, variation or termination of contractual obligations, and "agency" has a corresponding meaning (Kerr, 1991:3).

Tiessen and Waterhouse (1983:254), for the purpose of agency theory, view the firm as a set of contractual relationships among the suppliers of different factors of production and users of the firm's output. According to them, agency theory

examines an organisation as though it represents a situation where the principal entrusts his/her welfare to the agent, who makes decisions and takes actions on the principal's behalf. Thus agency theory casts light on how the relationship between the principal(s) and agent(s) should be structured in order to provide the appropriate incentives for the agent to take actions, which will maximise the welfare of the principal (Tiessen & Waterhouse, 1983:254).

An assumption that could be questioned with regard to agency theory is that both principals and agents act reasonably and that both parties use the relationship to maximise their own self-interest and personal benefit (Jensen & Meckling, 1976:308; Eisenhardt, 1989:58; Tiessen & Waterhouse, 1983:254). The reason for this interrogation is due to the possibility that the goals of the principals and agents do not always concur. There is valid reason to believe that the agent will not always act in the best interests of the principal because the actions that maximise the managers' expected utilities do not necessarily maximise the owners' expected utilities (Jensen & Meckling, 1976:308). Subsequently, there is a natural conflict of interest between the managers and the truant owners that arises when managers make decisions that maximise their own effectiveness but that do not maximise ownership wealth (Jensen & Meckling, 1976:308; Eisenhardt, 1989:58). Adams (1994:8) explains by saying that because the agent-managers have egocentric motives, they incur personal monetary gain; they are taking the opportunity to act against the interests of the owners of the organisation. The problem that arises is that due to information asymmetry the principal cannot easily verify the appropriateness of the behaviour of the agent, which now leads this discussion to examine the concept of costs.

Jensen and Meckling (1976:308) argued that this conflicting interest of the owners and managers needs to be held in balance: when neither party can enhance their wealth at the expense of the other. In order to maintain this equilibrium, both these parties (principals and agents) implicitly undertake to bear costs (Adams, 1994:8). To control the agent-manager's behaviour in order for the agent to take actions that will maximise the welfare of the principal, the principal-owner incurs monitoring costs; for example, the costs of subjecting financial statements to external audit scrutiny and costs of establishing compensation

policies (Adams, 1994:8; Jensen & Meckling, 1976:308). The agent-managers on the other hand incur bonding costs, for example the costs for managers to periodically report on how well they have managed the owners' resources and costs of internal audit. This is done to guarantee that they are acting responsibly and that they are not taking actions that will harm the principal or to ensure that the principal will be compensated if they do take such actions (Adams, 1994:8; Sherer & Kent, 1983:2; Jensen & Meckling, 1976:308). Jensen and Meckling's (1976:306) agency theory therefore helps to explain why organisations would voluntarily provide accounting reports.

Deegan (2009:265) cautions that incentive problems are at the heart of agency theory. According to him, within agency theory, a well-functioning firm is a firm that minimises those costs inherent in the principal-agent relationship (agency costs) (Deegan, 2009:265). Deegan (2009:265) emphasises the importance of having a mechanism to make an agent pay for actions that will harm the owners (principals). Otherwise, it is assumed, that the agent (or manager) will have an enticement to consume many perquisites, as well as to use confidential information for personal gain at the expense of the principals (the owners) (Deegan, 2009:265).

Naturally, the agency relationship causes a conflict of interest between managers and absentee owners when decisions made by managers to maximise their own utility do not maximise the owner's wealth (Eisenhardt, 1989:58; Jensen & Meckling, 1976:308). Consequently, there was a need for assurance to be provided by auditors to maintain the confidence of those who invest in business with regard to the reliability and credibility of the financial information used for decision making (Knechel, Salterio & Ballou, 2007:11). The need for auditing clearly arose out of the development of owner-managed businesses into entities which were owned by people who did not manage the business. Taking into account the growing concern of society about accountability (given the increased number of corporate scandals and the current global financial crisis, with its resulting impact on the world economy and society) stakeholder theory offers a more inclusive theory than agency theory (Christopher, 2010:688). According to Brennan and Solomon (2008:892), there has been a gradual shift away from

agency theory towards a more stakeholder-orientated theory, which is discussed in the following section.

2.2.3.2 Stakeholder theory

The world at large requires accountability where managers must be held accountable for the way in which they run their businesses, resulting in a need for the auditing profession to provide an independent service (an external audit) which assesses and evaluates whether managers are meeting their responsibilities (Porter, 2009:177-178). Flint (1988:12) argues that an audit is required where there is a duty of ensuring accountability between parties because it is "...a control mechanism to monitor conduct and performance, and to secure or enforce accountability". It can therefore be reasoned that for managers to fulfil their accountability, reliance is placed on the audit.

Freeman (1984:1) is of the opinion that the agency approach to obtaining an understanding of the business environment fails to take into account a wide range of groups who can affect and are affected by the business: its stakeholders. He defines the term 'stakeholder' as "...any group or individual who can affect or can be affected by the achievement of the organization's objectives" (Freeman, 1984:46). Stakeholders can be classified into two groups: firstly as primary stakeholders, being those who have a direct and contractual relationship with the organisation (e.g. customers, suppliers, employees, financiers, etc.), whereas secondary stakeholders are situated at the periphery of the organisation, but may still be impacted by its actions (communities and society at large) (Collier, 2008:936).

Odendaal (2005:24-25) is of the opinion that the mechanism of an audit originated in reaction to the needs of stakeholders to access information on the performance of an enterprise in which they might have an interest, because such individuals would not be in the position to obtain the relevant information and to correctly interpret it. Hevlund *et al.* (2010:23) support the above opinion when stating that "...the auditor's work reflects societies' need for trustworthy information". The auditor is therefore obliged to obtain sufficient (measure of

quantity of evidence) and suitable or appropriate (measure of quality including relevance and reliability of transactions, account balances and disclosures) audit evidence to be able to draw reasonable conclusions on which to base an audit opinion (Hayes, Dassen, Schilder & Wallage, 2005:353).

Gilling (1976:100) sees the auditing profession in terms of a social control, which according to Carnegie and Napier (2010:361) requires of auditors to serve the best interests of society at large. Deegan (2002:292-293) speaks of a “social contract” and defines it as the arrangement, explicit (legal requirements) or implicit (non-legislated societal expectations), between an organisation and members of society. He furthermore argues that an organisation’s survival will be threatened if society perceives that the organisation has breached its social contract (Deegan, 2002:293). Brennan and Solomon (2008:899) fully support this argument by stating that the accountability to stakeholders and responsibility to society in general is a key ingredient to the success of a business.

2.2.3.3 Summary

The previous paragraphs provided insight into agency theory resulting from the split between ownership and management because of the development of owner-managed businesses into entities which were owned by people who did not manage the business. It also explained stakeholder theory, supporting the concept of wider accountability. Furthermore, it clarified why agency and stakeholder theories are regarded and supported as the theoretical underpinning of the need for an audit.

2.2.4 Conclusion on the need for auditing

In line with the discussion of agency theory, information asymmetry and the demand for monitoring are among the reasons for undertaking external audits (Andersen, Francis & Stokes, 1993). Where there is a separation of ownership and control, the principal (the shareholder) is willing to incur a financial cost to monitor the activities of the agent (the director). The agent is responsible for producing most of the financial information required by the principal.

From the above discussion it may be concluded that the validation for the existence of the audit function should be understood by way of the need for accountability where managers manage businesses on behalf of absentee owners and other stakeholders. As is evident from agency and stakeholder theories, there is a natural conflict of interest between management and stakeholders, including shareholders. All parties seek to maximise their self-interest and management may not always act in the owners' and stakeholders' best interests (Mentz, 2014:48). Due to information asymmetry it is in the principal's interest to have the truth and fairness of the financial statements assured by an independent auditor. The audit may also be demanded because it is perceived to improve the quality of the information contained in the financial statements (Wallace, 1980).

It can therefore be stated that the purpose of an audit is to ensure proper financial reporting, which means ensuring transparency, assessing reliability and, in doing so, maintaining credibility (Hevlund *et al.*, 2010:23). Hence, the basic principles of enhancing credibility and reliability of information and increasing the confidence of users motivate the need for the auditing profession (Mentz, 2014:52). Normanton (1966:xii) makes the point: "Without audit, no accountability; without accountability no control; and if there is no control, where is the seat of power?"

Against this background it is obvious and undeniable that the auditing profession needs to be regulated. In the following paragraphs attention is given to the origin and development of audit regulation and deregulation in the UK and USA, followed by a detailed discussion on audit regulation in South Africa.

2.3 AUDIT REGULATION

As the need for auditing increased, the corresponding need for the regulation of the auditing mechanism evolved from nascence to full development. The origin and development of the regulation of auditing in South Africa was strongly influenced by the English Companies (Consolidation) Act of 1908, which explains the need to first understand the developments in formal corporate structures in

the UK (West, 2009:11). As earlier emphasised (section 2.2.2) over the last hundred years the history of auditing in the USA developed much more quickly than in the UK, and the researcher therefore also found it necessary to investigate the developments of the corporate structures in the USA (Brown, 1962:699; Matthews, 2013:143).

2.3.1 The origin and initial development of audit regulation in the United Kingdom and the United States of America

2.3.1.1 *United Kingdom*

Before the Industrial Revolution (1600–1800) companies were not governed by any comprehensive legislation that required them to be incorporated by a specific Act of Parliament (Brown, 1905). The increase in trade and commerce during this time led to the establishment of the Joint Stock Companies (Watts & Zimmerman, 1983).

Anderson (1977:7) argued that the Industrial Revolution resulted in large commercial and mechanised industries instead of the traditional home-factories which eased in the use of foreign capital. This, according to Brown (1905:73), resulted in entities for which management was passed from individual owners to hired professionals and where the absent owners became concerned over the protection and growth of their capital investments (also refer to section 2.2.2).

The demand for a proper system of accountable responsibility based on accurate record keeping gradually came to the fore. Puttick and Van Esch (2007:4) agree: “...it was imperative that those directing a business should account clearly and honestly to the owners, that is to say, the shareholders. The employment of an auditor to act as agent for the shareholders became a necessity and out of this need grew the profession of accounting and auditing as we know it today.”

This expressed desire for the professional auditor led to the first piece of legislation which would be recognised as modern company law, the Joint Stock Companies Act 1844. Although the importance of this first statute cannot be

denied (Barac, 1998:17), it was fairly limited in scope. Despite this Act requiring a statutory audit in its additional schedules, no mention was made of who could be appointed as auditor or what qualifications would be stipulated for such appointment (Hein, 1963:508). Furthermore, the concept of limited liability was also not considered (Barac, 1998:19).

The Joint Stock Companies Act 1856 remedied this omission (Barac, 1998:19) but again, no mention was made in the Act itself regarding the obligatory and statutory audit for companies (Anderson, 1977:7). Furthermore, this piece of legislation did not require more expansive record keeping and reporting. Only some guiding regulations were provided that *inter alia* required that the auditor should not also be a shareholder of the company (Hein, 1963:509).

Although the required statutory audit for registered companies was withdrawn for the period extending from 1856 to 1900, it was reinstated by the Companies Act 1900 in England as a counter-measure to the financial failure of certain companies (Hein, 1963:509). With the proclamation of this Act, obligatory annual audits were instituted for all limited liability companies registered in England (Hein, 1963:509; Fearnley *et al.*, 2000:301). No mention was made of who could be appointed as auditor nor what qualifications would be required for such appointment. However, the Board of Trade recognised the fellows of the Chartered Accountancy bodies for the execution of the audit of the business of companies (Hein, 1963:508-509). To some extent the duties of the auditor were identified in the Companies Act, but the Act remained silent on how the audit should be conducted (Hein, 1963:515-516). Matthews (2013:140) explained this statement as follows: "...the wording of the Acts was always couched in very general terms; for example, the 1900 Act merely stipulated that the auditor had to make a report on the balance sheet, stating whether it showed a true and correct view" (Matthews, 2013:140).

The Companies Act 1948 was the first act which clearly set out the requirement that the auditor of a company should be professionally qualified and furthermore specified what those qualifications should be in order for an individual to be admitted as an auditor (UK, 1948). This Act required that auditors had to state

whether proper books of account had been kept, whether the company was in compliance with the various and extensive aspects of the Act and state what loans to officers of the company had been made, if these were not disclosed in the summary of the accounts (UK, 1948).

The 1967 Companies Act went a little further than the 1948 legislation and required that only members of an accountancy body recognised by the Department of Trade and Industry, could act as company auditors (Fearnley *et al.*, 2000:301). This Act furthermore required that, "...the auditors carry out such investigations as will enable them to form an opinion on the adequacy of the books of account and their agreement with the balance sheet and profit and loss account" (Matthews, 2013:141). Some flexibility, however, was granted in the concession that "...the auditor must decide for himself in each case what steps are necessary" (De Paula & Attwood, 1976:251). Woolf (1997) states that the Companies Acts of the 1980s were no more prescriptive of the auditors' work than their predecessors.

2.3.1.2 United States of America

In contrast to the statutory obligation for an audit created by the UK 1900 Companies Act, no registered companies in the USA had a legal obligation to be audited (Matthews, 2013:145). Despite the fact that no enforceable legislation existed regarding compulsory audits, independent auditing in the USA was largely motivated by the demands of creditors, especially banks, for reliable financial information on which credit decisions could be based (Defliese *et al.*, 1990:10). This view had also been expressed by Littleton (1981:24-25) who asserted that banks needed dependable financial information as a basis for their extension of credit. Therefore to a large extent, until 1933, it is clear that audits were implemented in the USA because lenders and creditors demanded these (Defliese *et al.*, 1990:13).

In 1933, the New York Stock Exchange introduced a requirement for the listing of companies on the stock exchange that required independently audited financial statements to be published annually and filed with listing applications (Defliese *et*

al., 1990:13). It should also be kept in mind that the Wall Street Stock Exchange collapsed in 1929 (Zeff, 2003:191). In response to this event and in terms of the Securities Act of 1933 as well as the Securities Act of 1934 an audit became compulsory for all listed companies in North America (Defliese *et al.*, 1990:13). However, Chatfield (1977:132-133) is of the opinion that this new compulsion did not seem to have any effect on either the purpose or the method in USA audits – a sign that the non-existence of the requirement had not been vital prior to 1933, because audits were already in demand from the market forces.

The quick and escalated development of the auditing profession in the USA led directly to the perception that the USA had taken up the lead in the development of auditing and the auditing profession from the 1930s (Anderson, 1977:10). Swemmer (1987:66, as cited in Barac 1998:25) supports this view and remarks: “The most notable feature of the accounting and auditing profession’s development during this period (1900–1950) was the tendency by the US to take over from Britain as the leader in this field”.

It is of significance that although the audits of listed companies on the UK and USA Stock Exchanges were on a comparatively similar footing, they were dealt with in distinctly different ways, and “...with the Americans still appearing to lead the British” (Matthews, 2013:145).

2.3.2 Historical view of audit regulation in South Africa

The first South African company legislation was the Companies Act 46 of 1926 (RSA, 2004a:14). This company law was built on foundations that were put in place in Victorian England in the middle of the nineteenth century (Gloeck, 2004). The Companies Act of 1926 was the first Act in South Africa that made statutory annual audits compulsory for all registered companies (Union of South Africa, 1926).

The next major review of company law in South Africa was initiated in 1963 (RSA, 2004a:5). The result was the establishment of the Companies Act 61 of 1973 which replaced the 1926 Act (RSA, 2004a:5). The 1973 Act was hailed as

“...cutting the umbilical cord” between South African and English company law. Nevertheless, many of the principles and provisions of the 1926 Act were adopted (RSA, 2004a:14). It was therefore still based on the framework and general principles of the English law (RSA, 2004a:14) and still required all registered companies in South Africa to be audited (RSA, 1973).

2.3.3 Conclusion on audit regulation

The discussion provides a broad overview on the history of corporate law regarding audits in the UK, USA, and South Africa. The legal requirement for a professional auditor was introduced in the UK in 1948, while since 1967, such a person should be a member of an accountancy body. In the USA the requirement for an auditor was driven by market forces (credit suppliers) and this has been regulated since 1934, although the practice had, by then, been followed for some time. Statutory audits have been compulsory in SA since 1926. By that time the auditing profession was regulated, as discussed in the next section. Globally, the auditing profession has undergone a fundamental change over the years, moving from a position of, mostly, self-regulation to one of independent regulation. In order to better understand the current state of the auditing profession in South Africa, which related to the focus of this study (small and medium-sized audit practices) the regulation of the auditing profession in South Africa is more closely considered.

2.4 REGULATION OF THE AUDITING PROFESSION IN SOUTH AFRICA

From the earlier discussion on the history of auditing (section 2.2.2), it is clear that the origin of the Joint Stock Companies Act, together with a series of Companies Acts (section 2.3), led to the statutory recognition of auditing professions in the world and South Africa. In line with the focus of this study, which falls on audit practice regulated in terms of statute by the auditing profession, the latter is discussed in more detail.

In 1894, the first professional accounting body in South Africa was formed in the (then) Transvaal under the name of The Institute of Accountants and Auditors in

the South African Republic, followed in 1895, by The Institute of Accountants in Natal (Puttick & Van Esch, 2007:4). The next important development was the establishment in 1904 of The Transvaal Society of Accountants, which restricted practice to members of the Society. As a result of this legislation, The Natal Society of Accountants came into existence in 1909. Despite the lack of similar legislation, two other societies were voluntarily formed: in 1907 the Cape Society of Accountants and Auditors was formed followed shortly thereafter by The Society of Accountants and Auditors in the Orange Free State (Puttick & Van Esch, 2007:4).

Hereafter, several attempts were made to secure uniform legislation in South Africa. The first attempt, though unsuccessful, occurred in 1912 through the introduction of the Union Accountants' Registration Bill. In 1923 there was another attempt when an alternative Bill was introduced, but this was eventually withdrawn. It was only after the Companies Act of 1926 that a short Bill, namely The Chartered Accountants' Designation (Private) Act (1927), which authorised members to use the designation, Chartered Accountant (South Africa) or CA(SA), was approved in Parliament (Puttick & Van Esch, 2007:4-5).

According to Puttick and Van Esch, (2007:5) in 1936 the unification of the four provincial societies was suggested through the Commission's Bill together with:

- the creation of a register of accountants;
- limitations on the right to practice to persons who were members of one of the four societies; and
- the establishment of an accountancy board to control examinations.

However, neither this Commission's Bill nor the private Bill that followed in 1938 were taken any further. It was only in 1945, during a conference held in Cape Town, that the four provincial societies were consolidated into one auditing profession. Thereafter the Joint Council of the Societies of Chartered Accountants of South Africa was established on 1 January 1946 (Puttick & Van Esch, 2007:5).

After numerous discussions and conferences over the years a further conference was held, which finally led to the statutory recognition of the accounting profession in South Africa through The Public Accountants' and Auditors' Act 51 of 1951 (Puttick & van Esch, 2007:6; RSA, 1951). The Public Accountants' and Auditors' Board (PAAB) was established in terms of this Act with disciplinary powers for control of the profession, the registration and control of articled clerks and the conduct of examinations (RSA, 1951: section 2, section 23). It also provided for the investiture of candidates who passed the Qualifying Examination, who were then eligible for admission to one of the provincial societies and had the right to use the designation "Chartered Accountant (South Africa)" (CA(SA)) (Puttick & Van Esch, 2007:6).

Although the "Joint Council" changed its name to The National Council of Chartered Accountants (SA) in 1966, there was still a lack of unification of the provincial societies (Puttick & Van Esch, 2007:7). On 1 January 1980, the amalgamation of the four provincial societies was accomplished through the creation of a National Institute known as the SAICA, which is still (2015) the National Institute (SAICA, 2015a). Puttick and Van Esch (2007:7-8) further state that one of the most important consequences of the establishment of SAICA was the fact that the designation CA(SA) was then reserved to those persons who, after completing the Qualifying Examination and required period of training, registered as members of SAICA (as opposed to one of the four separate societies).

In 1991, PAAB consolidated amendments made over the previous few years and updated the terminology through the introduction of the new Public Accountants' and Auditors' Act No. 80 of 1991 (Puttick & Van Esch, 2007:7; RSA, 1991).

Six years later, in 1997 a new Bill, the Accountancy Profession Bill (the APB) was drafted, which visualised a structure with two main bodies, a Representative Council of Accountants (RCA) and a Regulatory Board for Auditors (RBA). While the broad accounting profession was regulated by the RCA, the existing functions of PAAB to regulate auditors were taken over by the RBA. The first model for

recognition and accreditation of institutes was introduced by this Bill and later on adopted by PAAB in 1999 (Puttick & Van Esch, 2007:9).

Questions were raised worldwide in the early years of the millennium regarding audit regulation as a result of the collapse of Enron and WorldCom in the USA and Parmalat in the UK (Teck-Heang & Ali, 2008:6; Khalifa *et al.*, 2007:837). Following this, PAAB took a much more focused role as the auditing profession regulator in South Africa (Puttick & Van Esch, 2007:10).

Having shifted the focus from self-regulation towards increased independent regulation of the auditing profession, the Draft Auditing Profession Bill 2004 was brought to the table (Puttick and Van Esch, 2007:11; RSA, 2004b). Puttick and Van Esch (2007:11) state that its main objective was to regulate the auditing profession and it provided for:

- the Independent Regulatory Board for Auditors;
- a Standard Setting Board for Auditor Ethics; and
- a Standard Setting Board for Auditing.

After all comments were taken into account and amendments made, the APA No. 26 of 2005 was approved on 12 January 2006 and revoked the Public Accountants' and Auditors' Act No. 80 of 1991 (RSA, 2005). The APA is still today the regulation relevant to the auditing profession in South Africa; some of its key objectives, as stated in the Act (RSA, 2005), are to provide for the:

- Establishment of the IRBA.
- Education, training and professional development of registered auditors.
- Accreditation of professional bodies.
- Registration of auditors.
- Regulation of conduct of registered auditors.

The statutory body, the IRBA, which was established by way of the APA, controls the auditing profession (also referred to as public accountancy) in South Africa

(IRBA, 2015c). The Board has between six and ten members while not more than 40% of the members may be registered auditors. The IRBA is funded through Registered Auditors (RAs) and firms (in the form of membership fees), monies received from Parliament as well as all other monies which may accrue to the Regulatory Board. The IRBA reports to the Minister of Finance annually (IRBA, 2015a).

A registered auditor is an individual registered as an auditor with the IRBA, the regulatory body for the auditing profession in South Africa (RSA, 2005). The APA furthermore stipulates detail regarding an individual who may and may not register as a registered auditor. This is elaborated on in section 2.5.2.2.

The purpose of the above discussions was to provide a background to the area of focus of this research: the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. Even though self-regulation of the auditing profession was replaced by regulation by a statutory independent regulatory body, IRBA, in 2006, at that time all companies, regardless of their size and public interest, had to be audited by auditors registered with the IRBA. This requirement changed in 2008 with the introduction of audit deregulation requirements (section 2.5.2). The deregulation of statutory audits in the UK, two decades earlier, provides an interesting context and is reflected upon in the following section.

2.5 REGULATORY REFORM

A historical review of the deregulation process of the statutory audit in the UK was conducted and is briefly summarised below. The researcher, after due consideration, decided to focus on the UK as that was the first country to remove mandatory audits for SMEs (Hevlund *et al.*, 2010:13) and developments of corporate structures in South Africa have been more influenced largely by the UK (West, 2009:15).

2.5.1 Historical view of audit deregulation in the United Kingdom

As previously mentioned, the first requirement for UK companies to be audited was introduced in the Companies Act 1908. When the European Union (EU) Fourth Directive on Company Law was published in 1978, providing the option for exemption of small companies in member states, the UK government after some reviews, took the decision to make no change to the *status quo* in the UK (Fearnley *et al.*, 2000:301). The main argument by those opposed to the audit of small companies was that an audit was an unnecessary regulatory and costly burden for owner-managed companies (Hevlund *et al.*, 2010:34). They argued that the principal credibility objective of an audit with respect to a company's shareholders was not achieved where the directors and shareholders are the same people (Hevlund *et al.*, 2010:34). Seow (2001:64) was of the opinion that a compulsory statutory audit for all companies is a "...highly inflexible measure" as it does not take into consideration the financial processes and needs of small companies. True as this may be, the decision was still taken that it remained in the public interest for companies to be audited (Fearnley *et al.*, 2000:301).

The number of small companies grew by 80% during the 1980's, and this reality again prompted the discussion for introducing audit exemption (Hevlund *et al.*, 2010:34). Shaw (1978) argued that the only alternative to a mandatory audit is "no audit". A similar attitude was adopted by Davison (1980:42) who then stated that "...surely, the proper alternative is no audit at all". At that time Shaw (1978) maintained that if company legislation is to be amended, any changes should be directed at companies in terms of the audit requirement rather than introducing a new form of assurance service.

Keasey, Watson and Wyncarczyk (1988) support the view that the burden of universal standards of auditing could result in an unreasonably high cost for small companies, particularly when external users could obtain more relevant information directly from company management if needed (Barker, 1985). Berry, Citron and Jarvis (1987) caution that management accounts and forecasts, as alternative sources of information, are considered less trustworthy and "inferior" to audited financial accounts. They emphasise that bankers for instance, regard

the full statutory accounts as the most important source of documentary evidence and information when making lending decisions. Seow (2001:66) agreed with this argument by Berry *et al.* (1987) in saying that there are doubts as to whether the decision to engage or disengage auditing really rests with company management because bankers could require audited financial statements when considering loans.

Wills (1999) acknowledges that the audit has its benefits with limits, especially in the small company context. Hurst (1994) remarks that the success or otherwise of audit deregulation in the UK therefore depends on the type of service the owners of small companies want, as well as what their bankers (or other lenders) want them to purchase, from their accountants.

From the above it is clear that various arguments in favour of and against small company audit exemption were raised before and after the legislation on audit regulation was introduced in 1994 (UK, 1994). These related to the need for such an audit, its cost implications, alternative assurance options and various stakeholder expectations. The following sections provide an overview of the legal requirements to exempt a small company from being audited.

2.5.1.1 *Small company qualification in the UK*

In order to determine the companies to which audit exemption applies in the UK, it is first necessary to understand which companies qualify as small ones.

In 1994 (the year when the audit exemption was introduced) a company qualified as small in a financial year if, for that year, two or more of the following conditions were satisfied (UK, 1992):

- An annual turnover of not more than £2,800,000.
- A balance sheet total of not more than £1,400,000.
- The average number of employees for that year did not exceed 50.

The requirements for a company to qualify as a small company, with regard to the annual turnover and balance sheet totals, altered in 2004 (UK, 2004). The 2004 Regulations to the Companies Act 1985 (Accounts of Small and Medium-Sized Enterprises and Audit Exemption) raised the annual turnover limit to £5,600,000 and the balance sheet total to £2,800,000 (UK, 2004). Again in 2008, the annual turnover limit was raised to £6,500,000 while the balance sheet total was raised to £3,260,000 (UK, 2008).

In April 2015, the UK's implementation of the EU's Accounting Directive was passed through Parliament, which further raised the thresholds for qualifying as a small company by a significant amount (Warmoll, 2015). The 2015 Regulations to the Companies Act 2006 raised the threshold of the annual turnover to £10,200,000 while the balance sheet total limit was raised to £5,100,000 in order for a company to qualify as a small one, which would then exempt it from the audit regulation (UK, 2015). Although the 2015 Regulations came into force on the 6th of April 2015, these Regulations will only take effect for financial years beginning on or after 1 January 2016; or where the financial year begins on or after 1 January 2015 (but before 1 January 2016) if the directors of the company so decide (UK, 2015).

The changes in the UK requirements since 1994, for a company to qualify as a small company, are summarised in Table 2.1.

Table 2.1: Changes in requirements to qualify as a small company in the UK

	1994 (introduced in 1992)	2004	2008	2015/2016
Annual turnover	≤ £2,800,000	≤ £5,600,000	≤ £6,500,000	≤ £10,200,000
Balance sheet total	≤ £1,400,000	≤ £2,800,000	≤ £3,260,000	≤ £5,100,000
Number of employees on average	≤ 50	≤ 50	≤ 50	≤ 50
<i>A company qualifies as a small company in a financial year if two or more of the criteria listed above are satisfied for that year.</i>				

Table 2.1 illustrates that over the past two decades the amounts of the turnover and balance sheet total thresholds to identify small companies increased significantly, while the requirement of limiting the number of employees to 50 remained the same. Audit exemption is not available to all companies that qualify as small companies. Therefore, it is necessary to further analyse which of the latter would be subject to audit exemption. A discussion of this follows.

2.5.1.2 *Small company audit exemption thresholds in the UK*

Legislation on audit deregulation was introduced in the 1994 Regulations to the Companies Act 1985 (Audit Exemption) which was implemented on 11 August 1994 (UK, 1994). These 1994 Regulations (UK, 1994) stipulated that a private company should, in addition to qualifying as a small company in terms of the Companies Act 1985 (refer to section 2.5.1.1), meet both the following criteria to be completely absolved from compliance with compulsory auditing:

- An annual turnover of not more than £90,000.
- A balance sheet total of not more than £1,400,000.

Furthermore, companies with a turnover in excess of £90,000 but not exceeding £350,000 and a similar balance sheet total constraint, were exempted from the audit requirement if a less onerous exemption report was filed after being completed by a qualified accountant (Seow, 2001:65). In this exemption report the accountant declares that the financial statements are in agreement with the accounting records of the company (Seow, 2001:65). The most important difference between this report and the audit was in the scope of the work to be performed, where the exemption report provides only limited assurance and the accountant is not required to seek any independent evidence to confirm the accounting records (Seow, 2001:65). The legislation does, however, provide for the fact that shareholders owning more than 10% of the issued equity, may insist upon the execution of a proper and comprehensive audit (UK, 1994).

In 1997 legislation in the UK concerning audit exemption for small companies was amended. This involved the threshold of the annual turnover being raised

from £90,000 to £350,000 in order to exempt all companies with a turnover not exceeding £350,000 from an audit, while the balance sheet total limit remained £1,400,000 (UK, 1997). The threshold was again raised in 2000 to a turnover of £1,000,000 (UK, 2000) followed by the change in 2004 which raised the exemption limit of annual turnover to £5,600,000 and the balance sheet total limit to £2,800,000 (UK, 2004). After the 2004 amendments, 67,000 companies were exempted from the audit requirement as a result of the increase in the turnover threshold from £1,000,000 to £5,600,000 (Quick, 2006a:8).

Perhaps the most significant consequence of this increase in the UK concerning the audit exemption threshold in 2004 was the "...fall in the number of registered ICAEW audit firms from over 6 500 in 2002 to fewer than 5 000" in 2006 (Quick, 2006b:84). The amount of auditing fees that were lost due to this legislation is estimated to be around £360 million (Grant, 2006). Regardless of the calculated loss, Grant (2006) found that the affected audit practices shifted their focus to deliver valuable services, other than audits, to their clients.

In an article, *Audit exemption and wrong accounts: new Act does not help*, Woolf (2007) indicated that in 2006 the Professional Oversight Board (POB) randomly selected 350 company accounts on public file in the UK. It was found that the majority of these accounts examined represented 'small' companies which were exempted from an audit by law and took advantage of this exemption. These accounts contained errors such as balance sheets that did not balance and issued share capital in excess of the authorised share capital (Woolf, 2007). These findings verify projections made by Seow (2001:76) that the adoption of audit deregulation may open the floodgates for adverse selection, where the very companies that may benefit most from, or mostly need, the statutory audit may opt for an exemption.

In 2008, the audit exemption thresholds were once again raised for small companies. The annual turnover threshold was raised from £5,600,000 to £6,500,000 while the balance sheet total limit was raised from £2,800,000 to £3,260,000 (UK, 2008). The conditions for exemption from an audit were changed one more time in 2012. A private limited company with a financial year

ending on or after 1 October 2012 was exempted from having its annual financial statements audited if it qualified as a small company in terms of the 2012 Regulations to the Companies Act 2006 (UK, 2012). From 1 October 2012, this change resulted in a private limited company being exempt from the audit requirement, without satisfying any additional criteria (apart from qualifying as a small company as discussed above in section 2.5.1.1).

Nevertheless, the Act still makes provision that even if the company is usually exempted from the audit, shareholders who own at least 10% of the shares, can insist that the company be audited (UK, 2006).

The changes in the UK annual turnover and the balance sheet total threshold requirements for a small company to qualify for audit exemption, as implemented throughout the last 21 years, are summarised in Table 2.2.

Table 2.2: Changes to the small company audit exemption thresholds in the UK

	1994	1997	2000	2004	2008	2012 onwards
Annual turnover	≤ £90,000	≤ £350,000	≤ £1,000,000	≤ £5,600,000	≤ £6,500,000	N/A
Balance sheet total	≤ £1,400,000	≤ £1,400,000	≤ £1,400,000	≤ £2,800,000	≤ £3,260,000	N/A
<i>In addition to qualifying as a small company, a company is also required in each financial year to meet both of the above criteria in order to be exempted from an annual audit.</i>						

As was the case with the amounts of the turnover and balance sheet total thresholds used to identify small companies (Table 2.1 refers), these thresholds also increased significantly to determine small company audit exemptions.

Since the introduction of the audit exemption in 1994, multiple studies on the statutory audit have been done (Collis, Jarvis & Skerratt, 2004; Collis, 2010; Hevlund *et al.*, 2010). In a study undertaken by Collis *et al.* (2004:97) in the UK, their findings identified a number of conclusions as to why companies generally chose to keep the annual statutory audit of their financial statements even though they were within their rights to be exempted. It was found that:

- Firstly, these companies usually had a larger annual turnover (still within the threshold in Table 2.2) than those companies who did not appoint a professional auditor.
- Secondly, the board of directors supported the notion that an independent audit would increase the quality and credibility of the financial reports.
- Thirdly, because these companies were ordinarily not entirely family owned, their shareholders had little or no insight with regard to the company.
- Lastly, the companies with audited financial statements generally used them to obtain or maintain credit from banks and other loan providers.

Irrespective of the constant rise in the threshold which exempts small companies from statutory audits, Seow (2001:76) believes that when the benefits of audits and the required assurance these bring are recognised by external and internal users of financial statements, the demand for audits would conquer all. This opinion was supported by the study performed in the UK in 1999/2000 by Collis *et al.* (2004:96) where they found that 63% of the sample of companies that could have gained from the audit exemption still chose to undergo a voluntary external audit. This suggests that the majority of companies that were affected by the increase in the exemption thresholds considered that the benefits of having their accounts audited outweighed the costs (Collis *et al.*, 2004:96). A similar study was again performed by Collis (2010:226) several years later and found that 43% of the small private companies that qualified for the audit exemption still chose a voluntary audit (Collis, 2010:226).

In an ironic but perhaps unintended consequence, audit deregulation in the UK may have a much more fundamental impact on the auditing profession in the sense that small audit practitioners may no longer be in a position to train audit staff (Fearnley *et al.*, 2000:305). Many of their clients are exempted from the mandatory audit requirement which would mean that small and medium-sized audit practices are not able to offer sufficient company audit experience for trainee accountants (Fearnley *et al.*, 2000:305). If audit training is concentrated solely in larger audit practices, this may lead to succession problems for small and medium-sized audit practices (Fearnley *et al.*, 2000:305).

2.5.1.3 Summary

Although various arguments could be raised against and in favour of small company audit exemption, the bold step to introduce such legislation in the UK was taken in 1994. The exemption, which should be read in conjunction with the qualification of a small company, uses indicators (turnover, balance sheet total and number of employees) to determine whether a company could be exempt from a mandatory audit. The measures of the turnover and balance sheet total thresholds have increased significantly since 1994.

2.5.2 Audit deregulation in South Africa

Judging by a first world country like the UK and keeping in mind that the framework of company law in South Africa up to the 20th century was essentially built on foundations which were put in place by the British Law, occasional changes to an Act dealing with corporate law are not unusual and this also relates to audit requirements.

2.5.2.1 Introduction to change

As a country, South Africa has fundamentally changed since the review of its company law that was initiated in 1963 and which resulted in the Companies Act 61 of 1973 (RSA, 1973). The Companies Act 61 of 1973 still required a compulsory statutory annual audit for all registered companies in South Africa (RSA, 1973).

The first democratic election, held in South Africa in 1994, paved the way for a new democratic dispensation and a new constitution (SA Info, 2015). Government set out to dismantle apartheid social structures since 1994 and create a democratic society based on equity, equality, non-racialism and non-sexism, in line with the Constitution (RSA, 2004a).

In the foreword of *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (RSA, 2004a) the then Minister of Trade and Industry

explained “A new constitutional framework and political, social and economic environment have been established post-1994. Corporate governance and other legislative developments since the 1990s have further underscored the need for reform. In addition, the South African and global economies are significantly altered in their functioning”. The reform of corporate law in South Africa became a priority as the 1973 Companies Act was seen as unnecessarily inflexible and a more business-friendly approach was demanded (RSA, 2004a).

During the early years of the new millennium one of the biggest questions facing South African companies was whether the audit of financial statements was a necessity or a luxury which few could afford. Those years were characterised by an ever-increasing inflation rate, interest rate hikes, escalating fuel prices, electricity rate rises and a weakening exchange rate; the pressure on the financial resources of companies was extensive (Crous, 2008:5; SAICA, 2008). The question that most shareholders and directors of companies were asking at that time was where to cut costs, and making choices by distinguishing between what they considered necessities and luxuries. Audit practices were confronted by the view that the audit report for a private company was considered a luxury which would just consume valuable financial resources while the benefit derived from these reports would not justify the cost and time spent (Crous, 2008:5).

During the same period (early 2000) the DTI in South Africa took a decision to review and modernise company law (RSA, 2004a). This decision was based on the need to bring South African law in line with international trends and to reflect and accommodate the changing environment for business, both in South Africa and globally (RSA, 2004a).

South African Company Law for the 21st Century: Guidelines for Corporate Law Reform (RSA, 2004a) further states that taking into account the vision of the economy and the particular challenges faced by South Africa, company law, with specific regard to audit regulation, should:

- Encourage entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing costs associated with the formalities of

forming a company and maintaining its existence, thereby contributing to the creation of employment opportunities.

- Promote efficiency of companies and their management.
- Ensure international compatibility and harmonisation with best practice jurisdictions.

2.5.2.2 Companies Act 71 of 2008

In 2003, a broad legislative reform programme was initiated by the DTI to ensure a regulatory framework that would promote growth, innovation, stability, good governance and international competitiveness (RSA, 2004a). The South African Companies Act 61 of 1973 (RSA, 1973) was replaced by the Companies Act 71 of 2008 (RSA, 2009). The Companies Act of 2008 was signed into law on 8 April 2009 and came into effect on 1 May 2011 (Shev, 2011), which allowed specific companies audit exemption. Additional guidance on the possible audit exemption was provided in the Companies Amendment Act 3 of 2011 (RSA, 2011).

(i) Compulsory audit

The Companies Act 61 of 1973 (RSA, 1973) stated that an annual audit must be performed for all companies. In the Companies Act 71 of 2008 (RSA, 2009), section 30(2) stipulates that an annual audit is only mandatory for the following profit companies:

- Public companies; or
- Other profit companies, when it is in the public interest, taking into account the economic or social significance of the company.

When regulation 28(2) of the Companies Regulations 2011 (RSA, 2011) is read together with section 30(2) of the Companies Act 71 of 2008 (RSA, 2009) and section 10(3) of the Close Corporations Act 69 of 1984 (Close Corporations Act) (RSA, 1984), an annual audit is also mandatory for the following:

- State-owned companies; or

- Any profit company or close corporation which, in the ordinary course of its primary activities, holds assets in a fiduciary capacity for persons who are not related to the company and the aggregate of these assets held at any time during the financial year exceeds R5 million.

(ii) *Public interest consideration*

To determine public interest, the 2008 Companies Act introduced a new points system, better known as a Public Interest Score (PIS). Gordon (2011) explains that the purpose of the PIS is to calculate to what extent the South African public, other than the owners, have a stake in the company. A private company, personal liability company or close corporation will need to calculate its PIS annually, at the end of the financial year, to determine whether it is desirable in terms of the public interest to have its financial statements audited (RSA, 2011). As set out in section 30(2) of the Companies Act 71 of 2008 (RSA, 2009), this is indicated by any relevant factors, including:

- The company's annual turnover;
- The size of its workforce; or
- The nature and extent of the company's activities.

More specifically, regulation 26(2) of the Companies Regulations 2011 (RSA, 2011) outlines the annual calculation of the PIS for a profit company or close corporation as the sum of the following:

- One point for each employee in the average number of employees of the company during the financial year.
- One point for every R1 million (or portion thereof) in third party liability of the company, at financial year end.
- One point for every R1 million (or portion thereof) in turnover during the financial year.
- One point for every individual who, at the end of the financial year, is known by the company to directly or indirectly have a beneficial interest in the company's issued securities.

Regulation 28(2) of the Companies Regulations 2011 (RSA, 2011), read together with section 10(3) of the Close Corporations Act (RSA, 1984), stipulates that a private company, personal liability company and close corporation will be subject to an annual audit if its PIS in a financial year is:

- 350 or more; or
- at least 100, if its annual financial statements for that year were internally compiled.

In terms of regulation 27(2) of the Companies Regulations 2011 (RSA, 2011) financial statements are internally compiled when they are not independently compiled and reported. The term “independently compiled and reported” is defined in regulation 26(1) of the Companies Regulations 2011 (RSA, 2011) to mean prepared by an independent accounting professional, on the basis of financial records and in accordance with any relevant financial reporting standards.

Section 30(2) (RSA, 2009) furthermore states that irrespective of the company’s annual PIS, an audit must still be performed if an audit is voluntarily elected in terms of:

- the company’s Memorandum of Incorporation (MOI);
- a shareholders’ resolution; or
- a decision by the company’s board of directors.

It should be noted that although an audit may not be required in terms of the 2008 Companies Act, the MOI may require an audit if a company adopted its existing Articles of Association, without amendment, as its MOI upon the introduction of the 2008 Companies Act. A company wishing to avoid future audits would need to amend its MOI before the relevant financial year end.

(iii) Auditor requirement

Seow (2001:64) reasons that an audit may also be preserved to maintain the level of goodwill between the company and its auditor especially where a

company is highly dependent on its auditor for the provision of other non-audit services. This may in fact influence management's choice to engage in voluntary audits.

According to section 41 of the APA, an audit must only be performed by a registered auditor (RSA, 2005): that is, an individual registered as an auditor with the IRBA, the regulatory body for the auditing profession in South Africa (RSA, 2005).

Section 37 of the APA (RSA, 2005) sets out the requirements for an individual to register as a registered auditor. A person may register if that individual:

- has complied with the prescribed education, training and competency requirements for a registered auditor;
- is a resident within the Republic;
- is fit and proper to practice the profession; and
- has arranged for continuing professional development if the applicant is not a member of an accredited professional body.

This same section also clearly states that an individual may not register as a registered auditor if he/she (RSA, 2005):

- has been removed from an office of trust because of misconduct;
- has been convicted anywhere in the world of an offence because of theft, fraud, forgery, perjury, corruption, etc.;
- has been declared by a court to be of unsound mind or unable to manage his or her own affairs;
- is an unrehabilitated insolvent;
- has entered into a compromise with creditors; or
- has been provisionally sequestrated.

The mission of the IRBA is to protect the financial interests of the South African public and international investors through the effective regulation of audits

conducted by registered auditors in accordance with internationally recognised standards and processes (IRBA, 2015a).

Regulation 29(4) of the Companies Regulations 2011 requires an independent review to be performed for a company or close corporation with a PIS in excess of, or equal to, 100 but less than 350 (if the financial statements were independently compiled) by either a registered auditor or a member in good standing of a professional body accredited in terms of section 33 of the APA (RSA, 2011). A CA(SA) is a member in good standing of a professional body (in this instance, SAICA) that has been accredited in terms of section 33 of the APA (RSA, 2011). Currently in 2015, the only professional body (to date) that has been granted accreditation by the IRBA in terms of the APA, is SAICA (IRBA, 2015d). Regulation 29(5) warns that an independent review must not be carried out by an independent accounting professional who was involved in the preparation of those annual financial statements (RSA, 2011).

(iv) Independent reviewer requirement

In the case where a company or close corporation has a PIS for the financial year of less than 100, an independent review need only be performed by a person who is qualified to be appointed as an accounting officer of a close corporation (RSA, 2011).

An accounting officer refers to a person who is qualified to be appointed as an accounting officer in terms of section 60 of the Close Corporations Act 69 of 1984 (RSA, 1984). This section in the said Act 1984 states that a person who is a member of a recognised profession which, as a condition for membership, requires its members to have passed examinations in accounting and related fields of study, qualifies to perform the duties of an accounting officer (RSA, 1984).

Section 30(2A) of the 2008 Companies Act specifies that a company's accounts will be exempt from an audit or independent review where all the shareholders are also directors (RSA, 2009). This section will not apply to companies with shareholders who are juristic persons, as directors must be natural persons

(Cassim, Cassim, Cassim, Jooste, Shev & Yeats, 2012). While one would expect this exemption to apply equally to close corporations, the Close Corporations Act fails to make it relevant to close corporations. In the case where the section 30(2A) exemption applies, a compilation engagement is required (RSA, 2009).

(v) *Assurance and non-assurance engagements*

Both audit and independent review engagements are assurance engagements, where the level of assurance provided will be determined by the form of engagement (IAASB, 2005: Framework). Compilation engagements on the other hand, are non-assurance engagements (IAASB, 2005: Framework). Assurance refers to the degree of confidence the auditor or independent reviewer adds to the information being reported upon (Cassim *et al.*, 2012:605; IAASB, 2005: Framework). As discussed in section 2.2.1, the purpose of the audit is to add credibility to the financial statements. This is achieved by the expression of an opinion by the auditor on the fair presentation, in all material aspects, of the financial statements after comprehensive testing was performed (IAASB, 2009: ISA 200). This opinion only provides reasonable assurance (rather than certainty) seeing that an auditor performs test checks and does not examine every transaction (Cassim *et al.*, 2012:605; IAASB, 2009: ISA 200).

In terms of International Standard on Review Engagements (ISRE) 2400, an independent review engagement involves less comprehensive procedures than an audit, resulting in moderate assurance being expressed by the independent reviewer on the fair presentation of the financial statements (IAASB, 2013: ISRE 2400 (revised)).

In contrast to the audit and independent review discussed above, no assurance is provided by a compilation engagement which requires the use of accounting skills to compile financial information (IAASB, 2013: ISRS 4410 (revised)). Furthermore, no opinion is expressed by the compiler performing a compilation engagement (Cassim *et al.*, 2012:605).

2.5.2.3 Summary

Based on the above discussion, the form of engagement required and those person(s) eligible to perform each of these engagements, as set out in the relevant sections and regulations outlined above, are summarised in Table 2.3.

Table 2.3: Form of engagement and person eligible to perform engagement

Category of profit company or close corporation	Form of engagement	Person eligible to perform engagement
State-owned company	Audit	Registered auditor
Public company	Audit	Registered auditor
A company (excluding a state-owned or public company) or close corporation which: <ul style="list-style-type: none"> holds assets in a fiduciary capacity, in its ordinary course of business, in excess of R5 million; has a public interest score of 350 or more; or has a public interest score of at least 100 but less than 350 and has its annual financial statements internally compiled. 	Audit	Registered auditor
A company or close corporation (excluding a public company, state-owned company or entity holding assets in a fiduciary capacity in excess of R5 million), which has: <ul style="list-style-type: none"> a public interest score of at least 100 but less than 350; and its annual financial statements independently compiled. 	Independent review <i>(unless the s 30(2A) exemption applies)</i>	Registered auditor/ Member in good standing of a professional body accredited in terms of s33 of the APA (CA (SA))
A company or close corporation (excluding a public company, state-owned company or entity holding assets in a fiduciary capacity in excess of R5 million), which has: <ul style="list-style-type: none"> a public interest score less than 100. 	Independent review <i>(unless the s 30(2A) exemption applies)</i>	Registered auditor/ Member in good standing of a professional body accredited in terms of s33 of the APA (CA (SA))/ Accounting officer

Source: Adapted Cassim et al. (2012:606-609)

It is important to note that these requirements took effect on 1 May 2011. Prior to this, the financial statements of all companies required an audit by an IRBA registered auditor and the financial statements of all close corporations were subject to a compilation engagement. These changes in the legislation have

therefore resulted in some companies being relieved from the audit requirement while certain close corporations are now required to undergo an audit or independent review.

Vandiar, former SAICA project director: Assurance and Members' Advice, warns entities that are exempt from the mandatory audit against choosing an independent review engagement for the wrong reasons (SAICA, 2011). He argues an audit is not "merely an expense" and should not be thought of as such (SAICA, 2011). Business leaders should always consider an audit, as good governance can be supported by it and it provides a reasonable level of assurance whereas an independent review provides only limited assurance (SAICA, 2011).

Vandiar (SAICA, 2011) acknowledges that there were some concerns from the outset when the potential relief for companies from mandatory audits was introduced in the 2008 Companies Act, especially expressed by the small and medium-sized audit practices. Small and medium companies which formed part of the key market of small and medium-sized practices (Goyal, 2007:73; Stainbank, 2008:13), could not avoid an audit based on the previous regulations in South Africa since an annual audit was mandatory for all companies. Naturally, the removal of the mandatory audit requirement for smaller companies from the Companies Act was seen as a threat as most small and medium-sized audit practices relied heavily on the provision of audit services (SAICA, 2011). In addition, Stainbank (2008:13) was of the opinion that the relaxation of the audit requirement would mean that smaller firms would need to refocus their business, as many of their clients would no longer require an audit.

2.6 CONCLUSION

The first part of the literature review of the study was presented in this chapter. It provided background and context for the study which aims to determine the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. The chapter commenced by focusing on the origin of and need for auditing. It explained the concept of auditing, demonstrating that the purpose of

an audit is to enhance the degree of confidence of users in financial statements, achieved by way of the auditor's opinion. This was followed by an overview of the history of auditing which offered a discussion on how the changes in contextual factors have contributed to the constant change in the objective of auditing and the role of auditors. Present day auditing has developed into processes that build on the business risk viewpoint of audit clients and indications are that auditors' focus is turning to quality and wider assurance expectations.

Both agency and stakeholder theories were discussed as the theoretical underpinnings for this study. The decision to include the history of the UK was based on the fact that the UK was the first country to remove mandatory audits for SMEs (Hevlund *et al.*, 2010:13) and developments of corporate structures in South Africa have been influenced largely by the UK (West, 2009:15). The history of auditing in the USA during the 1900s developed much more rapidly than in the UK and therefore it was necessary to include this as a backdrop to the discussion on audit regulation (Brown, 1962; Matthews, 2013). The legal requirement for a professional auditor was introduced in the UK in 1948, while the requirement for an auditor in the USA was already driven by market forces prior to its regulation in 1934. A brief historical view of audit regulation in South Africa, as well as the regulation of the auditing profession in South Africa, followed as an elaboration on the South African audit history in the first section of this chapter. A historical review of the deregulation process of the statutory audit in the UK as well as in South Africa was presented.

The audit exemption regulations of the Companies Act 71 of 2008 (RSA, 2009) could be seen as a catalyst of change in small and medium-sized audit practices in South Africa. These form the focus of this study but the concept of change in organisations such as small and medium-sized audit practices should be considered in other research.

The literature review continues in Chapter 3 and focuses on the concept of organisation, organisational change and organisational change in audit practices.

CHAPTER 3

ORGANISATIONAL CHANGE AND AUDIT PRACTICES

3.1 INTRODUCTION

This chapter focuses on organisational change as a fundamental component of the organisation and explains the concept of an organisation. In line with the aim of the study to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa, small and medium-sized practices (with specific reference to South Africa) are then considered as organisations. This is followed by a discussion of what is meant by organisational change as well as a brief overview on how change should be approached. Although several types of change exist, this study distinguishes between change that evolves over time and change that occurs as a result of a disruptive event. It elaborates on a process-oriented change theory at organisational level to also better understand the work setting within an organisation. This section contextualises the study. It provides background information on how change should be managed by organisations, knowledge which is needed in considering how small and medium-sized audit practices have managed the impact of the change in South African corporate law.

Van Tonder (2014:52) is of the opinion that change over an extended period is experienced as something that “happens to” or “happens in” organisations and is completely integrated with the organisational fibre. Yet managers and practitioners seldom recognise this reality. In contrast, a change event could serve as a catalyst, as a “thrust to the fore” (Van Tonder, 2014:2).

As noted, this study aims to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. Over the years audit practices have altered along with the development of the auditing profession (an evolving change) (Chapter 2 refers) while the audit relief regulation could be regarded as a disruptive change event. A picture is sketched here by means of a brief discussion, with reference to professionalization, concerning how audit

practices have changed. The literature review concludes with a study of factors driving change in audit practices.

3.2 THE ORGANISATION CONCEPT

Various definitions of an organisation are reflected upon in this section. This is followed by a discussion of small and medium-sized practices as organisations; lastly, attention is given to small and medium-sized audit practices in South Africa.

3.2.1 Defining the organisation concept

The nature of the organisation has been researched from almost every possible point of view, as is evident from the wide array of research streams from multiple disciplines that have focused on the subject, including management, economics, sociology, political science and psychology (Shenhav, 1995; Rozman, 2012:2).

George and Jones (1996:4) define an organisation as “a collection of people who work together to achieve a wide variety of goals”. According to Wilson and Rosenfeld (1990:2) organisations are “social collectivities ... filled with people”. Daft, Murphy and Willmott (2010:10) reiterate that [an] “...organization is a social entity” and add that an organisation “...is goal directed and deliberately structured and coordinated and linked to the environment”. Robbins and Coulter (2009:15) define an organisation as “a deliberate arrangement of people to accomplish some specific purpose”. Pfeffer (1997:7) states that “...the goal oriented or instrumental view of organizations implies that organizations are collections of individual efforts that are coordinated to achieve things that could not be achieved through individual action alone”. All of the above define organisations as social units consisting of people (or collectives) which have specific goals. Within organisations, various tasks and responsibilities are allocated to different members in a synchronised way in order to achieve the specific goals of the organisation. Robey and Sales (1994:7) refer to an organisation as “a system of roles and stream of activities to accomplish shared purposes”.

Schein (1980) admits that it is surprisingly difficult to provide a simple definition of the term “organisation” and more recently, Van Tonder (2014:14) says it is improbable that agreement will be reached on the definition, or the term, “organisation” with increasing differentiation and specialisation within the scientific disciplines.

Despite the above extensive and even expansive attempts at defining the term “organisation”, it was decided that for the purpose of this study, organisations are complex entities that are unique and purposeful and guided by leadership. An organisation is constantly changing and therefore stands in a changing relationship with the environment (Van Tonder, 2014:51). Terminology, such as “firm”, “practice”, “business”, “company”, and “corporation” may be regarded as synonyms for the term “organisation”.

Another perspective suggested by Greenwood and Empson (2003:910) is to define an organisation in terms of governance structures. They (2003:916, 917) maintain that the partnership and the private corporation are suitable vehicles for managing professionals, such as auditors, because they optimise the probability of job satisfaction, retention and effort for professional workers. In professional firms, knowledge of individuals represents the key income-generating asset (specialised technical knowledge, client-specific knowledge and industry knowledge) (Greenwood & Empson, 2003:917). The organisational forms available for small and medium-sized audit practices in South Africa are further explained in section 3.2.3.

3.2.2 Small and medium-sized audit practices as organisations

This study focuses on small and medium-sized audit practices as a type of organisation.

Worldwide economic growth has brought small and medium-sized entities into sharper focus. Known as SMEs in the business world and small and medium-sized practices in the professional world, the small and medium segment has never been as important as today (Goyal, 2007:73).

Although there is no practical definition of small and medium-sized audit practices, Goyal (2007:74) argues that there are a few common characteristics:

- Proprietorship or small partnership.
- Mostly single location services.
- More reliance on traditional practice (compliance with accounting, taxation and other regulation).
- Few sources of income.
- Mostly serving SMEs.
- No or negligible expenditure on human resources and research.
- Not part of any national or international network.

In addition, Greenwood and Empson (2003:921-926) add the following characteristics for small and medium-sized practices of this nature:

- Less complex, allowing partners to be responsible for decision-making.
- Exhibit homogeneity.
- Firm's capital is limited to the wealth of partners.
- Strategy to accommodate customisation to solutions of client problems.
- Vulnerability of partners to the risks of litigation.
- Motivate professionals using admission to the partnership as the lure.

The term "small practitioner" suggests interesting properties that derive from the comparative nature of the word "small", which encapsulates the physical (big/small firms), the geographical (global/local practitioners) and the moral (well-known/anonymous members) dimensions (Ramirez, 2009:384).

Small and medium-sized audit practices are traditionally organised as partnerships (Jeppesen, 2007:593). Partners in small partnerships are considered sufficiently knowledgeable to participate efficiently in decision-making (Greenwood & Empson, 2003:921). Professional audit practices, including small and medium-sized practices, are at the core of the professional accountants' activities and as these activities mean applying an esoteric body of knowledge to

resolve complex problems, they enjoy high levels of discretion and autonomy (Greenwood, Hinings, & Brown, 1990).

The issue that has been raised concerning the definition of what small and medium-sized practitioners are, and how they should be dealt with, can only be understood as part of the broader issue of regulated governance of the accountancy community and the innate nature of the professional body (Ramirez, 2009). These considerations are briefly discussed in sections 3.5.1 and 3.5.2.

Even though audit markets have been studied extensively over the past three decades, the research has focused largely on the top-end of the market (Bröcheler *et al.*, 2004:628,629). Bröcheler *et al.* (2004:629) argue that “considering the economic importance of the small audit client and small audit firm segment” this omission cannot be justified. Ramirez (2009:384) believes that small practitioners are among those members of the profession who are particularly proud of being chartered accountants and will not hesitate to oppose any attempt to modify or dilute the characteristics of a qualification they have sometimes fought hard to obtain. In the case of small practitioners, the Chartered Accountant qualification is all the more important since it is very often their only qualification and the only dimension of their professional identity (as opposed to members employed in industry, commerce or public services who also “belong” to the organisations for which they work) (Ramirez, 2009:384).

In their study on auditor human capital and audit firm survival in the Dutch audit industry, Bröcheler *et al.* (2004:643, 644) found that for small and medium-sized audit practices human capital variants (measured by the education, experience and development of staff at the founding of the firm and over time) are important determinants of audit practice performance. Higher levels of staff education at founding or during the lifetime of the practice, have a positive effect on the longevity of the practice and also make it more attractive for take-overs by larger practices (Bröcheler *et al.*, 2004:643). These authors also found that the aging of personnel of a small and medium-sized practice has a negative effect on practice performance (Bröcheler *et al.*, 2004:643).

3.2.3 Small and medium-sized audit practices in South Africa

Following the examination of the organisation concept and in particular, small and medium-sized audit practices as a type of organisation, this section sheds light on the ways in which these specific practices function specifically in South Africa. This includes a brief investigation of such audit practices operating as training offices for trainee accountants as well as of the type of services these practices provide to their clients.

3.2.3.1 Registration and inspections

Section 38 of the APA (RSA, 2005) sets out the requirements for the registration of audit practices as registered auditors and states that the only practices that may become registered auditors are:

- partnerships of which all the partners are individuals who are themselves registered auditors;
- sole proprietors where the proprietor is a registered auditor; and
- companies which are registered in terms of the Companies Act of 1973 where just those individuals who are registered auditors are shareholders of the company and where every shareholder is a director of the company and every director is a shareholder.

Audit firms that practice as registered auditors and perform mandatory audits of company financial statements, in terms of the 2008 Companies Act, are subject to firm inspections at least once in a three year cycle (IRBA, 2015f). Firm inspections are performed by the IRBA, the audit regulator in South Africa, in terms of section 47 of the APA (RSA, 2005), which provides that steps must be taken to promote the integrity of the auditing profession, including:

- investigating alleged improper conduct;
- conducting disciplinary hearings;
- imposing sanctions for improper conduct; and

- conducting practice reviews or inspections.

A firm inspection examines the quality control elements of leadership responsibilities, ethical requirements, client acceptance and continuance, human resources, engagement performance, monitoring and documentation. This inspection includes an examination of a risk-based sample of assurance engagements in order to monitor registered auditors' compliance with the relevant professional pronouncements and codes of conduct in the performance of the assurance function. An audit practice is charged for all inspections based on a percentage of the total fees, declared to the IRBA annually, for assurance work invoiced by that practice in the previous calendar year (IRBA, 2015f).

3.2.3.2 Classification

The IRBA has delineated a practice classification for every practice registered with them, based on two criteria: size and race. According to the IRBA, the size of audit practices is determined by the number of audit partners. The IRBA's classification is as follows in Table 3.1:

Table 3.1: The IRBA's classification of audit practices

Classification	Number of audit partners
Large practices	20+
Medium practices	5 – 19
Small practices	2 – 4
Sole proprietors	1

Source: IRBA 2015b

The IRBA furthermore classifies every practice by the number of audit partners of each particular race in that practice. The race groups are as follows:

- White;
- Black – African;
- Black – Indian;

- Black – Coloured; and
- Black – Chinese

It is thus clear that the IRBA only takes into consideration the partners of an auditing firm when determining the racial classification of a firm. Even if there should be qualified auditors in the employ of the firm they would not be brought into the calculation since they are not partners (IRBA, 2015b).

An audit firm may be a training office and this is addressed next.

3.2.3.3 Training function

SAICA and SAIPA are two professional accounting bodies that function in South Africa. Small and medium-sized audit practices accredited by SAICA or SAIPA may act in a training capacity for prospective CAs(SA) and Professional Accountants (South Africa), respectively. Individuals holding the CA(SA) designation, which is obtained after a period of education and training, have the potential to become registered auditors and to conduct audits, whereas this opportunity is not available to Professional Accountants (South Africa). The training function of small and medium-sized audit practices is detailed below.

Small and medium-sized audit practices may be accredited by SAICA as training offices with the main objective of training prospective CAs(SA). Accreditation will only be determined once a formal application process has been completed and SAICA is convinced that the audit practice (irrespective of its size) has the ability to deliver the appropriate range, depth and quality of training and experience (SAICA, 2015b). In addition, the training office (whether prospective or currently accredited) must demonstrate a commitment to provide the requisite experience for prospective CAs(SA) and must provide adequate training facilities (SAICA, 2015b). From 1 January 2016, a training office must furthermore demonstrate that it is economically sustainable and, in the case of organisations in public practice, that it has an existing client base that will enable it to provide the prescribed range and depth of experience to prospective or current trainees (SAICA, 2015b).

Each accredited training office must register one person with SAICA as a training officer. The person registered as a training officer must be a CA(SA) and in the case of a training office accredited for purposes of the auditing and assurance elective, the training officer must be a registered auditor. The said officer must, on behalf of the organisation, accept responsibility for the training of trainee accountants carried out at the given office, in accordance with the requirements of SAICA (SAICA, 2015b).

A small or medium-sized audit practice may also be accredited by SAIPA as an Approved Training Centre (ATC). The ATC must provide a suitable and professional training environment for the prospective Professional Accountant (South Africa) for their learnership, and is also required to demonstrate that resources are available for meeting the training requirements as prescribed by SAIPA (SAIPA, 2015). Each ATC must have an overall evaluator, who is a member in good standing registered with SAIPA, to act as a mentor and facilitate trainees with assembling their portfolios of work completed during the training programme to demonstrate the trainees' competence. SAICA members also qualify to register as overall evaluators (SAIPA, 2015).

A small or medium-sized audit practice, which may also act as a training office or an ATC, offers various services. A discussion of these services follows.

3.2.3.4 Type of services

Audit practices in South Africa place professional services at the disposal of the public for reward (RSA, 2005). For the purposes of this study, these professional services require accounting or related skills and are performed by a registered auditor. They include accounting, auditing, review, other assurance and related services, taxation, management consulting and financial management services (IFAC, 2012).

In terms of section 90(2)(b) of the Companies Act 2008, an auditor may not be a person who, by him- or herself (or with a partner or employees), usually or regularly performs the duties of an accountant or bookkeeper or performs related

secretarial work for the company, or who performed such functions during the five years immediately preceding the date of appointment as auditor of the company (RSA, 2009). This stipulation of the five-year period only commenced on 1 May 2011 (RSA, 2009).

It is imperative for an auditor to be independent of the company as this ensures that the integrity of financial information, which is disclosed to third parties, is maintained (Cassim *et al.*, 2012:421). Section 44 of the APA reinforces this by stating that a registered auditor may not audit any financial statements of an entity if he/she has or has had a conflict of interest, as prescribed by the IRBA, in respect of that entity (RSA, 2005). Potential conflicts of interest, including those arising from a compromise of the auditor's independence, are addressed in the Code of Professional Conduct for registered auditors (IAASB, 2014: BN 25).

3.2.3.5 Summary

In South Africa, all registered auditors who are acting as sole proprietors, or as partners in a partnership, or as shareholders and directors of a company, may register as an audit practice (RSA, 2005). These audit practices will furthermore be classified based on their size (number of audit partners) and race (ethnic groups these partners belong to). Small and medium-sized audit practices (that meet the requirements) may be accredited by SAICA as a training office to train prospective CAs(SA), and/or may also be accredited by SAIPA as an ATC to provide professional training for prospective Professional Accountants (South Africa). Each training office must register a qualified CA(SA) as a training officer with SAICA, (and in the case of a training office for auditing, that person must also be a registered auditor). For each ATC, an overall evaluator, who is a SAIPA or SAICA member, must be registered with SAIPA. These audit practices furnish professional services to the public, which include accounting, auditing, review, other assurance and related services, taxation, management consulting and financial management services. Since the auditor must always be independent of the company to maintain the integrity of the financial information, the auditor alone (or with a partner or employees) may not also perform the duties of an accountant/bookkeeper or related secretarial work for that company.

3.2.4 Conclusion on the organisation concept

Organisations may be regarded as complex entities that are unique and purposeful and guided by leadership. A small or medium-sized audit practice could be seen as a type of organisation which functions as a sole proprietorship or small partnership, mostly at a single location and relying on traditional services provided to SMEs, with negligible expenditure on human resources and research. In addition, a small and medium-sized audit practice does not form part of an international (or even national) network.

Other than sole proprietors, small and medium-sized practices are traditionally organised as partnerships. Such practices exhibit homogeneity, allow partners the responsibility for decision-making, allow for customisation of solutions to client problems, are vulnerable to litigation affecting partners and motivate staff using admission to the partnership as a lure. The human capital of these practices (measured by the education and experience of staff members) constitute important determinants of the practice's performance.

Auditors can practise in South Africa as partnerships, sole proprietors or companies (where all shareholders are registered auditors and directors of the company) (RSA, 2005). The number and race of partners determine the categorisation of audit practices as sole proprietors, small, medium-sized or large practices, as well as the ethnic grouping of the practice. Small and medium-sized audit practices may also be accredited by either SAICA (as a training office) or SAIPA (as an ATC) to provide the necessary training to prospective CAs(SA) or Professional Accountants (South Africa) respectively. Although audit practices deliver a variety of professional services: accounting, auditing, review, other assurance services, taxation, management consulting and financial management services, an auditor appointed by a company may not also perform (individually or together with a partner or employees) the duties of an accountant/bookkeeper or related secretarial work for that company.

The following section provides a detailed review of the background to organisational change to further the aim of this study.

3.3 ORGANISATIONAL CHANGE

As we find ourselves in the midst of a rapidly evolving society that is no longer characterised by the apparent stability of the previous century, change is also evident in the “shifting sense of value” in the global business context (Van Tonder, 2014:3). Jeppesen (2007:591) maintains: “The only thing stable these days is change”; hence, to be able to survive, organisations should adapt swiftly to market changes.

Organisations have been subjected to a state of constant change since the early 1990s and therefore institutional transformation has been considered one of the most salient features of the last decade (Korten, 1995; Van Tonder, 2014:4). De Geus (1997), nearly two decades ago, remarked that organisations seem to struggle with change, judging by their decreasing life expectancies, and Van Tonder (2014:4) adds that “their adaptive responses generally appear inadequate.” Van Tonder (2014:4) further remarks that during the 1990s these adaptive responses consisted mostly of mergers and acquisitions, corporate restructurings and strategy changes. Attempts to realign the organisation with changing environmental conditions are now a global reality. This requires an understanding of the term “organisational change”, a framework for how it should be approached and consideration of the types of changes. These aspects are considered in this section.

3.3.1 Defining organisational change

Change is a constant in organisational life, at both operational and strategic levels; therefore an organisation should constantly rethink and plan its future and how it will manage the changes required to stay relevant. Organisational change and organisational strategy are therefore inseparable (Burnes, 2004).

Van Tonder (2014:6) believes that descriptions of change diverge in terms of perspective and focus, but converge in terms of viewing change as a “process resulting in a difference of varying magnitude and nature in the state and/or condition of a given entity over time – whether the entity is a phenomenon,

situation, person, and/or object.” Because a definition of change lends itself to contextualisation and further specification, Van Tonder (2014:6) suggests replacing the word “change” with “organisational change” and defines the latter as follows: “Organisational change is a process resulting in a difference of varying magnitude and/or nature in the state and/or condition of the organisation over time.”

Senior (2002) describes organisational change as an on-going process to match the organisation’s strategy, processes, people and structure. It is usually manifest at a departmental or divisional level of the organisation.

From the above, it becomes clear that change is embedded in an organisation and is a process with wide implications for an organisation’s strategy, processes, people and structure.

3.3.2 Framework for organisational change

Although it is difficult to identify any consensus regarding a framework for organisational change management, there seems to be agreement on two important issues (By, 2005:370): Firstly, that the pace of change has never been greater than in the current business environment and secondly that change is provoked by internal and external factors and comes in all shapes, forms and sizes (Burnes, 2004; Carnall, 2003; Kotter, 1996; Luecke, 2003; Moran & Brightman, 2001; Okumus & Hemmington, 1998). Change therefore affects all organisations.

Another useful framework for viewing organisational change as a process is presented by Porras and Silvers (1991:52) who state that organisational change consists of the following components: an initiative, which alters critical organisational processes, which in turn influences individual behaviour, which subsequently impacts on organisational outcomes. Viewing organisational change as a process is useful for this study because the focus is on the effect of change, in the form of deregulation of statutory audits, on small and medium-sized audit practices.

In considering a framework for organisational change, cognisance should be taken of its pace and the reality that it is stimulated by both internal and external factors. The starting point is an initiative which critically alters an organisation's processes, influences individual behaviours and eventually impacts the organisation's outcomes. Guiding approaches for change depend on the rate of occurrence of change, the manner in which change arises and the scale of the change. These are further considered in the next section.

3.3.3 Guiding approaches to change

Successful management of change is a highly desired skill. Management of organisational change currently tends to be reactive, discontinuous and ad hoc, with a reported failure rate of around 70% of all change programmes initiated (Balogun & Hope Hailey, 2004). According to By (2005:378) this may indicate the fundamental lack of an effective framework for the successful management of organisational change, "...since what is currently available is a wide range of contradictory and confusing theories and approaches". It thus appears that for change to be managed within organisations, a distinct approach has to be followed. Mintzberg, Lampel and Ahlstrand (1998:325), bluntly state that "...change can't be managed. Change can be ignored, resisted, responded to, capitalised upon and created. But it can't be managed and made to march to some orderly step-by-step process". In this study, the researcher also aligns herself with the view of Seel (2000; 2001) "...that change can be influenced but cannot be directed, controlled, managed or imposed in the absolute sense".

In this section the focus is on current change management approaches with specific reference to the three categories of approaches as identified by Senior (2002): change characterised by the rate of occurrence, change characterised by how it comes about and change characterised by scale.

3.3.3.1 *Change characterised by the rate of occurrence*

According to the early approaches to organisational change management, it was suggested that organisations could not be effective if they were constantly

changing (Rieley & Clarkson, 2001). In later years it was argued that it is of utmost importance to organisations that people are able to accept continuous change (Burnes, 2004; Rieley & Clarkson, 2001). According to Leifer (1989), change should be a normal and natural response to internal and environmental conditions.

The main types of change categorised by the rate of occurrence (Grundy, 1993; Luecke, 2003; Senior, 2002) are continuous change (Grundy, 1993; Luecke, 2003; Senior, 2002) and incremental change (Burnes, 2004). Grundy (1993) and Senior (2002) distinguish between “smooth” and “bumpy” incremental change. Grundy (1993:26) defines discontinuous change (bumpy) as “change which is marked by rapid shifts in either strategy, structure or culture, or in all three”. This sort of rapid change can be triggered by major internal problems or by considerable external one-time events (Luecke, 2003:102). In sharp contrast to the above, Burnes (2004) identifies continuous change (smooth) as the ability to change continuously in a fundamental manner so as to keep up with the fast-moving pace of change.

Incremental change takes place when individual parts of an organisation deal progressively and independently with one problem and one objective at a time (Burnes, 2004). Grundy (1993) proposes dividing incremental change into “smooth incremental change” (change that evolves slowly in a systematic and predictable way at a constant rate) and bumpy incremental change (characterised by period of relative peacefulness punctuated by acceleration in the pace of change). Senior (2002) suggests that smooth incremental change, which evolves slowly in a systematic and predictable way, is “exceptional and rare” in the current environment and in the future. Burnes’ (2004) term for “bumpy incremental change” is “punctuated equilibrium”. Various scholars have used these concepts in their change management approaches; for example, Luecke (2003) is of the opinion that these categories are quite complex, and therefore suggests combining continuous and incremental change. Furthermore, Burnes’ (2004) “punctuated equilibrium” model has been merged with Grundy’s (1993) “bumpy incremental change” model as they both take the same approach.

From the above it is clear that the rate at which change occurs can be used as a change attribute. It makes provision for continuous change and incremental change.

3.3.3.2 *Change categorised by how it arises*

When characterised in terms of how change arises, there are several different approaches (By, 2005:373). Bamford and Forrester (2003) mention that the literature is dominated by planned and emergent change as two approaches to change. Burnes (2004) makes it clear that there is no single widely accepted and practical approach to organisational change management. Nevertheless, the planned approach to organisational change attempts to explain the process that brings about change (Burnes, 1996; Elrod II & Tippett, 2002). The planned approach emphasises the importance of understanding the different states which an organisation will have to go through in order to move from an inadequate state to an identified preferred state (Elrod II & Tippett, 2002).

The planned approach was initiated in 1946 by Lewin who was a theorist, researcher and practitioner in interpersonal, group, intergroup and community relationships (Elrod II & Tippett, 2002). Lewin's model of change is built upon the three steps of "unfreezing" the present level, moving to the new level and then "refreezing" this new level (Elrod II & Tippett, 2002). Since this model is regarded as rather broad, several authors have attempted to refine and make it more practical (Bamford & Forrester, 2003). Bullock and Batten (1985) developed a four-phase model of planned change that presents the process as consecutive steps: exploration, planning, action and integration. Burnes (2004) regards this as a highly applicable model for most change situations.

Since the early 1980s criticism (Kanter, Stein & Jick, 1992; Burnes, 1996) has been directed at the planned approach to change, despite it being held to be highly effective (Bamford & Forrester, 2003; Burnes, 2004). The following points are relevant to this criticism: firstly, the emphasis of this approach falls on small-scale and incremental change and is therefore not applicable to situations that require rapid and transformational change (Burnes, 1996, 2004; Senior, 2002).

Secondly, with regard to the planned approach, it is assumed that organisations operate under constant conditions (Bamford & Forrester, 2003). Burnes (1996, 2004) and Wilson (1992) reason that the current, fast-changing environment weakens this theory. Thirdly, some situations require more directive approaches. For instance, a situation of crisis requires major and swift change that does not allow for opportunity for widespread consultation (Burnes, 1996, 2004; Kanter *et al.*, 1992). The critics therefore argued that the planned approach to change ignores organisational politics and conflict and assumes that change could be easily identified and resolved (Burnes, 1996, 2004).

Rather than considering change as driven from the top down, the emergent approach tends to regard change as driven from the bottom up (Bamford & Forrester, 2003; Burnes, 1996, 2004). The emergent approach to change emphasises that change should be perceived as a continuous, open-ended process of adaptation to changing circumstances and conditions (Burnes, 1996, 2004; Dawson, 1994). In other words, this approach stresses the unpredictable nature of change. The uncertainty of both the external and internal environment makes this approach more pertinent than the planned approach (Bamford & Forrester, 2003). According to Burnes (1996:14), the emergent approach stresses a promotion of “extensive and in-depth understanding of strategy, structure, systems, people, style and culture, and how these can function either as sources of inertia that can block change, or alternatively, as levers to encourage an effective change process”.

Bamford and Forrester (2003) and Wilson (1992) argue that the emergent approach to change still lacks consistency, rationality, and a diversity of techniques. According to Burnes (1996) the validity and applicability of this approach depends on whether or not one believes that all organisations operate in dynamic and unpredictable environments, to which they constantly have to adapt. If that is the case, which some researchers doubt, “the emergent model is suitable for all organizations, all situations and at all times” (Burnes, 1996).

The manner in which change arises can be seen as a change attribute. The literature refers to two dominant approaches to consider this phenomenon, the

planned one and the emergent one. Both these approaches could be criticised, pointing towards the difficulty of dealing with change.

3.3.3.3 *Change categorised by its scale*

Dunphy and Stace (1993) propose four different characteristics of change identified by scale: Fine-tuning, incremental adjustment, modular transformation and corporate transformation. Further consideration is given to these characteristics.

Nelson (2003) refers to fine-tuning as convergent change. According to Dunphy and Stace (1993) the purpose of fine-tuning is to identify and develop personnel suited to the present strategy, connect mechanisms and build specialist units to increase capacity as well as devoting attention to cost and quality. In this process, policies, methods and procedures should be refined. Furthermore, the fine-tuning should nurture the commitment of individuals and groups to the excellence of the organisation's mission. Recognised and established roles should be clarified while confidence in accepted beliefs and norms should be stimulated (Dunphy & Stace, 1993).

According to Senior (2002) incremental adjustment involves discrete modifications to management processes and organisational strategies. It does not include fundamental change.

Modular transformation is change identified by major changes or modifications of one or several departments or divisions. These changes might be radical as opposed to incremental adjustments, but only focus on a part of an organisation rather than on the organisation as a whole (Senior, 2002).

The fourth characteristic of change identified by scale is described as corporate transformation. This change is entity-wide and characterised by radical alterations in the business strategy. Examples of this type of change could be reorganisation, revision of interaction patterns, reformed organisational mission and core values, and altered power and status (Dunphy & Stace, 1993).

Using scale as a change attribute requires the consideration of sections of the different steps; fine-tuning, modification, transforming the whole organisation. The latter includes radical alterations of the business strategy.

3.3.4 Types of change

Different authors hold different views on types of change. While Luecke (2003) proposes that a state of continuous change can become routine in its own right, Leifer (1989) views change as a normal and natural response to internal and environmental conditions. However, Burnes (2004) and Rieley and Clarkson (2001) regard it as being of vital importance to organisations that people are able to accept continuous change.

A very obvious observation, according to Van Tonder (2014:100), is that change theorists for the most part have categorised change in terms of extremes, "...often as polar opposites in a descriptive dimension". Such "absolute" forms of change that emerge from the literature are: continuous, discontinuous and radical change; evolutionary and revolutionary change and punctuated equilibria; transformational change and organisational transformation. The brief consideration of these extremes of change presents us with the distinct impression that so-called different types of change may not be that different (Van Tonder, 2014:100-110).

Ackerman (1986) expresses a view on change which distinguishes between the following forms: developmental change (an improvement of what is in existence); transitional change (implementation of a known new state, and management of the interim transition state over a controlled period of time); and transformational change (emergence of a new state out of the remains of the chaotic death of the old state, which is unknown until it takes shape).

From the above it is evident that distinct classes of change representing intermediate or in-between points on the observed continuum between incremental evolutionary change on the one hand and radical revolutionary change on the other hand are not identified. Van Tonder (2014:110) argues that

two primary change types underlie the pool of different change typologies and concepts. For the purpose of this study the researcher focused just on these two types of changes:

- A steady-state, incremental or step-by-step, sequential change which generally evolves over extended periods of time, does not have a disruptive influence on the system and is generally perceived to be within the control of the system – referred to as *Type I* change.
- A major, disruptive, unpredictable, paradigm-altering and system-wide change which has a very sudden onset and escalates rapidly to a point where it is perceived as beyond the control of the system – referred to as *Type II* change.

While there is acknowledgement that limitations of existing knowledge do not allow us to thoroughly comprehend the synchronised and integrative nature of both *Type I* and *Type II* change processes within organisations, theory and practice indicate that “organisations nonetheless change through combinations of both” (Van Tonder, 2014:111). Precisely how and when one of the two types of change converts into the other, and for what period of time, is still unclear. Attempts to define this transition (e.g. the punctuated equilibrium perspective) (Tusman, Newman & Romanelli, 1986; Gersick, 1991) have added more descriptive clarity, but no causal or predictive clarity and, although the chaos and complexity perspective on organisational change is able to further specify the circumstances that could lead up to this transition, prediction is still impossible (Van Tonder, 2014:111).

For Van Tonder (2014:112) empirical studies clearly confirm that at least two distinct types of change (*Type I and Type II*) occur within organisations; while not only does organisational change involve both types in succession, but it may in fact be desirable at times to consciously pursue rapid, revolutionary and disruptive organisational change (*Type II*). Van Tonder (2014:112) also mentions that managed change processes are limited in terms of what they can achieve; therefore major turnaround strategies designed to reposition the organisation are

unlikely to succeed if they are approached from a *Type I* change perspective and methodology. The sustainability of any change is dependent on an underlying cognitive change which resides in the category of *Type II* change (Van Tonder, 2014:112).

3.3.5 Conclusion on organisational change

Change is a reality and is embedded in an organisation. It could be considered as a process which impacts on an organisation's strategy, processes, people and structure. A useful framework for organisational change is to regard an initiative as the starting point which then manifests in an organisation's processes, individuals' behaviours, influencing outcomes. Change attributes could be considered in deciding on a change management approach. These include the rate of change (continuous or incremental), the way in which change arises and the scale of its occurrence.

Different views exist on the types of change. For the purpose of this study the researcher recognises *Type I* (incremental or step-by-step change over an extended period of time) and *Type II* (disruptive, unpredictable change) changes. It is Van Tonder's view that this naming convention bypasses the tendency to overemphasise the descriptive parameter occurring in a label such as, for example "revolutionary change" (Van Tonder, 2014:111).

3.4 A PROCESS-ORIENTATED CHANGE THEORY AT ORGANISATIONAL LEVEL

Porras (1987:51) considers an organisation as being built on a foundation of four basic dimensions which constitute the specific factors in the work setting. Since this setting is the environment in which people work and since the environment plays a key role in determining the behaviour of people, these four dimensions define the features that, if changed, will ultimately alter the expectations of people and, as a consequence, their on-the-job behaviours (Table 3.2).

Table 3.2: Organisational components in the Stream Organisation Model

1. Organising arrangements	2. Social factors	3. Technology	4. Physical settings
A. Goals B. Strategies C. Formal structures D. Administrative policies and procedures E. Administrative systems F. Formal reward systems 1. Evaluation system 2. Pay systems 3. Benefits packages	A. Culture 1. Basic assumptions 2. Values 3. Norms 4. Language and jargon 5. History B. Interaction processes 1. Interpersonal 2. Group 3. Intergroup C. Social patterns and networks 1. Communication 2. Problem solving/decision making 3. Influence 4. Status D. Individual attributes 1. Attitudes and beliefs 2. Behavioural skills 3. Feelings	A. Tools and equipment B. Technical expertise C. Service offerings D. Technical policies and procedures	A. Location

Source: Adapted from Porras (1987:52)

Table 3.2 is a summarised description of the organisational components in the Stream Organisation Model (Porras, 1987:52). The four dimensions, foundational areas, or streams, of the organisation according to this table are:

- Organising arrangements.
- Social factors.
- Technology.
- Physical settings.

These four dimensions, areas or streams can also be regarded as four major interrelated subsystems of an organisational work setting (Porras, 1987). Each subsystem consists of specific components that strongly influence the work behaviour of individual members. Individual behaviour, in turn, is a primary factor of two categories of organisational outcomes: the level of organisational performance and the level of individual development of members of an organisation.

In this study, the researcher included these four foundational areas as the basis for the semi-structured interviews for data collection purposes. The foundational areas form the components of an organisation; by asking questions pertaining to elements of these dimensions, the researcher attempted to determine the impact of mandatory audit relief on small and medium-sized audit practices in totality. Porras (1987:51) regards the four dimensions as the “broad process through which system inputs are transformed into system outputs”.

The four organisational components in the Stream Organisation Model of Porras (1987) are explained in the succeeding paragraphs (section 3.4.1 to 3.4.4).

3.4.1 Organising arrangements

The organising arrangements’ stream or area contains all the parts of the organisation that are set up to formally synchronise both the behaviour of people in the organisation as well as the functioning of various parts of the organisation. This area usually exists in written form and describes the way the organisation is supposed to work, not necessarily the way it actually does. Organising arrangements are formal elements of organisations that are developed to provide the coordination and control necessary for organised activity. Examples of such arrangements are formal structures and reward systems (Robertson, Roberts & Porras, 1993:620). They are also known as the formal side of the organisation (Porras, 1987:51).

The following core organising arrangements are the most typical targets of planned change efforts:

- Goals.
- Strategies.
- Structures.
- Policies and procedures.
- Administrative systems.
- Reward systems.

Goals tell people what the organisation is trying to achieve and define what the aim of each individual should be (Porras, 1987:54). *Strategies* prescribe the way the organisation is to go about achieving its goals and broadly define the behaviours most desired by the organisation (Porras, 1987:54). *Structures* refer to the formation of relationships between various authorities and also describe the overall composition of an individual's role (Porras, 1987:54). *Policies and procedures* provide individuals with guidelines outlining acceptable and unacceptable behaviour in the work setting (Porras, 1987:54). In order to develop all relevant resources, provide information and coordinate data, one needs certain systems in place, which are referred to as *administrative systems*. And lastly, the *reward systems* assess and reward people for their contributions to the success of the system in reaching its goals (Porras, 1987:54).

Almost all organisational changes involve changes in the behaviour of members. To make change durable, members of the organisation must integrate the new policies or improvements into their daily routines. Employees must learn and live these behaviours in the short term, and leaders must institutionalise them so that new patterns of behaviour displace old ones (Edmondson, Bohmer & Pisano, 2001; Greiner, 1967; Kotter, 1995).

Doing so, however, is not straightforward. Armenakis, Harris and Feild (1999) have developed a model for reinforcing and institutionalising change. According to the model, leaders can amend formal structures, procedures and human resource management practices. Resources and services can be employed; innovation through trial runs and pilot projects can be disseminated; data can be

collected to track the progress of change and employees can be engaged in active participation (Armenakis *et al.*, 1999).

This area assumes reasonableness and individual behaviour consistent with rational choices. If all its components were aligned and consistent with one another, then the messages sent out by them would all reinforce the same behaviours and exert a rather powerful force. Porras (1987:55) recognises that people do not always respond consistently with what the organising arrangement's stream of variables tells them to do. Employees respond in many different ways, some of them quite unpredictably, and they do so for a variety of reasons. Some of these reasons are rooted in the fact that there are other key areas of the organisation, such as social factors, which also have powerful effects on people and their behaviour (Porras, 1987:55).

3.4.2 Social factors

Social factors include all aspects directly related to people in the organisation: their characteristics, their patterns and processes of interaction and their features as larger social groups. Social factors, according to Robertson *et al.* (1993:620) are the individual and group characteristics of the people in an organisation, their patterns and processes of interaction and the organisational culture. This stream is known as the informal organisation in contrast to the organising arrangements, which are considered the organisation's formal side (Porras, 1987:55). Porras (1987:63) identifies the four social factors which describe the human and said informal side of the organisation: culture, interaction processes, social patterns and networks and the individual attributes. Porras (1987:63) calls these factors the "...most intangible, the softest or 'mushiest' parts of the organization and the most difficult to characterize or pin down." He adds that they heavily influence the three other dimensions of the organisation (Porras, 1987:63).

Employees' perceptions of the organisation's readiness for change have been identified as one important factor in understanding sources of resistance to change. These perceptions may assist or weaken the effectiveness of a change intervention (Armenakis, Harris & Mossholder, 1993). McDonald and Siegal

(1993) state that employee attitudes toward a pending change can impact morale, productivity and turnover intentions. Individuals hold preconceived notions about the extent to which the organisation is ready for change (James & James, 1992). It can therefore be deduced that readiness for change is conceptualised in terms of an individual's perceptions or, stated otherwise, the perceptions of the organisation's readiness for change are based on an individual's unique interpretation of the organisation's context. Therefore it is necessary to understand employees' perceptions of readiness for change in order to comprehend the change process.

In order to understand readiness for organisational change, three classes of variables have been identified. These may be related to an individual's interpretation of organisational reality: they are individual attitudes and preferences, work group and job attitudes, and contextual variables (James & Jones, 1980).

Individual attitudes and preferences, as one class of variables, is based on the individual's experience within the organisation, as well as personal attitudes about change in general (Schneider, Gunnarson & Niles-Jolly, 1994). Organisational experiences influence an employee's opinion about the organisation's adaptability and expectations on how the organisation will fare during changing conditions (Schneider *et al.*, 1994). Furthermore, perceived support or stated otherwise, an employee's perceptions that the organisation cares for his or her well-being and is supportive of his or her concerns (Eisenberger, Huntington, Hutchinson & Sowa, 1986), may impact their reaction to the anticipated change such that it is perceived as less threatening, and that change is therefore viewed more favourably (Rush, Schoel & Barnard, 1995; Lau & Woodman, 1995).

Work group and job attitudes are the second class of variables considered important components of "climate perceptions". James and James (1992) identify two underlying factors related to overall "climate perceptions": job challenge and autonomy and work-group cooperation; friendliness and support. Cummings and Huse (1989) emphasise the trust-factor as a variable in interpersonal and social

dynamics within one's work group and add that having trust in management as well as in one's co-workers is important for change efforts to be successful.

Contextual variables comprise the third class of variables regarded as important in understanding how an employee perceives the organisation's readiness for change. Armenakis *et al.* (1993) refer to the degree to which organisational policies and practices are supportive of change. This may include flexible policies and procedures as well as logistics and systems support, which in turn may increase employee confidence in the organisation's ability to withstand change and create the momentum necessary to sustain the change effort.

It is clear that an organisation cannot exist without its employees and that change within organisations cannot take place or be dealt with effectively if the individual employee is not engaged in the change initiative. Individuals should eventually internalise and accept the change and finally support efforts to manage this change process (Van Tonder, 2014:8). Beer and Nohria (2000) state that the lack of participation and involvement by the employee is one of the primary reasons why so many organisational efforts to achieve change effectively fail.

Forisha-Kovach (1984) believes that individual change may be considered to occur at a faster pace than that of the systems and organisations in which the individual participates, but makes the point that in fact individuals change far more slowly than managerial assumptions and actions would normally suggest. Van Tonder (2014:8) states this more explicitly in the following words: "...change occurs at the rate that the individual employee is able to deal with and respond to the change. The interdependence between individual change and organisational change remains essentially undetected, at best understated."

3.4.3 Technology

The technology stream of the organisation includes all of the factors that directly contribute to the transformation of organisational inputs into organisational outputs. Technology refers to everything directly associated with the transformation of organisational inputs into outputs, such as work flow design and

job design (Robertson *et al.*, 1993:620). The organisational dimension of technology therefore describes a wide array of variables, including (Porras, 1987:63):

- the tools, equipment and machinery used in the transformation process;
- technical expertise of organisational members;
- the design of jobs required to perform the transformation or service offering for a service orientated organisation; and
- technical policies and procedures.

Porras (1987:66) points out that technology has, rightly or wrongly, featured as the most dominant dimension of organisational design since the inception of the modern industrial organisation and quite directly affects employee behaviour. He adds that the more dominant and well defined the technology of a system, the more impact it has on individual behaviour. An understanding of the various components of the technology stream and the ways in which they affect individuals is a prerequisite for successful organisational change (Porras, 1987:66).

3.4.4 Physical setting

The physical setting consists of concrete structures and objects of the “non-social/non-technical” part of the environment in which people work. It is the physical space in which the organisation’s activities occur (Robertson *et al.*, 1993:620-621). Thus, the location of the workplace of employees can do much to prevent or enable effective organisational behaviour (Porras, 1987:69). Creating a physical design that most appropriately matches the type of work to be done and the ways individuals must work to accomplish their tasks most effectively, according to Porras (1987:67), is one of the most important organisational components to consider. This can make the inclined behaviour of an individual easier or more difficult to perform (Porras, 1987:69).

In a study undertaken on small and medium-sized audit practices in the Netherlands, all the participants strongly believed that a local presence is needed

in a practice to best serve one's clients. These practices all agreed that it makes sense from a cost reduction perspective to have fewer offices, but also stressed that it is rather important, especially for small and medium-sized practices, to 'show your face' in the market (Lander *et al.*, 2013:141).

3.4.5 Conclusion on a process-orientated change theory at organisational level

Porras (1987:70) emphasises that the four organisational dimensions or streams (organising arrangements, social factors, technology, and physical setting) as discussed in the section above, must be designed so as to best deal with the environmental demands placed on the organisation, while at the same time creating work setting conditions that will best support effective on-the-job behaviours of organisational members. Their interconnection - the fact that they strongly affect and influence one another - is a central part of understanding how the organisation functions and how it changes.

As a result of the literature review above it is appreciated that organisational change is purely and simply undertaken in pursuit of continued adaptation and survival. An organisation's relationships with its external stakeholders, its markets, its regulators, and so forth, will drive internal adaptive changes. However, it is not possible to secure optimal alignment between environment and organisation without also securing internal alignment between the organisation's structure, systems and policies; consequently, adaptation is an on-going process of adjustment that is effected in response to environmental change (Van Tonder, 2014:112).

Once it is acknowledged that change is an integral component of the organisation, as in the case of the impact of mandatory audit relief on small and medium-sized audit practices, the mind sets of auditors will change accordingly and lead to altered forms of practice. The need for the management of change will diminish gradually over time as the social components of the small and medium-sized audit practices develop, with change being as much a common

feature of daily functioning as leadership and reward structures (Van Tonder, 2014:52).

Porras (1987:ix) presents a striking summary of the issue of organisational change when he writes that: “Those who viewed it as something to resist and overcome have atrophied and died. Those who seized it, used it, flowed with it, integrated it, and accelerated it, have, by and large, flourished and prospered”.

A brief description of organisational change in audit practices is presented in the section below.

3.5 ORGANISATIONAL CHANGE IN AUDIT PRACTICES

Change is a recurring theme in this dissertation. It was considered in Chapter 2 by describing the ways in which the auditing profession has evolved or changed over the years (section 2.2.2 refers). Attention was again drawn to it in discussions contained in Chapter 2 on changes in audit regulation (section 2.3 and 2.5) and the regulation of the auditing profession in South Africa (section 2.4). In the first part of this chapter, the “change theme” was again expounded. Section 3.3 explained the concept, framework and approaches for organisational change. A process-orientated change theory, identified by Porras (1987) was suggested to consider the impact of mandatory audit relief on small and medium-sized audit practices. This section turns the focus towards the auditing profession and provides an overview on professionalization and factors that drive change in audit practices.

3.5.1 Professionalization

The Industrial Revolution was the stimulus for the creation of new professions such as architects, engineers, accountants and actuaries in the nineteenth century in the UK (Matthews, Anderson & Edwards, 1998) and the USA (Romeo & Kyj, 1998). MacDonald (1995:1) offers a useful working definition of professions as “occupations based on advanced, or complex, or esoteric, or arcane, knowledge”. This definition identifies knowledge as an essential ingredient in professionalism.

In assessing the content of the term “professionalization” by Larson (1977) it is deemed or suggested to be mainly a process by which the market for expertise is controlled through creating scarcity of resources. It is also regarded as a way to create a monopoly for skills and services (Abbott, 1988).

For Johnson (1972), professionalism is not so much an inherent characteristic of an occupation, but a means of organising and controlling an occupation. This perspective places power or occupational dominance (Freidson, 1970) at the centre of studies of professionalism. Professions are able to leverage their superior technical, political, and organisational resources to retain control over their own occupational labour markets, including “the social and economic methods of organising the performance of [their own] work” (Freidson, 1970:185).

Ramirez (2009:382) proposes that professions can be considered to be segments in action. These actions might be capable of correlation to accommodate the results of specialised aspects of divisions of professional labour. However, from a collective action perspective, it will more broadly represent the instrument of recognition of any specific form of professional identity. Bucher and Strauss (1961:326) advanced a similar opinion, stating that professions serve admirably as informal amalgamations of connected segments in pursuit of different objectives to be attained by different means and manners, and yet delicately joined together under a common identity and name at a set and particular period in time.

Although there is no fixed set of characteristics that can be recognised to apply to a profession, Defliese *et al.* (1990:52) argue that at least the following characteristics must be present:

- The formal recognition of professional status by a government body by way of issuing a licence.
- Acquiring specialised knowledge through formal learning.
- Implementing and monitoring a code of ethics to be complied with.

- Recognition and acceptance by the public of the work performed by the member as well as the professional status used.
- Having a social responsibility towards a client aside from the work that was performed.

Greenwood (1957:45) identified five attributes of a profession which relate to the characteristics of Defliese *et al.* (1990) as mentioned above. These are systematic theory, authority, community sanction, ethical codes and a culture, and are briefly discussed in the succeeding paragraphs (Greenwood, 1957:45-53).

- *Systematic theory*

Theory is the base in terms of which the professional justifies his/her operations in concrete situations. Preparation for a profession involves considerable involvement with systematic theory. This characteristic is almost absent in the training of the non-professional (Greenwood, 1957:46).

- *Authority*

The professional obtains specialised knowledge through extensive education in the systematic theory of his/her discipline. A professional occupation has clients that are obliged to accept the decision of the professional controlling authority as opposed to a non-professional occupation with customers that can criticise, for instance, the quality of the commodity purchased and even demand a refund (Greenwood, 1957:47, 48).

- *Community sanction*

Every profession strives towards powers and privileges which are authorised and conferred by a community. Among its powers is, for instance, the professions' control over admission into and training for the profession. Confidentiality is one of the most important privileges of a profession. Professionals encourage clients to disclose information in order to facilitate efficiency. These powers and privileges constitute a monopoly granted by the community to the professional group (Greenwood, 1957:48, 49).

- *Ethical codes*

Every profession has a “built-in” ethical code which enforces ethical behaviour on the part of its members. The formal part of the profession’s ethical code is a written code regarding which the professional usually swears an oath, when being admitted to practice. The unwritten code is the informal part but nonetheless carries the weight of formal prescriptions (Greenwood, 1957:50).

- *Culture*

The culture of a profession is distinct from a non-professional culture and consists of its values, norms, and systems. The social values of a professional group are its basic and fundamental beliefs. The essential worth of the service, which the professional group extends to the community, affords such an example. The norms of a professional group are a guide to behaviour and cover every standard interpersonal situation likely to recur in professional life. The symbols of a profession include its emblems, history, heroes and villains, clients and so forth (Greenwood, 1957:53). “The transformation of a recruit into a professional is essentially an acculturation process wherein he internalises the social values, the behaviour norms, and the symbols of the occupational group” (White, 1953).

The first two attributes of a profession (systematic theory and authority) as described above, refer to the client-professional relationship. The professional authority also has professional-community consequences, which were explained in the last three attributes (Greenwood, 1957:48).

O’Regan (2001:205) believes that the social legitimacy of a profession is derived from the manner in which [its] “...knowledge base is institutionalised and ethically framed”. A profession’s institutional framework governs and restricts access to the profession, which requires certification of members based on formal and professional education requirements (O’Regan, 2001:205).

Professions such as audit practices are institutions that, over the last 30 years, have experienced profound changes and now tend to be multidisciplinary

(Suddaby & Greenwood, 2005). Professions are thus not only key mechanisms for, but also primary targets of, institutional change (Muzio, Brock & Suddaby, 2013).

The next section concentrates on factors driving change in audit practices. This discussion provides background and closely links to the purpose of this study: the impact of mandatory audit relief on small and medium-sized audit practices in South Africa.

3.5.2 Factors driving change in audit practices

A number of upheavals in the accounting industry have challenged the traditional professional practice (Lander *et al.*, 2013:132-133) and may be regarded as factors that have driven change in audit practices. These include the following:

- Computer aided audit systems have reduced the intricacy and labour intensity of the audit process (Brock, 2006). On the client side, the increased emphasis on reducing costs, the internet and mobile technologies has increased the pressure on audit fees (Ahroni 1999). Brock (2006) identifies technical innovations as a factor that is changing the accounting profession. Lander *et al.* (2013:141) state that developments in technology require more formal organisation. Porras in his work (1987:51) identified that this would have a direct impact on the four dimensions of an organisation but it would also affect the organising arrangements component through change in formal structures, policies and procedures, etc.
- Globalisation causes accountancy organisations to function in terms of international standards and the needs of international clients (Nachum, 1996). Accountants are challenged by global standards and new knowledge requirements (Botzem & Quack, 2009). Arnold (2009) identifies financial globalisation as a factor that is changing the face of accounting. Lander *et al.* (2013:141) are of the opinion that the globalisation of clients has led firms to join international networks, which in turn demand certain changes in structural arrangements that will again have a direct impact on the organising arrangements component of the practice (Porras, 1987:51).

- Statutory protection for providing services has been reduced or removed (Hart *et al.*, 1992), resulting in increased professional competition (Gray, 1999). This is aligned with the social patterns and networks component identified by Porras (1987:52) as part of the social factors dimension of the organisation.
- Increased regulation (such as the Sarbanes-Oxley Act in the USA) has brought about changes in the organisational structure of accounting firms (Greenwood & Suddaby, 2006), increasing organisational process controls and reducing the importance of the individual accountant (Lander *et al.*, 2013). Lander *et al.* (2013:141) identify imposed rules and regulation as a driver for change, which demands high levels of quality control. As Porras pointed out in his work published in 1987, (1987:51) not only would this driver impact the organising arrangements through systems, formal structure, policies and procedures, but it would also have an impact on the social factors dimension of the organisation.
- Firms face changes in clients' demands, which result in the role of the traditional accountant slowly being changed towards that of an advisor to the firm (Ramirez, 2009). Romanelli and Tushman (1994) refer to the changing environmental conditions that are influencing the face of accounting. Increased regulation, automation of services and changing client demands have recently disrupted a long period of stability. These major environmental jolts (Meyer, 1982) are assumed in prior literature to result in revolutionary transformations of organisations rather than their actual evolutionary development (Greenwood & Hinings, 1996). However, the work of Lander *et al.* (2013) presents evidence of the co-existence of old and new values and beliefs (Brock *et al.*, 2007) rather than a comprehensive transformational resolution or total rejection of the structures and processes associated with commercialisation. In this regard, Lander *et al.* (2013:141) also identify clients' demands for more specialised advisory services as a main driver, influencing not only the role of the accountant but also organisational practices. Although the claim to professional status and integrity was seen as a successful commercial strategy of auditors in the past, commercialisation of the audit has always been part of a larger debate (Barrett, Cooper & Jamal,

2005:22). Commercialisation is currently more about providing for a wider range of services in response to clients' needs, rather than an appeal to integrity or public service (Barrett *et al.*, 2005:22). These commercial developments also create tensions at the institutional level – in this case, the professional organisation. These changes in the professional organisation are related to shifts in auditor identity: how the accounting and auditing “professional” shifts are being more sensitive to business and how commercialisation changes the nature of what it is to be an audit professional. Commercialisation may lead to audit practices diversifying, resulting in revised ideas of what a good auditor is and who their clients are (Barrett *et al.*, 2005:22-23). Clients are not only more critical towards the service they receive, but also demand more and different services, i.e. full service advice (Lander *et al.*, 2013:132,133). Such a shift towards commercialisation impacts a practice's organising arrangements and social factors, identified by Porras (1987:52) as providing services other than traditional audits to a wider client base. An organisation's technological component (Porras, 1987:51) will also be influenced.

Organisations have to decide how they respond to these changing factors which challenge the traditional professional practice. Lander *et al.* (2013:141) suggest the following four ways:

- Firms should make choices about their governance system.
- Firms need to decide on their management control systems.
- Firms must re-evaluate their organisational structure.
- Firms need to decide how to respond to the increasing client demand for international services.

It has been alleged that SMEs form a disproportionately large segment of business in any economy (Bröcheler *et al.*, 2004:629). Naturally, this segment becomes the key market for small and medium-sized audit practices, which are traditionally involved in assisting the SMEs in their compliance with accounting, taxation and other regulatory requirements (Goyal, 2007:73). Some of these

practices have also extended their services to “advisory” and “consultation” areas to cater to the business needs of the SMEs in the continually evolving business environment (Goyal, 2007:73).

Lander *et al.* (2013:138) are of the opinion that when the core product of the professional accountant, the consolidation of annual accounts and the evaluation thereof, becomes automated, the corresponding profit margins drop significantly. As a result, accounting and auditing firms naturally seek other sources of revenue. Lander *et al.* (2013:138) observe that most firms start developing specialised advisory services. This shift to more advisory type services is also demanded by clients. Clients want to be advised on ways to improve their bottom line (profits). This again stimulates the formation of advisory services. In this sense, the traditional role of the auditor has been modified from that of an *ex post facto* evaluation of the business information provided by the client, to that of a consultant presenting business advice in a high risk, highly competitive market place (Lander *et al.*, 2013:138). It is to be assumed that the economic crisis has also impacted on the audit firms other than the Big 4 directly, forcing them to proactively approach clients and provide a broader range of services with higher profit margins (Lander *et al.*, 2013:138).

It is evident, based on the literature reviewed above, which deals with factors driving change in audit practices and the consequent demand for organisations that have to decide how they respond to these changing factors, that the topic of continuity planning in audit practices cannot be ignored. The Global Accounting Alliance (GAA) commissioned a research project in 2014 in cooperation with the 11 member bodies that make up the alliance, with the purpose of identifying members’ comparative levels of knowledge and preparedness in relation to succession and continuity planning (Kriel, 2014:30). Amongst the participants were 213 SAICA members of whom 51% represented sole practitioner firms and 49% presented multi-partner firms (of which more than 80% comprise 2-5 partners). Sole practitioners considered the following priorities as some of the most important items to be addressed in their firms’ succession or continuity plans: client retention plan; exit strategy; and communication of succession plans or elements thereof to key staff, prospective and new business owners (Kriel,

2014:30). In contrast, multi-partner firms viewed the following as some of the most important items to be addressed in the succession or continuity plan: client retention plan in the event of succession, exit strategy and pre-emption rights of existing partners/business owners (Kriel, 2014:30).

The findings indicate that only one in ten sole practitioners had a written or formal business succession plan in place. The purpose of a succession or continuity plan is to enable the practice to continue to function as close to normal as possible during a critical incident (Kriel, 2014:30).

The relief from mandatory audits, introduced by the regulatory reform, can be regarded as such a critical incident, specifically concerning small and medium-sized audit practices as many of their clients will no longer require an audit (Stainbank, 2008:13). Such a continuity plan should deal with prevention (where possible), impact analysis, response and recovery of risks. A succession or continuity plan assists a firm to consider and focus on its future exit strategies from the effects of the incident and how to achieve this (Kriel, 2014:31). Although managers/owners who share ownership in multi-partner firms might have discussed aspects of succession planning, only 21% had a written or formal business succession plan. The primary reasons behind practitioners not having a succession plan include time constraints or the fact that succession plans are perceived “not to be an issue for their firm” (Kriel, 2014:31). It is an exceptional attitude to encounter among auditors that if they should ignore the issue long enough, perhaps it will go away. More than one third of sole practitioners do not even know where to start developing a plan. The results of this survey were cause for alarm to SAICA, as there seemed to be quite a disconcerting sense of disinterest pertaining to succession and continuity planning (Kriel, 2014:31).

The reality of the above forces a rethink of the impact of mandatory audit relief on small and medium-sized audit practices as it seems that audit practices are still blasé regarding succession and continuity plans.

3.5.3 Conclusion on organisational change in audit practices

The auditing profession has to meet expectations to maintain its status as a profession. These include the issue of specialised knowledge, enabling it to retain control over divisions of professional labour. Its professional identity is characterised by the formal recognition of professional status by the IRBA, requirements to acquire specialised knowledge through formal learning (education, training and professional examinations required for the certification of members), adherence to a code of conduct and recognition and acceptance by the public, thereby meeting its social responsibility. Over the past 30 years the culture of audit practices has changed because they have tended to become multidisciplinary. Factors driving this change are technology developments, globalisation, competition, increased regulation and focus on commercialisation, due to the expansion of services provided. Change is also evident in small and medium-sized audit practices. One such change event is the relief from mandatory audits introduced by regulatory reform, the focus of this study. Prior research indicates that the sustainability of small and medium-sized audit practices within this environment remains a matter of concern.

3.6 CONCLUSION

In the first part of this chapter, attention was paid to the concept of organisation as well as to an explanation of small and medium-sized practices as organisations and small and medium-sized audit practices in South Africa. Institutional transformation has been considered one of the most salient features of the last decade; therefore organisational change was the main focus of this section. From the literature, a definition of organisational change, a framework for organisational change as well as guiding approaches to change were reviewed. Specific reference was made to the three categories of approaches as identified by Senior (2002): change characterised by the rate of occurrence, change characterised by how it comes about and change characterised by scale. The views of different authors on types of change have been identified, but for the purpose of this study, the two types of changes (*Type I* and *Type II*) as identified by Van Tonder (2014:110) were supported and highlighted. A process-orientated

change theory at organisational level with specific reference to the four organisational components in the Stream Organisation Model of Porras (1987:52) was suggested for this study. It aims to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa and considers the impact of change on organising arrangements, social factors, technology and physical settings.

The concept of professionalization was discussed as an introduction to the section on organisational change in audit practices, followed by the views of various authors on the factors which have driven change in audit practices (Lander *et al.*, 2013; Brock, 2006; Ahroni 1999; Nachum, 1996; Botzem & Quack, 2009; Arnold, 2009; Hart *et al.*, 1992; Gray, 1999; Greenwood & Suddaby, 2006; Ramirez, 2009; Romanelli & Tushman, 1994; Meyer, 1982; Greenwood & Hinings, 1996; Brock *et al.*, 2007). These factors consist of technological developments, globalisation, competition, increased regulation and focus on commercialisation due to the expansion of services by service providers. Reference was also made to the four ways in which organisations could respond to these changing factors, as suggested by Lander *et al.* (2013). As change is also evident in small and medium-sized audit practices, the chapter concluded with a brief discussion on the existence of succession or continuity plans of audit practices. A study carried out by Kriel (2014) revealed that the sustainability of these audit practices in an environment impacted by the relief from mandatory audit requirements remains a concern, as on average only one out of every five small and medium-sized audit practices have a written or formal succession or continuity plan in place. This gap could have a significant impact in times of change.

In the next chapter (Chapter 4) the methodology and qualitative research design used in the research study are thoroughly discussed.

CHAPTER 4

RESEARCH METHODOLOGY

4.1 INTRODUCTION

The previous chapter concluded the literature review for this study. From the literature review in Chapter 2, it became clear that auditing originated in medieval times and that the UK and the USA played a leading role in the development of auditing. As auditing developed over the years, there was a need for regulation, which was addressed by means of legislation. In terms of South African corporate law, from the time of the Companies Act of 1926, the financial statements of all companies were required to be audited annually (RSA, 1926). This continued until the Companies Act of 2008 announced mandatory audit relief for specific companies (RSA, 2009).

The second part of the literature review (Chapter 3) focused on organisational change, which may evolve over time or be more sudden owing to a disruptive event such as a change in corporate legislation. It also elaborated on process-oriented change at the organisational level and provided information on how change should be managed. The discussion in Chapter 3 shows that audit practices have changed and that small audit practices still have a role to play in the audit landscape. The literature discussed in Chapters 2 and 3 provided the background for this study, which aims to investigate the impact of mandatory audit relief on small and medium-sized audit practices. Chapter 3 included a discussion on the establishment of audit practices in South Africa, with the intention of quantifying and qualifying the unit of analysis for this study.

This chapter addresses the research methodology encompassing the research approach, research design, population and sample selection, data collection techniques, trustworthiness of data, and data analysis for this study. Ethical considerations are also reported on.

4.2 RESEARCH APPROACH

A qualitative approach was used in this study and focused on two areas: the phenomena that transpire naturally in the 'real world' as well as a study of those phenomena in all their intricacy (Leedy & Ormrod, 2010:135). Qualitative researchers rarely try to simplify what they observe. Instead, they recognise that the issue they are studying has many dimensions and layers, and so they try to portray the issue in its multi-faceted form (Leedy & Ormrod, 2010:135).

Most researchers strive for objectivity in their research and believe their observations should be influenced as little as possible by any perceptions, impressions and biases they may have. Some qualitative researchers argue that an objective approach to studying human events like social structures, creative products and so on, is neither desirable nor, perhaps, even possible (Creswell, 2009; Eisner, 1998; Wolcott, 1994). The researcher's ability to interpret and make sense of what he or she sees is critical for understanding any social phenomenon. Leedy and Ormrod (2010:135) therefore refer to [the] "researcher as an instrument", with Denzin and Lincoln (2005) earlier making the same point because researchers need to make sense of the subjective and socially constructed meanings expressed concerning the phenomenon being studied. They (Denzin & Lincoln, 2005) therefore point out that qualitative research is associated with an interpretive philosophy. According to Creswell (1994:162) the qualitative approach is suitable for the following types of research projects and is therefore appropriate for this study:

- for research on a small and medium scale;
- where the researcher is the primary instrument in the data collection;
- when the data that emerges from a study is descriptive; and
- when the focus is on the participants' perceptions and experiences.

Creswell (2009:176; 2014:185-186) identifies several characteristics of qualitative research. Specifically, the following ones were applicable to this study:

- Natural setting: “Qualitative researchers collect data in the field at the site where participants experience the issue or problem under study” (Creswell, 2014:185). The researcher visited the audit practices (selected cases), communicated face-to-face with the participants (audit partners) and listened to and observed them behaving and acting within their usual context.
- Researcher as key instrument: “Qualitative researchers collect data themselves through examining documents, observing behavior, or interviewing participants” (Creswell, 2014:185). The data gathered was not inferred but rather gathered directly from the participants by the researcher.
- Participants’ meanings: “In the entire qualitative research process, the researcher keeps a focus on learning the meaning that the participants hold about the problem or issue” (Creswell, 2014:186). In this study the researcher did not focus on the meaning she brought to the research or the meaning expressed in the literature. Instead, the findings of the research were later contextualised within the literature.
- Interpretive: “Qualitative research is a form of interpretive inquiry in which researchers make an interpretation of what they see, hear, and understand. Their interpretations cannot be separated from their own background, history, contexts, and prior understandings” (Creswell, 2009:176). The researcher realised that within her own interpretations, the participants’ views should receive more emphasis. Therefore multiple views of the phenomenon emerged.

4.3 RESEARCH DESIGN

The research design comprises four distinct components: A paradigm, the strategy, the method and the analysis (Voce, 2005).

4.3.1 Paradigm

A paradigm, according to Joubish *et al.* (2011), is fundamentally a worldview, a framework of beliefs, values and methods within which research takes place. Guba and Lincoln (1994:105) argue that research methods are of secondary

importance to the paradigm that is applicable to one's research. These authors define the latter "as the basic belief system or world view that guides the investigation, not only in the choices of method but in ontologically and epistemologically fundamental ways". Creswell (2014:6) has chosen to use the term "worldview" instead of paradigms. Crotty (1998) refers to epistemologies and ontologies whereas Neuman (2000) speaks of broadly conceived research methodologies.

According to Saunders *et al.* (2012:128) the research philosophy adopted in a study can be thought of as assumptions about the way in which one views the world. Creswell (2014:6) states that these worldviews are shaped by the discipline area of the student, the beliefs of advisers and faculty in a student's area, and past research experiences. Saunders *et al.* (2012:128) are of the opinion that these assumptions underpin the research strategy and the methods chosen as part of that strategy. Only if an understanding of these worldviews exists, can the assumptions be examined, evaluated for appropriateness and perhaps be amended.

Saunders *et al.* (2012:129) examine two ways of thinking about research philosophy: ontology and epistemology. Ontology, according to them is concerned with the nature of reality, and they identify two aspects of the former (Saunders *et al.*, 2012:131). The first aspect is objectivism which represents the position that social entities (organisations) exist in reality, external to and independent of social actors (humans) (Saunders *et al.*, 2012:131). The second, subjectivism, asserts that social phenomena are created from the perceptions and consequent actions of social actors (Saunders *et al.*, 2012:131). This study acknowledged objectivism as an aspect of ontology due to specific consequences which were brought about in all audit practices as a result of the corporate law reform in South Africa. However, the role of social actors (participants) in the decision making processes undertaken to determine the service offerings of audit practices from the time of the implementation of the Companies Act in 2011 is also recognised in this study. Therefore with regard to the two aspects of ontology as identified by Saunders *et al.* (2012:132), this study

supports the view that it is possible to make use of both objective and subjective lenses.

Epistemology concerns what comprises acceptable knowledge in a field of study (Saunders *et al.*, 2012:132). Interpretivism, as one aspect of epistemology, advocates that it is necessary for the researcher to understand differences between humans in their roles as social actors (Saunders *et al.*, 2012:137). The researcher supported interpretivism because not only are audit practices complex business situations, they are also unique organisations (Saunders *et al.*, 2012:137). They are a function of a particular set of circumstances and individuals coming together at a specific time. An interpretivist perspective is highly appropriate in the case of business and management research and it has therefore been selected for the purpose of this study (Saunders *et al.*, 2012:137). In this study, every participant (audit partner) contributed his/her own subjective experience to the study which the researcher used to gain a deep understanding of the whole (the impact of mandatory audit relief on small and medium-sized audit practices) and of how each part relates to and is connected to the whole.

Creswell (2014:6) identifies four worldviews: post positivist, constructivist, transformative and pragmatic. For the purpose of this study, a constructivist philosophical worldview (also referred to as social constructivism), which is regarded as applicable to qualitative research, (Creswell, 2014:8) was used.

It is an established belief in social constructivism that individuals fundamentally desire to understand the environment, the world in which they live and work (Creswell, 2014:8). Since every individual experiences life subjectively and thus also differently from the way others do, the content and meaning of these experiences vary considerably. Multiple and varied meanings consequently oblige the researcher to allow for the complexity of views, rather than attempting to narrow down meanings into a few categories or ideas (Creswell, 2014:8). The objective of the research is consequently to seek an extensive reliance on the views of the participants. Questions posed are broad and general so as to create space for the participants to construct or create meaning as regards the research problem, based on their discussions or interactions with other persons (Creswell,

2014:8). Questions are thus formulated to elicit a response that cannot always be anticipated. The researcher, however, should focus on the intention of making sense, through interpretation, of the meanings that other individuals express and have about the world (Creswell, 2014:8).

Crotty (1998) identified several assumptions in constructivism; these were followed in this study:

- Humans construct meaning as they participate in and understand the world. The researcher therefore used open-ended questions so that the participants could share their views.
- Human beings make sense of their world based on their social and past perspectives. These perspectives or meanings are *inter alia* imparted to us by our culture. For this study the researcher therefore sought to understand the context or setting of the participants through visiting them and gathering information personally. She subsequently interpreted what she found based on her own experiences and background.
- Meaning is social, arising from interaction with a human community. In this study, the researcher generated meaning from the data collected from audit partners in small and medium-sized audit practices.

The way in which a researcher asks the research questions will inevitably involve him/her in exploratory, descriptive or explanatory research, leading to an answer that is exploratory, descriptive, explanatory, or a combination thereof (Saunders *et al.*, 2012:170).

The overall research design of this study was descriptive as the purpose of descriptive research is to gain an accurate profile of events, persons or situations (Saunders *et al.*, 2012:171). A clear picture of the phenomenon (for this study the shift in small and medium audit practices) on which one wishes to collect data is needed prior to the collection of the data, a necessary requirement of descriptive research (Saunders *et al.*, 2012:171). The researcher has identified specific, small and medium-sized practices as units of analysis for this study to determine

the impact of mandatory audit relief on these selected practices. In this study conclusions are drawn from the data described, upon which future research could build because a description in management and business research should be thought of "...as a means to an end rather than an end in itself" (Saunders *et al.*, 2012:171).

4.3.2 Strategy

Saunders *et al.* (2012:173) define a strategy as a plan of action to achieve a goal. A research strategy is the methodological link between the philosophy (paradigm) and subsequent choice of methods to collect and analyse data (Denzin & Lincoln, 2005). In choosing a research strategy, a reasonable level of coherence must be achieved throughout the research design which will enable the researcher to answer the research question and meet the objectives (Saunders *et al.*, 2012:173).

A case study strategy was decided upon as this research strategy allows researchers to focus on (a) case(s) in order to retain a holistic and real-world perspective (Yin, 2014:4). According to Yin (2014:18) case study research includes both single- and multiple-case studies. For the purpose of this study a multiple-case strategy was followed where results were reported in a descriptive way. Schramm (1971) believes that the crux of a case study is that it tries to illuminate a decision or set of decisions: why they were taken, how they were implemented and with what result.

Yin (2014:29) identifies five components of a case study research strategy:

- Study questions: Case study research relates to "how" and "why" questions (Yin, 2014:29). The main research question in this study was "how did the relief from mandatory audit impact upon small and medium-sized audit practices in South Africa?" Therefore a multiple case study strategy was suitable.

- Study propositions: Each proposition points towards something that should be examined, within the scope of study. Yin (2014:30) clarifies that some studies may not have propositions; for instance, when the topic is the subject of “exploration”. However he explains that every study should still have some purpose (objective). Therefore, the design for a study should state objective(s) (Yin, 2014:30). The objective of this study was to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa.
- Unit of analysis: The case(s) to be studied should be identified. Yin (2014:31) explains that the tentative definition of the unit of analysis is related to the way in which the initial research question(s) are defined. In this study the unit of analysis was a small- or medium-sized audit practice.
- Linking the data to the propositions: This study required the case study data to be combined as a direct reflection of the study proposition(s) or purpose(s). Although this component is discussed in detail in Chapter 5, Yin (2014:35-36) emphasised that a proper research design can create a more solid foundation for the later analysis. It might happen that a researcher realises that too much data was collected and some cannot be analysed or, alternatively, that too little data was available, preventing the proper use of a desired analytic technique.
- Criteria for interpretation of the findings: When carrying out case studies, a major and important consideration is to identify and address rival explanations for the findings. Addressing such conflicting issues becomes a criterion for interpretation of the findings: the more competing explanations that have been addressed and rejected, the stronger will be one’s findings (Yin, 2014:36). During the design of the data collection, the researcher attempted to anticipate the important opposing arguments in order to formulate interview questions, which would allow for a debate over rival explanations.

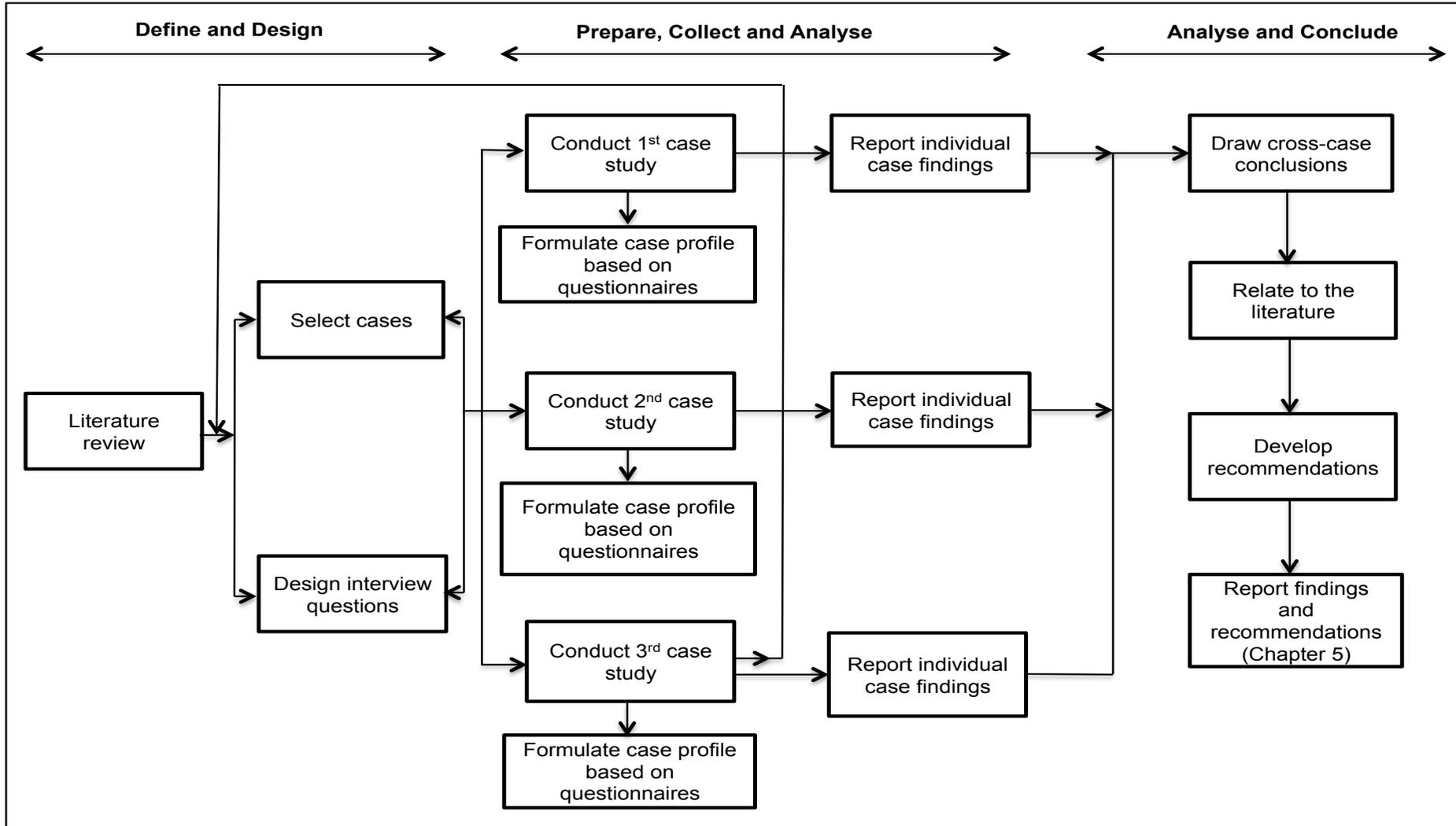
The first three components, that is, defining the study’s questions, propositions and unit of analysis, guided the research design by identifying the data to be collected. The last two components: defining the logic linking the data to the

proposition(s) or purpose(s) and the criteria for interpreting the findings, directed the design by anticipating the case study analysis, suggesting what was to be done after the data was collected (Yin, 2014:29-36).

Yin (2014:56) considers single- and multiple-case designs to be variants within the same methodological framework. As previously mentioned, this study is based on a multiple-case design. Multiple-case study designs are becoming more prevalent (Yin, 2014:63), but also have advantages and disadvantages. The evidence from multiple cases is often considered more compelling and the overall study is therefore regarded as being more robust (Herriott & Firestone, 1983). However, conducting a multiple-case study could require extensive resources and time beyond the means of a single researcher and is therefore more expensive and time-consuming (Yin, 2014:57).

A misleading analogy that exists is to incorrectly consider multiple cases to be similar to the multiple respondents in a survey (“sampling” design). Instead, the “replication” design is analogous to multiple case studies where each case must be carefully selected so that it either (a) predicts similar results (a literal replication) or (b) predicts contrasting results but for anticipated reasons (a theoretical replication) (Yin, 2014:57). The complexity of the research topic may mean that the choice of a small number of cases (in this study small and medium-sized audit practices) could not adequately represent the population (all the small and medium-sized audit practices). Critics using a sampling logic might therefore deny the acceptability of the study. In contrast, if the replication logic is used, the study is eminently feasible (Yin, 2014:59).

Figure 4.1: Multiple-case study procedure



Source: Yin (2014:60) Adapted

The replication approach to multiple-case studies is illustrated in Figure 4.1. This figure shows that the first step in designing a study consists of the identification of theoretical constructs based on the literature review. It then indicates that the selection of the cases (in this study there are three) and the formulation of interview questions are essential steps in the design and data collection process. Each individual case study is regarded as a 'whole' study, in which evidence is sought regarding the facts for the case (Yin, 2014:59). The conclusions of each case are then considered to be the information needing replication by other individual cases (Yin, 2014:59). The results of the individual and multiple cases should be the focus of the findings, which will be reported in Chapter 5 of this study.

For each individual case, the findings should indicate how and why a particular proposition (purpose) was revealed (or not revealed) (Yin, 2014:59). Across cases, the findings should reflect the extent of the replication logic and why certain cases were predicted to have certain results, whereas other cases, if any, were predicted to yield contrasting results (Yin, 2014:59).

Although a multiple-case study strategy was selected for this study, of which the evidence is often considered to be more rigorous than a single case strategy (Herriott & Firestone, 1983), a limitation of case study research needs to be mentioned. Yin (2014:20, 21) mentions that the apparent inability to generalise from case study findings (especially from a single case) is a concern. He explains that the case study does not represent a "sample" and therefore the goal is to expand and generalise theories. Case studies therefore are generalizable to theoretical propositions and not to populations.

Following the thorough discussion above on the first two components of the research design (namely the paradigm and the strategy) as defined by Voce (2005), the last two components are recognised as the method and analysis, and are discussed below.

4.3.3 Method and analysis

Yin (2014:103) points out that case study evidence can originate from many sources, but identifies six of the most common methods of obtaining evidence in case studies as follows:

- documentation;
- archival records;
- interviews;
- direct observations;
- participant-observation; and
- physical artefacts.

Interviews, which are one of the most important sources of case study evidence (Yin, 2014:110), were chosen by this researcher as the method to collect case study evidence. For a detailed discussion on interviews as a research method, refer to section 4.5.

Creswell (2014:194) states that the method also needs to include detail on how the data in the study will be analysed and interpreted, ultimately to make sense of the data in order to report on the findings. For this study, the different steps taken as part of the data analysis are discussed in-depth in section 4.7.

4.4 POPULATION AND SAMPLING

Cohen, Manion and Morrison (2000:92) point out that the quality of the research will not only be driven by the appropriateness of the methodology and instrumentation used, but also by the suitability of the population and sampling strategy that has been adopted.

4.4.1 Population

Population can be defined as the entire group of persons or set of objects and events the researcher intends to study (Collins *et al.*, 2000:147; Roscoe, 1969 as

cited in Mouton, 1996:134). For the purpose of this study, the population comprised small and medium-sized audit practices registered with the IRBA in the Pretoria region. From the literature study the researcher deduced that the client base of small and medium-sized audit practices typically consists of enterprises that are also small and medium-sized (Goyal, 2007:73; Stainbank, 2008:13) and, based on this premise, small and medium-sized audit practices would therefore most probably be directly affected by mandatory audit relief. In contrast, larger audit practices mostly deliver audit services to listed companies and larger enterprises (Samaha & Hegazy, 2010:896, 899-901; Abidin & Baabbad, 2015:23), which will still be compelled to have annual statutory audits performed, despite the introduction of the Companies Act of 2008 (RSA, 2009).

4.4.2 Unit of analysis

The unit of analysis is an audit practice, as explained in the selected cases below.

4.4.3 Selection of cases and participants

Yin (2014:63) cautions that the researcher must choose each case wisely because multiple-case designs should follow a replication (not a sampling) logic. The cases should be compared with multiple experiments. As previously explained, when the results are similar this is known as literal replication whereas in the case of contrasting results, the replication is theoretical (Yin, 2014:63). This should be explicitly disclosed at the outset of the investigation (Yin, 2014:63).

The researcher has decided on the specific small and medium-sized audit practices selected for the following three reasons:

- The researcher selected unique (specific) cases that are especially informative.
- The researcher used these cases for in-depth investigation.

- The purpose is less about generalising to a larger population, but rather about gaining a deeper understanding (Neuman, 1997:206).

Small and medium-sized audit practices are registered with the IRBA according to pre-determined regions in South Africa. The Gauteng Region, being the economic hub of South Africa (Stats SA, 2014:12), comprises mostly small and medium-sized practices (IRBA, 2015e). The claim of being the economic hub of South Africa is accorded on the premise that since 1998 Gauteng has remained the largest contributor of the nine provinces to the South African economy (Stats SA, 2014:10-12).

With reference to Table 4.1, which locates Pretoria within the Gauteng province, this city comprises a substantial number of the audit practices situated in the Gauteng Region (at least one third) and for this reason, as well as that of convenience, Pretoria was selected as the preferred representative population for this study.

The IRBA classifies the size of audit practices by the number of audit partners (IRBA, 2015b). As previously indicated in Chapter 3 section 3.2.3.2, according to the IRBA, registered audit practices in South Africa in the form of sole proprietors consist of one audit partner, while a small audit practice has two to four audit partners and a medium audit practice has five to 19 audit partners (IRBA, 2015b). As the aim of this study was to establish the impact of mandatory audit relief on small and medium-sized audit practices, it was decided to focus on the lower end of the audit landscape. The selected medium-sized practices for this study did not exceed five audit partners. Employees, regardless of whether or not they are registered auditors, are not included in the determination of the size of an audit practice. The following table (Table 4.1) reflects the IRBA's classification of audit practices in the Gauteng Region.

Table 4.1: IRBA’s classification of audit practices

Classification	Number of audit partners	Number of audit practices	
		Gauteng Region	Pretoria
Large practices	20+	11	9
Medium practices	5 – 19	23	10
Small practices	2 – 4	190	57
Sole proprietors	1	790	229

Source: IRBA (2015b) adapted

As displayed above, the focus of this study is on the lower end of the audit landscape. To accommodate this focus, the researcher has stratified the Pretoria regional list according to the number of audit partners per registered audit practice (IRBA, 2015e). For the purpose of this study, using the IRBA’s classification (IRBA, 2015b) as a guideline, the researcher reclassified the sizes of audit practices as follows:

- Sole proprietors: 1 audit partner.
- Small audit practices: 2-3 audit partners.
- Medium audit practices: 4-5 audit partners.

These 3 groups were identified as the cases for this multiple-case study. The following number of audit practices for each case was selected:

- Case 1 (sole proprietors): 7 audit practices with 1 audit participant each.
- Case 2 (small audit practices): 4 audit practices with 1 participant each.
- Case 3 (medium audit practices): 3 audit practices with 1 participant each.

Therefore, a total of 14 participants who are audit partners of sole proprietors, small audit practices and medium audit practices were invited to be interviewed by the researcher. According to Guest, Bunce and Johnson (2006:59) data saturation in a qualitative study occurs within 12 interviews, which supports the selection of the 14 participants for this study.

Table 4.2: Multiple-case selection for this study

Cases	Selected practices	Number of interviewees
Case 1 (Sole proprietors: 1 partner)	7	7
Case 2 (Small audit practices: 2-3 partners)	4	4
Case 3 (Medium audit practices: 4-5 partner)	3	3
Total	14	14

To investigate the impact of mandatory audit relief on small (a term which also includes sole proprietors as explained previously) and medium-sized audit practices, careful consideration was given to the selection of the participants. As mentioned previously, the typical client base of small and medium-sized audit practices is predominantly smaller enterprises (Goyal, 2007:73; Stainbank, 2008:13). Since these enterprises are also the type of companies most likely to make use of the audit relief offered by the corporate law reform, this creates an expectation of a more pronounced impact (Stainbank, 2008:13).

Furthermore, it was important to consider the years during which small and medium-sized practices were in existence. In order to determine the impact of mandatory audit relief on these practices, it was required that the selected audit practices operated in this capacity, both prior to and after the implementation of the mandatory audit relief.

Equally important was the selection of the specific audit partners to be interviewed. In order for the participants to reflect on the impact of the audit relief, it was necessary to identify participants who were already audit partners before the change in legislation and who were still practicing at the time of the study. In addition, audit partners should be responsible for strategic decision-making within their audit practices (Greenwood & Empson, 2003:921). These partners were in the most favourable position to reflect on the impact of the change in the Companies Act of 2008 (RSA, 2009) regarding the relief from mandatory audits.

The next criterion for selecting the audit practices as cases for this study was the increase or decrease in the number of audit partners in the small and medium-

sized audit practices before and after the implementation of the mandatory audit relief. When making the selection, despite not being able to confirm the reason for the change in the number of partners as being a direct consequence of the change in the legislation, the researcher did regard this criterion to be relevant in identifying the cases. It provided the opportunity to determine whether the impact of mandatory audit relief on these audit practices had resulted in partner changes.

With reference to the above discussion, the following criteria were applied in selecting the audit practices as cases and the audit partners as participants for this research study:

- Years of existence: small and medium-sized audit practices which were established before the introduction of the Companies Act in 2008 (RSA, 2009) and at the time of the study were continuing their operations as audit practices.
- Profile of partners: partners practising as registered auditors before and after the introduction of the 2008 Companies Act, and at the time of the study.
- Audit practices (other than sole practitioners) in which the number of partners had changed (increased/decreased) since the introduction of the requirements of the Companies Act of 2008 (RSA, 2009) in 2011.

4.5 DATA COLLECTION

Qualitative research draws data from a variety of sources, including the following (Cooper & Schindler, 2006:196):

- People (individuals or groups).
- Organisations or institutions.
- Texts.
- Settings and environments.
- Objects, artefacts, media products.
- Events and happenings.

In this study data was collected from people (audit partners) and organisations (small and medium-sized audit practices). Audit partners were requested to participate in personal interviews, as stated earlier in section 4.4.3, whilst a questionnaire on the profile of the audit practice (Annexure A) was completed by each participant to assist in writing up each case. Saunders *et al.* (2012:372) regard the research interview as a purposeful conversation between two or more people, requiring the interviewer to establish a relationship, to ask succinct and explicit questions, to which the interviewee is willing to listen attentively and respond. Careful listening to the answers is essential to be able to further explore any issues. Interviews are typically classified as being structured, semi-structured, or open-ended when unstructured/in-depth (Leedy & Ormrod, 2005:184; Mertler, 2009:109; Walliman, 2005:284; Saunders *et al.*, 2012:374) and are the principal means of understanding people's experiences and perspectives (Stringer, 2004:64).

For the purpose of this study the researcher made use of semi-structured interviews (Annexure B), which are non-standardised. This kind of interview:

- relies on developing a dialogue between interviewer and participant;
- requires more interviewer creativity;
- uses the skill of the interviewer to extract more, and a greater variety of, data; and
- uses interviewer experience and skill to achieve greater clarity and elaboration of answers (Cooper & Schindler, 2006:205).

Semi-structured research interviews as a method of data collection are advantageous in certain situations which can be grouped into four categories (Saunders *et al.*, 2012:378-379):

- The purpose of the research: In this study it was necessary to understand the reasons for the decisions of the research participants (audit partners), or to understand the reasons for their attitudes and opinions. According to

Saunders *et al.* (2012:378) conducting in-depth or semi-structured interviews is a suitable approach in these circumstances.

- The significance of establishing personal contact: Saunders *et al.* (2012:378) have found that managers are more likely to agree to be interviewed, rather than complete a questionnaire. An interview provides them with an opportunity to reflect on events without needing to write anything down which may comprise sensitive and confidential information. These arguments are also valid for audit partners of small and medium-sized audit practices.
- The nature of the questions: Easterby-Smith, Thorpe and Jackson (2008) state that the semi-structured interview will undoubtedly be the most advantageous method to obtain data where, *inter alia*, the questions are either complex or open-ended and where the order and logic of questioning may need to be varied. Interview questions (Annexure B) used in this study were mainly open-ended ones. This allowed the researcher to vary the questions based on responses to gather further information.
- Length of time required and completeness of the process: Saunders *et al.* (2012:379) are of the opinion that participants are generally willing to agree to be interviewed where clear expectations are established about the length of time required, and participants understand and agree with the objectives of the research interview. Participants were informed about the objective of the study and that the duration of interviews would be approximately an hour. All participants targeted agreed in advance to be interviewed.

Semi-structured interviews also provide the opportunity for the researcher to probe where she wants the interviewees to explain or build on their responses. This is important when adopting a constructivist epistemology, as the researcher is concerned with understanding the meanings that participants ascribe to various phenomena (Saunders *et al.*, 2012:378).

Based on the literature review, the semi-structured interview questions were prepared beforehand to ensure that the best possible questions were formulated. Thereafter each interviewee was sent an interview protocol consisting of a copy of the purpose of the research as well as the interview questions that were to be

discussed during the actual interview. By doing this the researcher minimised any risk of confusion, ensured that the participants understood the goals and prepared for the interviews. This also set the tone of the interview and was expected to minimise any reluctance to participate in the study.

The researcher conducted individual, face-to-face interviews, with the obvious benefit of being able to observe and record non-verbal as well as verbal behaviour. During the interviews, flexibility and freedom of expression were allowed. The mode of questioning was changed if the occasion so demanded and the respondents had the opportunity to ask for clarity or further elaboration.

As suggested by Creswell (2014:194) a tape-recorder was used during the interviews to record responses. The recordings were externally transcribed for analysis at a later stage. Copies of the transcripts were emailed to the participants, affording them the opportunity to make changes. Consent from the participants was obtained and all ethical requirements were met (refer to section 4.8).

4.6 TRUSTWORTHINESS OF DATA

It is imperative in any research study that the researcher is able to persuade the reader that the findings of the research are worthy of attention (Lincoln & Guba, 1985:290). While the terms “reliability” and “validity” are essential criterion for quality in quantitative paradigms, Agar (1986) suggests that these terms are not suitable for qualitative research.

To ensure reliability in qualitative research, examination of trustworthiness is essential. Seale (1999:266) states that the “trustworthiness of a research report lies at the heart of issues conventionally discussed as validity and reliability”.

Lincoln and Guba (1985:300) use “dependability” in regard to qualitative research, which closely corresponds to the notion of “reliability”.

Trustworthiness is therefore a matter of concern to readers. Lincoln and Guba (1985:289-329) identify four criteria which must be met to generate that confidence: credibility, transferability, dependability and confirmability. Each of these is briefly discussed in the paragraphs that follow.

4.6.1 Credibility

Credibility requires the researcher to carry out the research in such a way that the findings are to be found credible. In this study the researcher made use of two techniques which made it more likely that credible findings and interpretations were produced: peer debriefing and member checks.

Firstly, peer debriefing is regarded as an activity that provides an external check on the research data that has been collected which might otherwise remain only within the researcher's mind (Lincoln & Guba, 1985:308). Thus the researcher had her findings reviewed by an objective peer, a colleague who has knowledge about the research field (area of inquiry), who was not in an authoritative relationship with the researcher and who was prepared to play devil's advocate (Lincoln & Guba, 1985:308). The data collection process was discussed with her to gain an outside opinion on the themes and questions asked. The actual data was not discussed with her at all (to ensure confidentiality); just the collection process was peer-examined.

As suggested by Lincoln and Guba (1985:308), the most important purposes served by the peer debriefing were:

- The process assisted the researcher to be honest in exposing her methods to searching questions by her colleague.
- The debriefing provided an opportunity to test uncertainties and assumptions.
- Furthermore, the debriefing cleared her mind of emotions that could have clouded her good judgment.

A member check as a second technique for credibility was applied in this study. A transcript of the interview was emailed to participants for reaction and further input. Purposes served by member checks done by the researcher were, inter alia (Lincoln & Guba, 1985:314):

- Assessing intentionality: ensuring that the intention of the participant in providing certain information was properly understood by the researcher.
- Providing the participant with an opportunity to clarify interpretations by the researcher.
- Providing the researcher with the opportunity to gather additional information or to summarise as the first step to data analysis.

4.6.2 Transferability

It was not the intention to specify external validity in this study, but rather to provide sufficient descriptive data (“thick description”) in order to enable someone to reach a conclusion about whether the findings fit into contexts beyond the study situation (transferability) (Krefting, 1990:216). Lincoln and Guba (1985:316) caution that: “not just any descriptive data will do”, but that a researcher is responsible to provide the widest possible range of information. They further maintain that transferability is the responsibility of a person (other than the original researcher) wanting to transfer the data to another situation/population (Lincoln & Guba, 1985:316).

In the light of the above, the researcher has nevertheless engaged in purposeful sampling by selecting multiple cases as previously mentioned and several audit partners as interviewees. This sample provides a database that could contribute to the transferability of judgments.

4.6.3 Dependability

Dependability addresses the consistency criterion of the research (Krefting, 1990:217). Lincoln and Guba (1985:316, 317) are of the opinion that since there can be no credibility without dependability, it ought to be necessary to demonstrate dependability separately.

Reporting on the detailed data collection (refer to section 4.5) and data analysis processes (refer to section 4.7) followed in this study provides information on how repeatable the study could be. It presents “auditable” information which Krefting (1990:221) regards as an indicator for dependable qualitative research.

Dependability can also be enhanced through triangulation where weaknesses of one method of data collection could be compensated for by other methods (Krefting, 1990:221). The researcher did not make use of triangulation in this study because she alone conducted the interviews, instead of using an “inquiry team” as recommended by Lincoln and Guba (1985:317).

4.6.4 Confirmability

Guba (1981) as cited in Lincoln and Guba (1985:319) states that the main technique for establishing confirmability is the confirmability audit. Although the researcher did not make use of an inquiry auditor to attest to the dependability and confirmability of the research, she conducted her research with an excess of records stemming from the interviews known as the “audit trail” (Lincoln & Guba, 1985:319).

Audio recordings and field notes of all interviews were captured by the researcher and have been kept safe for future reference, if required. A person unrelated to the study transcribed the interviews. The researcher checked the transcripts, and, as mentioned, thereafter these were emailed to participants for consideration. Participants’ feedback was considered.

Confirmability was furthermore assessed by the researcher who applied several steps as recommended by Lincoln and Guba (1985:323) as some of the tasks of an inquiry auditor that were fulfilled by the researcher. She had to ascertain whether the findings were grounded in the data, and reach a judgment as to whether inferences based on the data were logical, examining for instance the quality of the interpretations. The researcher depended on the guidance of her two supervisors, both experienced and highly knowledgeable in this research field, to ensure confirmability as a criterion of trustworthiness.

Interviewer and interviewee bias had to be considered and assessed. Saunders *et al.* (2012:381) mention three types of potential bias for consideration by the researcher. Interviewer bias exists where the comments, tone or non-verbal behaviour of the interviewer create bias in the way that interviewees respond to the questions being asked. Through the questions asked as well as in the way she interpreted the responses, the researcher was careful not to impose her own beliefs and frame of reference. Saunders *et al.* (2012:381) also mention interviewee or response bias, which may be caused by perceptions about the interviewer. They further explain that although an interviewee may, in principle, be willing to participate in a study, he/she may nevertheless be sensitive to the exploration of certain themes (Saunders *et al.*, 2012:381). This could result in the interviewee choosing not to reveal and discuss an aspect of the topic, to avoid further probing questions that would intrude on sensitive information that participants are unwilling or not empowered to discuss. The outcome of this might therefore be a “partial ‘picture’ of the situation” (Saunders *et al.*, 2012:381). By including the views of various audit partners from multiple cases, the researcher was able to test theoretical perspectives and this strengthened the credibility of the study.

The above discussion confirms that by taking these considerations relating to credibility, transferability, dependability and confirmability into account, the trustworthiness of the study was ensured.

4.7 DATA ANALYSIS

According to Marshall and Rossman (1995:133) and De Vos *et al.* (2002:339), data analysis refers to the process of organising data in a creative way, to compare and interpret the data. Terre Blanche *et al.* (2006:321-340) concur that qualitative analysis entails a thorough description of the characteristics, processes, transactions and context which constitute the phenomenon being researched. Kumar (2005:240) emphasises that analysing qualitative data demands the application of content analysis, which refers to analysing the contents of the interviews in order to identify the main themes emerging from the responses.

Maree, Creswell, Ebersohn, Eloff, Ferreira, Ivankova, Jansen, Nieuwenhuis, Pietersen, Plano Clark and Van der Westhuizen (2010:47-62) describe qualitative data analysis as usually being based on an interpretative philosophy aimed at examining the meaningful and symbolic content of qualitative data. Phrased differently, it tries to establish how participants understand a specific phenomenon by analysing their perceptions, attitude, understanding, knowledge, values, feelings and experiences in an attempt to approximate their construction of the phenomenon.

In the data analysis approaches presented by De Vos *et al.* (2002:339), Terre Blanche *et al.* (2006:321-340), Kumar (2005:240), Miles and Huberman (1994:9) and Saunders *et al.* (2012:550-563) the following steps appeared as essential to this researcher and were applied as steps to analyse the data collected for this study:

- preparing data for analysis;
- identification of themes;
- assigning codes to main themes;
- categorising or classifying responses under a main theme; and
- integrating the themes and responses into the text of the report.

In this study the analysed data was organised according to audit partner participants and then grouped into a case. This was followed by interpreting and making sense of the data and subsequently drawing conclusions. The collected data that required analysis comprised brief phrases and detailed paragraphs as answers to semi-structured and open-ended questions, as well as field notes, summaries and word-for-word transcripts of individuals' interviews.

4.7.1 Preparing data for analysis

Descombe (2005:269) makes it clear that qualitative data may be obtained from a variety of research methods and can come in diverse formats but, whatever the format, it needs to be organised before being subjected to a process of analysis. Descombe (2005:269) further argues that the preparation of data for analysis includes:

- Getting the material into similar format.
- Providing space for researcher's comments when collating data.
- Allocating unique serial numbers to each item of data.

For the purpose of this study an interview protocol (refer to section 4.5) was used which provided a degree of interview structure. After the data was collected, the audiotapes were played and the data from the audiotapes independently transcribed, verbatim. Based on the interview protocol used, these transcripts were presented in similar formats for analysis.

4.7.2 Identification of themes

Kumar (2005:240) describes this step as vital as it involves going through the descriptive responses given by the respondents for each question with a view to understanding the meaning communicated. Thereafter broad themes are identified and accurately named. Terre Blanche *et al.* (2006:322-323) refer to this step as familiarisation and immersion, which calls for the researcher to develop

ideas and theories through interacting with the field notes (where applicable) and interview transcripts.

Based on the literature review in Chapters 2 and 3, seven broad themes were identified in this study:

- Need for an audit.
- Organisational arrangements.
- Social factors.
- Technology.
- Physical settings.
- Organisational performance.
- Sustainability.

4.7.3 Data coding

According to Kumar (2005:325), coding incorporates assigning codes to or labelling of themes by going through responses to the same question to identify commonality in meaning and assigning codes to data relevant to particular themes. Terre Blanche *et al.* (2006:325) suggest that coding could be done in different forms, such as the use of coloured marker pens, making copies of responses and cutting responses into smaller sections which are grouped together, using key words or assigning numbers to themes. In this study, codes were assigned to data applicable to a particular theme, and this was supplemented by a computer aided analysis process as described in section 4.7.5.

4.7.4 Data categorising

After identifying the themes, the next step is the examination of the transcripts of all interviews and the use of codes to classify the responses under the different themes (Kumar, 2005:241). In this step all responses and field notes relating to a specific theme were grouped together.

4.7.5 Data integration

After classifying responses within different themes, the process of integrating the responses into the text of the report is the next step. The manner in which the integration is performed depends on the individual researcher's preference. Integration approaches include: keeping verbatim responses emerging during the theming phase and counting how frequently a theme has occurred (Kumar, 2005:241). This study applies both approaches during the data analysis phase. This permitted the researcher to make deductions about generalisations concerning the population studied.

Apart from a manual data analysis process as describe above, the researcher mainly made use of ATLAS.ti™ as a computer aided qualitative data analysis software (CAQDAS) programme. This software, when systematically used, can aid continuity and increase both transparency and methodological rigour (Saunders *et al.*, 2012:581). Saunders *et al.* (2012:546) remark that whilst the use of analysis software for quantitative data is almost universal, the use of CAQDAS for qualitative data has gained momentum over the past years.

Lewins and Silver (2009) summarise the basic ways in which the CAQDAS programmes are able to facilitate qualitative data analysis as explained by Saunders *et al.* (2012:582):

- Structure of work: the ability to store and connect between all data files within the research project.
- Closeness to data and interactivity: [the] almost immediate access to all data once it has been introduced.
- Explore the data: a word, a phrase or a collection of words could be searched and retrieved within the context.
- Code and retrieve: inductive, deductive or a combination of coding schemas could be used to code, retrieve and recode data.
- Project management and data organisation: the research project as a whole could be managed and data could be organised.

- Searching and interrogating: on the basis of language used and coding and relationships between codes, different units of data could be explored.
- Writing memos, comments, field notes, etc. to record additional information systematically in relation to the data.
- Output: generating reports which could be exported to other applications.

The above functions of ATLAS.ti™ were used in the study for the data analysis.

4.8 ETHICAL ASPECTS

Resnik (2011:1) defines ethics as norms for conduct that distinguish between acceptable and unacceptable behaviour. He indicates that ethics focuses on the disciplines that study standards of conduct, while “research ethics” studies behaviour norms. Resnik (2011:1) further summarises ethical principles by various codes: for example, honesty, objectivity, integrity, carefulness, openness, respect for intellectual property, confidentiality, responsible publication, responsible mentoring, respect for colleagues, social responsibility, non-discrimination and competence. These values were considered during this study.

There are four aspects relating to ethical behaviour that were considered during this study: seeking permission to conduct the study, the right to self-determination and justice, the right to informed consent and the right to privacy (Mkhize, 2009:20).

4.8.1 Seeking permission to conduct the study

Permission was sought from the Research Ethics Committee of the Faculty of Economics and Management Sciences at the University of Pretoria to conduct the study. Once approval from the committee was received (Annexure C), a letter requesting permission to visit the selected audit practices for research purposes was sent to the audit partners (Annexure D).

4.8.2 Right to self-determination and justice

As Mkhize (2009:20) argues, the right to self-determination is based on the ethical principle of respect for people and indicates that humans are capable of controlling their own destiny and should be treated as free and autonomous agents. Participants were informed in writing of their right to choose to participate, or not to participate, in the study. The researcher ensured that the dignity of respondents was maintained throughout the study.

4.8.3 Right to informed consent

Informed consent is a prerequisite in all research that involves identifiable participants except in cases where an ethical committee judges that such consent is not possible or the benefits of the research outweigh the potential harm to participants (Richards & Schwartz, 2002:137). In accord with this prerequisite, participants were presented with the intention of the study by a letter explaining the objective of the study and specifying that they might withdraw at any time from the research (Hannan, 2006:12; Motaung, 2008:96). Participants communicated their decision to participate or not to participate by signing the attached consent form (refer to Annexure D) which Mkhize (2009:21) refers to as the prospective participant's agreement or disagreement to participate in a study.

4.8.4 Right to privacy

In this study privacy implied that participants could speak, think and behave without interference or without running a risk of their private utterances, thoughts or behaviours being utilised to demean or embarrass them in any way (Hannan, 2006:8; Mkhize, 2009:22). Participants were informed in writing (as part of the above mentioned consent form: Annexure D) that their views would be used solely for the purpose of the research and be treated as confidential.

4.9 CONCLUSION

The research methodology used in this study has been discussed in detail in this chapter. A qualitative research approach was used and the reasons for this decision were outlined. It was decided to discuss the research design with reference to the paradigm, the strategy, the method and the analysis. The concept “paradigm” is regarded as a worldview by various authors (Guba & Lincoln, 1994:105; Saunders *et al.*, 2012:128; Creswell, 2014:6), as well as a research philosophy, a framework of beliefs and values and methods within which research takes place. Ontology and epistemology as two major ways of thinking about research philosophy were elaborated on. Constructivism was identified as a philosophical worldview in this qualitative study; the reasons for this decision were stated. For the purpose of this descriptive research a multiple-case study strategy was followed with semi-structured interviews as the data collection method. The population and unit of analysis were mentioned and a detailed discussion followed where the selection of cases (participants) with specific reference to the reasons and criteria was clarified. The IRBA’s classification of audit practices was applied as a guideline to identify small and medium-sized audit practices in the Pretoria region as cases for the study. Furthermore, criteria, such as: years in existence, profile of the partners and a change in the number of partners in a practice since the implementation of the Companies Act of 2008, were taken into consideration for selecting the participants. Four criteria, as elucidated by Lincoln and Guba (1985:289-329), must be met to generate confidence in the research findings: credibility, transferability, dependability, and confirmability. These criteria and how they applied to this study were explained and all ethical requirements as set out in this chapter were complied with. The data analysis process as used was outlined in terms of data analysis preparation, identification of themes, coding and categorising data and finally integrating the data. The tool ATLAS.ti™ was used to assist in the data analysis.

Chapter 5 presents the data analysis categorised according to the above mentioned steps. The findings are discussed with regard to the literature review in Chapters 2 and 3.

CHAPTER 5

DATA ANALYSIS, FINDINGS AND INTERPRETATION

5.1 INTRODUCTION

As part of achieving the aim of this study, Chapters 2 and 3 provided an overview of the literature. In Chapter 2, the origin, regulation and deregulation of auditing were examined while Chapter 3 considered organisational change and audit practices.

In Chapter 4 the research methodology were explained, which included a discussion of constructivism as a philosophical worldview for this qualitative research study. A multiple-case study strategy was selected with semi-structured interviews as the data collection method; the motivation for this decision was explained. The population and selected cases for the study were also elaborated upon. The remainder of Chapter 4 reflected on the trustworthiness of the collected data and concluded with ethical considerations.

Chapter 5 provides detailed findings obtained from the collected data. The views shared by participants and their experiences as reflected upon during the semi-structured interviews are discussed. This has resulted in rich descriptions of the cases that provide the researcher with a deep understanding and insight about the given phenomenon, mandatory audit relief. This chapter initially presents the cases and participants and then briefly outlines the data analysis method, followed by the findings and interpretation for each case. Thereafter, the findings and interpretation for the cross-case analysis are presented with reference to the relevant sections of the literature review. Finally, a conclusion is drawn.

5.2 CASES AND PARTICIPANTS

The cases and participants for this study as explained in Chapter 4 are summarised in Table 5.1.

Table 5.1: Summary of cases and participants

Case	One	Two	Three
Classification	Sole proprietors (1 partner)	Small audit practices (2-3 partners)	Medium audit practices (4-5 partners)
Number of audit practices	7	4	3
Number of participants	7x1=7	4x1=4	3x1=3
Participants	P1, P2, P3, P4, P5, P6, P7	P8, P9, P10, P11	P12, P13, P14

References made to quotations from participants can be interpreted as follows:

- C = Case
- P = Participant
- Number before colon = starting line of quotation in Atlas.ti
- Number after colon = ending line of quotation in Atlas.ti

For example: **C1P3, 51:53** refers to Case 1, Participant 3, starting on line 51 and ending on line 53.

Abbreviations have been allocated for each of the cases, as per Table 5.2.

Table 5.2: Abbreviation for each case

Case	Abbreviation
Case 1 (sole proprietors)	SPs
Case 2 (small audit practices)	SAPs
Case 3 (medium audit practices)	MAPs

The following criteria were applied in selecting the audit practices as cases and the audit partners as participants for this study:

- Years in existence (SPs, SAPs and MAPs which were established before the introduction of the Companies Act in 2008 and at the time of the study were continuing their operations as audit practices).

- Profile of partners (partners practicing as registered auditors before and after the introduction of the 2008 Companies Act, and at the time of the study).
- Audit practices (other than sole practitioners) in which the number of partners has changed (increased/decreased) since the introduction of the Companies Act in 2011.

5.3 DATA ANALYSIS

As explained in Chapter 4, Marshall and Rossman (1995:133); De Vos *et al.* (2002:339) and Kumar (2005:240) all contend that analysing qualitative data demands the application of content analysis, which refers to analysing the content of the interviews in order to identify the main themes emerging from the responses. Codes (or sub-themes) are then assigned to the main themes in order to classify responses in terms of the themes. Lastly, the themes and responses are integrated into the text of the report (De Vos *et al.*, 2002:339; Terre Blanche *et al.*, 2006:321-340; Kumar, 2005:240; Miles and Huberman, 1994:9; Saunders *et al.*, 2012:550-563). The collected data that required analysis consisted of brief phrases and detailed paragraphs as answers to semi-structured and open-ended questions, and also included field notes, summaries and word-for-word transcripts of each interview. Each of the semi-structured interviews was conducted in either English or Afrikaans. In so far as the Afrikaans interviews were translated into English when compiling the word-for-word transcripts, careful consideration was given during this process to ensure that the participants' words/answers were directly translated and that no attempt was made to change the participants' words or phrases. The exact translated quotations for Afrikaans speaking participants and verbatim quotations for English speaking participants are presented in italics in this chapter.

Based on the literature reviews presented in Chapters 2 and 3 the following seven broad themes were identified and emerged from the empirical research of the study:

- Need for an audit.
- Organisational arrangements.
- Social factors.
- Technology.
- Physical settings.
- Organisational performance.
- Sustainability.

These are summarised in Table 5.3. The findings of the study are presented in accordance with the outline provided in this table. Findings of each of the cases are discussed separately. Thereafter, a cross-case analysis is presented. Where reference is made to the masculine form, it refers to both genders.

Table 5.3: Summary of themes and sub-themes emerging from the study

THEMES						
Need for an audit	Organisational arrangements	Social factors	Technology	Physical setting	Organisational performance	Sustainability
SUB-THEMES						
<ul style="list-style-type: none"> • The need for an audit • Mandatory audit relief • Independent review 	<ul style="list-style-type: none"> • Goals • Strategies • Client profile/size • Type of services • Structure • Change in human resources • Administration • Systems, policies and procedures • Challenges • Training office • Ownership 	<ul style="list-style-type: none"> • Management style • Staff morale at time of change • Current staff morale 	<ul style="list-style-type: none"> • Information technology programs • Information technology equipment 	<ul style="list-style-type: none"> • Office space/design 	<ul style="list-style-type: none"> • Income streams • Expenditure 	<ul style="list-style-type: none"> • Practice sustainability • Future role of auditors • Other matters

5.4 FINDINGS AND INTERPRETATION: CASE 1 (SP)

5.4.1 Introduction

Case 1 comprised seven SPs that complied with the selection criteria, as determined by the researcher and explained in Chapter 4 section 4.4.3 and Chapter 5 section 5.2. Each SP was requested to complete a questionnaire which served as an audit practice profile. Table 5.4 furnishes a summary of the profiles of these SPs before the introduction of the 2008 Companies Act (prior to change) and at the time of completion of the questionnaire (current).

Table 5.4 Profiles of sole proprietors (SPs) selected as units of analysis: Case 1

Participant	P1		P2		P3		P4		P5		P6		P7	
Date of incorporation	2010 – SAP 2012 – SP		1994		2010		1 st = 2010 2 nd = 2014		2007		1998		2003	
	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²
Number of partners	3	1	2	1	1	1	1	1	1	1	1	1	1	1
Staff composition														
▫ Number of managers	N/A	0	9	7	0	0	0	0	2	2	2	2	0	0
Number of trainee accountants														
▫ SAICA	N/A	0	1	2	0	0	0	0	0	0	0	0	0	0
▫ SAIPA	N/A	0	2	1	0	0	0	0	0	0	3	3	0	0
Qualifications of staff (excluding partners)														
▫ Number of CAs(SA)	N/A	0	2	1	0	0	0	0	2	2	0	0	1	1
▫ Number of post-graduate staff	N/A	0	3	3	0	0	0	0	2	2	0	0	0	0
▫ Number of graduate staff	N/A	0	4	3	0	0	0	0	3	3	6	6	6	6
▫ Other, studying towards Accounting degree	N/A	0	3	3	0	0	0	0	0	0	0	0	0	0
Number of assurance clients	65	60	300	67	N/A	10	3	28	24	6	38	13	15	0
Services (% of total income)														
▫ Auditing	100%	80%	18%	8%	N/A	5%	27%	59%	20%	5%	39%	33%	10%	0%
▫ Accounting – clients subject to	0%	0%	0%	0%	N/A	0%	0%	0%	0%	5%	0%	0%	0%	0%

Participant	P1		P2		P3		P4		P5		P6		P7	
Date of incorporation	2010 – SAP 2012 – SP		1994		2010		1 st = 2010 2 nd = 2014		2007		1998		2003	
	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²
audits by other firms														
▫ Accounting – clients not subject to audits	0%	15%	57%	62%	N/A	90%	60%	33%	35%	35%	19%	22%	60%	65%
▫ Tax	0%	5%	0%	0%	N/A	5%	13%	6%	20%	20%	21%	25%	30%	30%
▫ Forensic	0%	0%	0%	0%	N/A	0%	0%	0%	0%	5%	0%	0%	0%	0%
▫ Advisory	0%	0%	2%	2%	N/A	0%	0%	1%	10%	15%	8%	7%	0%	0%
▫ Payroll	0%	0%			N/A	0%	0%	0%	10%	10%	3%	2%	0%	0%
▫ Secretarial	0%	0%	23%	28%	N/A	0%	0%	1%	5%	5%	10%	11%	0%	5%
Impact of change on income														
▫ Increase							✓		✓					
▫ Decrease	✓		✓								✓			
▫ No change					✓								✓	
Extent of above change														
▫ Less than 10%					✓									✓
▫ 10%-25%			✓						✓		✓			
▫ 25%-50%	✓													
▫ 50%-75%														
▫ More than 75%							✓							

¹ Prior to change = before the introduction of the 2008 Companies Act

² Current = at the time of completion of the questionnaire (Annexure A)

Three unique SPs, as explained below, were included in Case 1. One SP participant (Participant 1) practiced as one of three audit partners in a SAP prior to the implementation of the 2008 Companies Act. Some months after the introduction of the mandatory audit relief, he established his practice as a SP and therefore he meets the criteria as a participant for Case 1. The staff composition of this SP prior to the implementation of the relief was not taken into account, as reflected in Table 5.4 above, since the staff formed part of the SAP and a direct comparison cannot be made with the staff of the SP. Another SP participant (Participant 2) was a partner in an audit practice that had practiced as a partnership before the 2008 Companies Act and could therefore be considered a SAP in terms of this study. Shortly after the said relief was introduced, one partner left the SAP, resulting in the remaining partner practicing as a SP; hence the inclusion in Case 1. The third unique SP participant (Participant 4) was registered and practiced as a SP prior to this relief. A few months after the change, he deregistered as a member of the IRBA, only to re-register again as a RA and practice as a SP. All the remaining SP participants practiced as SPs prior to the change and were still practicing as such during the time of the interviews.

From the above profile table of SPs in Case 1 (Table 5.4), it is notable that the sole proprietorship of Participant 2, with reference to its seven managers, is the largest. This SP furthermore employed one SAIPA and two SAICA trainees. Table 5.4 indicates that the number of assurance clients of this sole proprietorship has decreased dramatically from 300 prior to the 2008 Companies Act, to 67 currently. Apart from the sole proprietorships of Participants 2 and 6, no other SP in Case 1 employed any SAICA or SAIPA trainees. Except for one SP (Participant 4), all other participants indicated a decrease in auditing services offered by their SPs since the introduction of the 2008 Companies Act. Participant 3 only established his SP some months prior to the introduction of the mandatory audit relief and it was therefore not accurate to compare his current income position to that when he had just started his practice. However, it is clear that since the implementation of the 2008 Companies Act, his practice has not been able to grow its audit services and currently represents a disappointingly low 5% of his total income. It is evident that three of the seven SPs have experienced a decrease in income since the introduction of the given relief; two

SPs between 10% and 25% and one SP between 25% and 50%. However, Participants 4 and 5 indicated that they have experienced an increase in their practices' income since the introduction of the mandatory audit relief. The practice of Participant 4 reported a significant increase of more than 75% in his SP's income since the introduction of the 2008 Companies Act. Participants 3 and 7 indicated that there had been no change in their respective practices' income since the implementation of the 2008 Companies Act.

This section proceeds with a discussion of the findings from the responses of SP participants, with specific reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance and sustainability.

5.4.2 Need for an audit

5.4.2.1 The need for an audit

The majority of the SP participants responded with the statement that there is definitely a need for an audit. One SP participant believed an audit *"is important"* (C1P1, 11:11), another SP participant added that an audit *"is valuable"* (C1P6(1), 12:12) while a third SP participant stated that an audit *"gives assurance to all the relevant stakeholders of the company"* (C1P5, 15:15). One of the SP participants responded to the question on whether there was a need for an audit as follows: *"There is no doubt about it"* (C1P3, 183:183).

The aforementioned SP participant elaborated on the above statement by saying that he personally *"won't place value"* (C1P3, 181:181) on financial statements that were not audited, because he is aware how easily information in financial statements can be manipulated, for example, by way of journal entries. Another SP participant reasoned that because of the regulation of the auditing profession as well as the auditing standards that have to be complied with when performing an audit, both the auditor and the client will be attuned to ensuring that the reporting on financial information is done accurately. According to him this is not the case with a compilation engagement. One of the SP participants added that a

client, who does not have the financial knowledge to interpret financial statements, could be presented with a compilation report with the false impression that this is an audit report. Consequently, the client might base decisions on unaudited financial statements, believing that these have been audited and are credible.

This participant explained as follows: *“The point is, in my experience that the client doesn’t have the knowledge and he trusts on a set of financial statements that someone else just tell him: yes it is audited financial statements. If I look at those financial statements, then I see it is a compilation report” (C1P1, 11:11).*

Without contradicting the view that there is a need for an audit, one SP participant pointed out that for each client, *“...the circumstances should determine the need” (C1P4, 14:14).* The remaining two SP participants remarked that they do not necessarily believe there is always a need for an audit. One SP participant explained that: *“If the intended users of the financial statements are the shareholders [and are not reliant on financial assistance from a] bank then it doesn’t make sense to incur excessive cost to have your financials audited” (C1P2, 14:14).* The other SP participant reasoned that for clients (small companies and family businesses) wanting to comply with regulation with their main focus on the profitability of their businesses, an audit *“won’t add value” (C1P7, 21:21)* to their businesses and is *“not worth the cost” (C1P7, 23:23).* This SP participant’s final remark on the value that the audit adds to small companies and family businesses was: *“I can rest assure you, zero” (C1P7, 15:15).*

5.4.2.2 Mandatory audit relief

The majority of the SP participants did not support the introduction of this relief. One of the SP participants stated that, aside from the loss of income for the auditor as an outcome of such relief, it could also lead to financial statements being presented fraudulently, which would result in the end user being affected. He added that the end user was *“the person that should have been protected through the regulation in the first place” (C1P1, 19:19)* and that the consequence of the change in the Companies Act meant that the end user was not protected.

He used the example of a young and inexperienced entrepreneur, who does not necessarily have the financial knowledge to interpret the financial statements, but uses them to make business decisions (for instance, buying a franchise). Before the introduction of the mandatory audit relief, the Companies Act protected this end user by way of a compulsory audit engagement for all companies. However, as a consequence of the said relief, such a company's financial statements (the franchise being purchased) could be fraudulent, which will negatively affect the end user.

Two of the SP participants, who were not in favour of this relief, expressed some concerns regarding the factors taken into consideration when calculating the PIS. One SP participant explained that one of the factors, namely, the average number of employees of the company for the financial year (section 2.5.2.2 in Chapter 2), carries too much weight in determining the PIS. He supported this by using the example of one of his clients operating a security company. The nature of this industry requires the company to have a very large workforce resulting in a PIS in excess of 350, which is not necessarily a true reflection of the company's public interest. He remarked: *"I have a client who had a five hundred and something PIS score, but he has a thirty million turnover. It is a security company. He has five hundred employees being paid peanuts. Now his PIS is five hundred and fifty"* (C1P6(2), 82:82). He recommended that the Companies Act should make provision for differentiation on turnover based on a company's industry, rather than applying a generic PIS.

Another SP participant agreed with the above view that the average number of employees of a company for a financial year is not an appropriate determinant of the public interest in a company. He referred to a family business, in the form of a close corporation that has operated three filling stations for the past 30 years. As a close corporation, an audit was not required in terms of regulation before the introduction of the 2008 Companies Act. With the introduction of the mandatory audit relief and the change in the Companies Act, this close corporation is now required to calculate its PIS annually. Owing to the nature of the industry, this close corporation has a large number of employees leading to a PIS of more than 350, which results in the close corporation's financial statements requiring an

audit. He responded: “...telling those people now that there’s new value that’s going to be added because in terms of the compliance or in terms of the Companies Act, now you [the close corporation] must be audited because you make the cut. People say it’s crazy” (C1P7, 29:29). He added that the turnover factor was also not an accurate indicator for public interest across all industries. Using the same filling station business as an example, he explained that having an annual turnover of R60 million is normal for this industry, but that about 93% of that turnover represents cost, resulting in a low profit-margin. He agreed that some industries could be assessed on their turnover, but recommended that other industries should rather be assessed on their profit-margin for a more realistic result: “To use turnover to be honest...you are killing them [companies in such industries]” (C1P7, 45:45). He concluded that companies from different industries cannot be judged uniformly by using a fixed percentage for the turnover attribute in calculating the PIS; therefore he believed that the attributes currently used could result in an incorrect measure of public interest.

Another SP participant held a more balanced view and considered mandatory audit relief from the practice’s and the client’s viewpoint: “...from the small micro/medium size companies’ perspective, it is a good thing. From an auditing practice’s perspective, it’s a loss of income” (C1P2, 18:18).

The two SP participants who were in favour of the relief pointed out that an audit was not necessarily adding value to the financial statements of a private company, but merely increased the company’s expenses. One of these SP participants elaborated as follows: “...it has removed a lot of the red tape for your SMEs and it has assisted companies with reduced audit fees” (C1P5, 19:19).

5.4.2.3 Independent review

One SP participant expressed concern about the introduction of this relief, which offers an alternative to an audit in the form of an independent review engagement. He acknowledged that his clients, who were aware of this alternative to the audit, had opted for independent review engagements in order

to save on audit fees. His concern was based on the experience of one of these clients who had opted for an independent review for a financial year, but was required to have an audit performed on the financial statements the following year. This would result in the audited financial statements containing opening balances that were not previously audited, requiring an audit to be performed in retrospect. He responded as follows: *“Your opening balances, your last years were not audited. So this is my biggest issue [with] this, this new Companies Act” (C1P3, 191:191).*

5.4.2.4 Summary of the need for an audit

The majority of SP participants stated that there is definitely a need for an audit to provide assurance on the credibility of financial statements and to add some value. Hence, they did not support the introduction of the mandatory audit relief. Due to audit regulations and audit standards that have to be complied with for the purposes of an audit, SP participants generally believed that auditors and their clients demonstrate commitment towards the correctness of reporting on financial information, while this is not the case for a compilation engagement. Therefore, such relief could lead to fraudulent financial statements, which would be to the detriment of the end user. There was also concern expressed by a SP participant that clients without sufficient knowledge regarding financial information could perceive compilation engagements as providing similar assurance to that offered by audits. It was further remarked that, prior to the mandatory audit relief, the end user was protected by the Companies Act through the requirement of a compulsory audit engagement for all companies.

The minority of SP participants who were in favour of this relief were of the opinion that individual circumstances should be the determining factor for the need for an audit. This minority group argued that an audit might not be worth the cost and its value could be questioned, especially in the case of small companies and family businesses. As an alternative and to save costs, the independent review was preferred provided that the PIS of the company was within acceptable limits. However, attention was drawn to the risk attached to the cost saving factor when variation in the PIS from year-to-year could result in an audit engagement

where the opening balances had not been audited previously, and an audit would need to be performed retrospectively. Two SP participants criticised the formula used to calculate the PIS; the weight that the average number of employees of a company in a financial year carries in determining the PIS and the disregard for industries to which turnover attributes relate, were questioned.

5.4.3 Organisational arrangements

5.4.3.1 Goals

Although three SP participants indicated that the introduction of the relief had no impact on their practices' goals, the remaining SP participants had experienced a change. One SP participant stated that his practice was obliged to "*explore other avenues to generate income*" (C1P2, 22:22), while another SP participant added that this relief resulted in the goals of his practice shifting because of the "*focus from audits to advisory services and tax planning*" (C1P5, 23:23). These views agree with the information presented in Table 5.4 that auditing fees as a percentage of total income for Participant 2's practice had decreased to 8% (from 18% prior to the 2008 Companies Act) while for Participant 5's practice they had decreased from 20% (prior to the 2008 Companies Act) to 5% in 2015.

Another SP participant mentioned that for his practice, the initial goal was to function as an audit practice (refer to 5.4.3.5) with a stable audit client base, with the aim being to focus on delivering audit services to the government: "*So I knew that every year when the year starts, AG [Auditor General] will allocate a certain amount of audit work. So that was the premise on which I started*" (C1P3, 50:50). As a result of the change in the Companies Act, within two years he realised that he had to change the practice's goals and focused more on accounting services. Based on the information provided, 90% of his practice's income is currently from accounting services rendered to clients not subject to audits (refer to Participant 3 in Table 5.4).

5.4.3.2 Strategies

With the exception of only one SP participant, all the others needed to change their practice strategies since the introduction of the given relief.

As indicated above (refer to 5.4.3.1), some of the SP participants explained that their practices experienced a change in their goals as a result of the said relief, which consequently led to their practices adjusting their strategies. Three SP participants did so by shifting their focus away from audit engagements and focusing more on providing non-audit services (accounting, advisory and taxation services) (refer to 5.4.3.4). The following views by one of these SP participants provides a clear picture: *“I had to change [my] strategy and [move] mainly to non-audit [services]” (C1P3, 52:52) “...my strategy has been to advise” (C1P3, 211:211)*. One of these SP participants reported that since the introduction of this relief the focus of his practice has shifted from audit engagements to such an extent that it is currently only performing non-audit services. However, he pointed out that although he is currently not performing any audits for various reasons (refer to 5.4.3.4), from a strategic point of view, he preferred to stay registered as a member with the IRBA. He believed that this enabled him to meet clients’ expectations as they perceived that if their non-audit services were performed by a person registered as a CA(SA) as well as an auditor, it would result in a higher level of applied expertise, and would ultimately deliver a satisfactory outcome: *“...they know being helped by a qualified CA who’s also an auditor...the word ‘auditor’ [is] adding value”. “...that’s why I’m keeping the IRBA thing for that credibility” (C1P7, 89, 95, 87)*.

In contrast to the practices of the above three SP participants, who modified the strategies of their practices to move away from audit engagements, the practice of one SP participant, which had focused more on non-audit services before the 2008 Companies Act, took the strategic decision to focus his practice on audit engagements. After he (Participant 4) decided to re-register with the IRBA as an auditor in 2014 (refer to 5.4.1), he specifically decided to focus his practice’s attention mostly on category A audit engagements, servicing audit clients with the

highest risk of public exposure, which resulted in an increase of more than 75% in his total income (refer to Table 5.4 and section 5.4.7.1).

Another SP participant indicated that his practice had diversified as a result of the specific relief. He added that this diversification resulted in his practice now specialising in the issue of Exempt Micro Enterprise (EME) certificates, a clear demonstration of how his SP's strategy has changed. He explained this by saying: *"Those certificates [were] a thing I chased to get money due to the change"* (C1P1, 27:27). One SP participant also mentioned that his practice *"used to focus on SAICA article[d] clerks"* but altered this strategy as a result of the mandatory audit relief, and *"now [the practice] tend[s] to focus more on SAIPA" trainees* (C1P2, 26:26).

5.4.3.3 Client profile/size

The majority of the SP participants indicated that although the type of services needed by their clients has changed since the introduction of the said relief, there was no change in their practices' overall client size. One SP participant expressed that although he did not lose any of his clients, the fee income from the clients has reduced: *"[clients] stayed because I lowered my fees, to compete with the SAIPA guy. So when you come to me today for a compilation, I actually won't charge you more than the SAIPA guy next door"* (C1P1, 61:61). Another SP participant reasoned that he did not experience a decrease in his client base because *"a lot of [his practice's clients] still ask for voluntary audits"* (C1P6(2), 18:18).

One SP participant (Participant 4) did in fact experience an increase in his practice's client base (refer to Table 5.4). The main reason for this outcome was that as a result of the introduction of the relief, *"many young qualifying IRBA members either did not register as an RA or resigned"* and consequently *"more clients were referred to [him] for audit purposes"* (C1P4, 26:26).

Despite the above views, one SP participant who had indicated that his practice's client base did indeed decrease as soon as his clients became aware of the

mandatory audit relief (refer to Participant 2 in Table 5.4), stated that these clients mostly moved to accounting practices, irrespective of any possible difference in level of expertise which could have impacted on the quality of services, because *“the client will rather go where the monthly fee is less”* (C1P2, 29:29).

5.4.3.4 Type of services

Apart from one exception, it was clear from the SP participants' views that all SPs experienced a decrease in the number of audit engagements performed since the relief. It is evident from Table 5.4 that the current fee income from audit engagements for the majority of the SP participants represented less than 10% of the total income received from all their service offerings. This was clearly the driving factor for the majority of the SP participants to focus, and expand, on their other service offerings.

One of the SP participants stated that his SP had been obliged to diversify its service offerings since the introduction of the said relief. He made it clear that ideally the focus of his SP would remain on audit engagements. However, this was not possible because since this introduction the demand for audits has declined. This forced his practice to expand its service offerings, even though his practice was willing to perform high risk audits (classified by the IRBA as category A audits) although in the past it had mostly performed category C audits (classified by the IRBA as low risk audits). This SP participant explained that his practice expanded its service offerings by referring to services such as: accounting and taxation services, involvement with contractual work for other audit practices, the performance of factual findings reports, Black Economic Empowerment (BEE) services and even specialising in the issuance of EME certificates (refer to 5.4.3.2). He substantiated the above by stating: *“basically...anything where I can use my qualifications to put my signature on work”* (C1P1, 117:117).

Other SP participants supported the above discussion as follows: *“increased our emphasis on advisory and tax services. We also now provide more financial*

manager functions to our smaller clients” (C1P5, 30:30); “We tend to focus more on networking with financial planners and attorneys” (C1P2, 33:33); “...changed from a regulatory point of view to a value adding point of view” (C1P4, 22:22).

One SP participant referred to the number of audit engagements performed by his practice as *“negligible” (C1P3, 9:9)* since the introduction of the said relief, whilst another SP participant stated he was currently only performing *“full accounting services...including taxes” (C1P7, 63, 65).*

One SP participant had, since the introduction of the given relief, re-registered as a member with the IRBA to practice as an RA (refer to 5.4.1). In contrast with all the other SP participants, he had decided to shift his practice’s focus from other service offerings, towards category A (high risk) audit engagements, which resulted in an increase in the number of audit engagements performed by his practice (refer to section 5.4.3.2).

5.4.3.5 Structure

Only three SP participants commented on how the mandatory audit relief altered their practices’ structures. Their views are presented below. One SP participant, who previously had been a partner of a SAP, has modified the structure of his practice to a SP since the introduction of this relief (refer Participant 1 in Table 5.4 and section 5.4.1). He mentioned that since he practiced alone, without partners or staff, he used *“fixed agreements with other practices” (C1P1, 85:85)* when he needed support in other services (refer to section 5.4.3.6) and that such arrangements proved to be cost-effective. He elaborated as follows: *“I sub-contract some tax and accounting services, your type of services that you physically need to go to a SARS office, which takes more time than I can ever collect from the client. For those type of things, I use sub-contracting, and that typically for a SAIPA person” (C1P1, 85:85).*

The second SP participant (Participant 2) who also altered his practice’s structure after the introduction of the mandatory audit relief, reported that his practice had functioned as a partnership before the change and became a SP afterwards

(refer to Participant 2 in section 5.4.1). This was a result of the decision of one partner to leave the auditing profession as a result of the introduction of the said relief (refer 5.4.3.11).

According to the third SP participant (Participant 3) he had established his practice a few months before this event. At that time he had an office and applied for accreditation with SAICA as a training office “*I got the office, it was the time I was applying for SAICA’s accreditation*” (**C1P3, 219:219**) and functioned as a SP (“*to have a full audit firm set up*” (**C1P3, 81, 83**)). Within two years after the implementation of the mandatory audit relief, he had realised that the SP was not performing as anticipated and that the number of audit engagements was not sufficient to keep the practice running; this forced him to adjust the practice’s initial structure to its current structure. This SP participant is practicing alone and is making use of sub-contracting where he needs additional support (refer to section 5.4.3.6).

The remaining SP participants stated that they had not experienced any change in the structures of the SPs as a result of the given audit relief.

5.4.3.6 Change in human resources

One of the SP participants (Participant 2), the only SP participant in this study who was accredited as a training office with SAICA (refer to Table 5.4), maintained that after the introduction of the mandatory audit relief his SP adjusted its human resources practices by no longer newly appointing SAICA trainees. He remarked that in the future: “*[The] focus is no longer to acquire SAICA article clerks, we can’t give them sufficient audit exposure*” (**C1P2, 42:42**).

Three of the SP participants pointed out that they were practicing without full time employees. Two of these SP participants reported that they had entered into “*fixed agreements*” (**C1P1, 81:81**) with “*various other consultants*” (**C1P3, 67:67**) if they were in need of supporting services; consequently the change did not affect their human resources practices. One of these SP participants explained that by making use of sub-contracting, although he could not confirm whether it

was more cost-effective, he could provide clients with a higher quality service: *“I haven’t made that calculation [to compare costs]. Maybe I’m paying more on sub-contracting, that might be so. But remember the service I’m getting can’t be compared. So if you consider that premium, I’m better off by sub-contracting” (C1P1, 89:89).*

The remaining SP participants revealed that the introduction of this relief had no impact on their sole proprietorships’ human resource practices.

5.4.3.7 Administration

Without exception, all the SP participants agreed that the introduction of this relief brought about no administrative changes to their practices.

5.4.3.8 Systems, policies and procedures

As previously reported, the majority of the SP participants did not experience any changes in their practices’ systems, policies and procedures as a result of the relief.

Only one SP participant changed the functioning of their practice due to the decrease in audit engagements performed as a result of the modification in the Companies Act. He stated that his practice specifically allocated the audit engagements to only those staff members who needed the audit exposure in terms of their SAICA training requirements. Prior to the introduction of the mandatory audit relief, his practice had performed a large number of audits which made it possible to expose all staff to audit engagements. He responded as follows: *“We use[d] to do a lot of audits, [but] because the volumes have decreased, we need to allocate the audit clients to people who need...audit experience and exposure for their training” (C1P3, 67:67).*

Another SP participant mentioned that, although not as a result of the introduction of the said relief, he had implemented a *“quality control manual” (C1P6(2), 54:54)* as part of his practice policies and, as a result, the quality of work within his

practice had improved over the past three years. He explained: *“I would actually say I standardised my audit methodology and I use software to at least remind me to meet all the requirements” (C1P6(2), 54:54).*

5.4.3.9 Challenges

Some SP participants were outspoken about the challenges experienced by their practices as a result of the introduction of the given relief. SP participants for example stated that: *“the impact was rather huge” (C1P1, 53:53)* and *“ultimately it did affect me holistically...my practice couldn’t go in a direction which I wanted” (C1P3, 34:34).*

A challenge raised by three SP participants was the impact that the relief had on their practices as training offices for SAICA trainees. One of the SP participants asserted that this change had reduced the number of audit engagements performed by his practice and also training opportunities for SAICA trainees. Another SP participant remarked that the process of training SAICA trainees was *“just too cumbersome” (C1P6(2), 40:40)*; therefore it was no longer feasible for his practice to undertake this task. A third SP participant added that since the introduction of this relief, his practice decided against employing SAICA trainees because the practice could not retain these trainees after completing their traineeship and this negatively impacted on business continuity. He responded as follows: *“Soon they [SAICA trainees] realised that they can provide the same service not as an employee but as a competitor in the market” (C1P2, 53:53).*

Another factor perceived by SP participants as a challenge for their practices was the firm inspections by the IRBA. One SP participant regarded this as one of the main contributing factors as to why his practice decided to move away from audit engagements due to the cost implications and the time and effort required for the IRBA firm inspections. He responded: *“...then IRBA will come to do a file review, and charge you more [for that inspection] than you have charged [the client]” (C1P7, 7:7).* Another SP participant concurred with the above view and added that: *“Practice review from IRBA is extremely stressful...IRBA [is] a lot more focused on applying rules rather than the principles of audit working papers,*

which in turn causes time lost in order to compile unnecessary working papers that will not decrease the risk of audit objectives not being obtained” (C1P4, 58:58).

Another challenge experienced by two of the SP participants was that many of their practices’ clients compared the fees charged by their practices with fees charged by SAIPA registered accountants for the same non-audit services (compilation engagements and other accounting services). This put the SPs under enormous pressure to lower their fees to stay competitive (refer to 5.4.3.3).

As already discussed in detail in section 5.4.2.3 above, one SP participant pointed out that another challenge experienced by SP practices as a result of the mandatory audit relief was performing an audit engagement on financial statements previously only subject to an independent review. This resulted in performing a retrospective audit on the opening balances, which had cost implications for the clients.

Although it was not as a direct result of the relief, one SP participant also revealed that the South African Revenue Service (SARS) expects audited information: “...*there’s nothing you can take to SARS...not [being] audited” (C1P7, 131:131).* It therefore appears that audit engagements in the past also provided audited information for SARS’ purposes, which, with the change of the Companies Act, is no longer the case. This SP participant added that together with the complex and time consuming processes at the SARS offices, it was becoming “*really tormenting*” (C1P7, 131:131) and a challenge for SPs.

5.4.3.10 Training office

As is evident from Table 5.4, five of the seven SP participants were neither accredited as training offices with SAICA, nor as ATCs with SAIPA. One of these SP participants explained this by saying that the burdensome administrative process to remain accredited as a training office with SAICA was not worthwhile: “*I’m not up for the admin of SAICA to train somebody else*” (C1P1, 73:73). This SP participant added that the continuity of his practice did not benefit from

employing SAICA trainees because it was unable to retain them after they had completed their traineeship. These statements are substantiated by the detailed discussions on other organisational challenges (refer to 5.4.3.9). As explained in section 5.4.3.5, one SP participant reported that his SP was accredited with SAICA as a training office when he established his practice, but within a few months after the mandatory audit relief was introduced he was forced to cancel his practice's accreditation as a training office with SAICA, because he could no longer provide adequate training for SAICA trainees due to the decrease in his practice's audit engagements.

One of the SP participants from a SP practice accredited as a training office indicated that his practice was only accredited as an ATC with SAIPA to train prospective Professional Accountants (South Africa). His practice's decision not to be accredited as a training office with SAICA was supported by the various explanations detailed above. However, the SP participant added that the cost and administration associated with being accredited as an ATC with SAIPA was *“not half as bad as a training office [with] SAICA” (C1P6(2), 13:13)*; therefore the SP would continue to train SAIPA trainees.

5.4.3.11 Ownership

With the exception of one SP participant, all the other SP participants stated that there had been no change in the ownership of their practices since the introduction of the relief.

As explained in sections 5.4.1 and 5.4.3.5, one SP participant revealed that he used to have a partner in the practice, but as a result of the changed Companies Act, the partnership dissolved when his partner decided to leave the auditing profession, and since then this SP participant has practiced as a SP. He explained: *“We were a partnership. My ex-partner decided to go corporate and sold his interest to me. My ex-partner got an offer to join a big company as a FD [financial director], and hence moved on” (C1P2, 37, 57)*.

5.4.3.12 Summary of organisational arrangements

From the SP participants' views here, it can be concluded that the majority of them believed that the mandatory audit relief had impacted on the goals of their practices, with specific reference to income generation and service offerings. This finding links closely with the views of the SP participants regarding possible changes in their practices' strategies, client profile/size and the type of service offerings due to the mandatory audit relief. In all of these sub-themes, reference was made to the decrease in SPs' audit engagements and the increase in other services as avenues of income that they were forced to take on as a result of the mandatory audit relief, which they might otherwise have forfeited. Subsequently, SP participants reported that their practices shifted their focus towards providing more non-audit services such as accounting, advisory and taxation services. Other services also mentioned by some SP participants were contractual work for other audit practices, factual findings reports, BEE services, the issuing of EME certificates, advisory and taxation services as well as assisting financial planners and attorneys. As a result of the expansion and diversification of service offerings, the potential drop in income due to the said relief was managed. An interesting finding was that, based on the belief that clients tend to respect the expertise and value the service offerings of a CA(SA) and auditor, one SP participant decided to continue to be registered as a member with the IRBA, even though his practice did not perform any audit engagements. Furthermore, while the types of services needed by the SPs' clients have changed since the introduction of the mandatory audit relief, there was no decrease in the overall client size for the SPs. One exception was noted; a SP participant had deregistered as an auditor with the intention of focusing his practice on non-audit services. In 2014 he again registered as an auditor and since then his SP has been focusing on audit engagements (including high risk engagements).

A further example of a strategy that has changed (which is also linked to the sub-themes of training offices, change in human resources, and challenges) was captured in the view of a SP participant whose practice initially only focused on SAICA trainees, but whose focus has shifted to SAIPA training as a result of the mandatory audit relief and the related decrease in audit engagements of his

practice. It is clear that the cost and administration associated with being accredited as an ATC with SAIPA were perceived by SP participants as not being as onerous as those associated with being accredited as a training office with SAICA. In addition, a SP participant pointed out that he had decided not to appoint SAICA trainees any longer since his practice could no longer offer them sufficient audit exposure, while another modified the work allocation within his SP to ensure that SAICA trainees still receive sufficient audit exposure. However, it should be noted that the majority of SPs were neither accredited as a training office with SAICA nor as an ATC with SAIPA. According to them, the administrative process to remain accredited as a training office with SAICA was just not worthwhile.

For most of the SP participants, the mandatory audit relief did not impact on the human resource practices of their sole proprietorships. Three SP participants continued to practice alone without any full time employees.

With regard to the structure, administration and systems, policies and procedures, and ownership as sub-themes under organisational arrangements, the majority of the SP participants did not experience notable changes as a result of the mandatory audit relief. Two SP participants decided to practice as SPs and entered into fixed agreements with other practices to supply them with other services, as and when needed. One participant was forced to alter his structure from a SAP to a SP due to the departure of his partner who had left the auditing profession after the introduction of the mandatory audit relief. Another SP participant practiced as one of three audit partners in a SAP, but a few months after the introduction of the said relief, he left the SAP and established his practice as a SP.

The challenges revealed by SP participants as a result of this relief included various issues mentioned above. Not only was the cost burden of the IRBA firm inspections mentioned as a challenge, but some SP participants also criticised the amount of time and work that the IRBA firm inspections demanded. Another challenge mentioned by SP participants comprised fee pressures due to clients' expectations that the fees of SPs should compare favourably with those levied by

SAIPA registered accountants offering the same non-audit services. Therefore SPs found themselves under enormous pressure to lower their fees in order to stay competitive. A third challenge mentioned by SP participants related to the need for the performance of audit engagements on financial statements which were previously only subject to an independent review. A SP participant further perceived the requirements of SARS for audited information as a challenge, because such information is no longer readily available due to the replacement of audits by independent review or compilation engagements in some cases. This, together with the complex and time consuming processes of SARS offices, has left SPs severely challenged.

5.4.4 Social factors

5.4.4.1 Management style

One SP participant responded that his practice's management style was "*still evolving to better the control over work in progress*" (C1P2, 61:61). All the other SP participants remarked that the introduction of the mandatory audit relief had brought no change to their practices' management styles.

5.4.4.2 Staff morale at time of change

All the SP participants stated that since the introduction of the relief, no impact on the staff members' morale had been noticed.

5.4.4.3 Current staff morale

The SP participants were all in agreement that the given relief had no influence on the staff morale in their practices.

5.4.4.4 Summary of social factors

From the above statements, it was evident that all seven of the SP participants unanimously agreed that the introduction of this relief had no impact on their

practices' management style or staff morale – neither at the time of the change nor currently. One SP participant, however, acknowledged that his practice's management style was still evolving.

5.4.5 Technology

5.4.5.1 Information technology programs

The majority of the SP participants remarked that their practices were using the Caseware™ program as their auditing software; however, this was the case even before the mandatory audit relief was introduced. One SP participant added that although his practice *“no longer require[d] Caseware™ for audits [it still] use[d] it for compilation of financial statements” (C1P5, 65:65).*

One SP participant stated that his practice had not used any auditing software in the past, but approximately two years ago *“started to [introduce] the audit software” (C1P6(2), 54:54)* to standardise its audit methodologies and run its practice more effectively; however, this SP participant mentioned that this was not as a result of the mandatory audit relief (refer to 5.4.3.8).

5.4.5.2 Information technology equipment

All the SP participants responded that the introduction of the relief had no effect on the information technology equipment (hardware) used in their practices.

5.4.5.3 Summary of technology

From the above discussion it was clear that there were no changes to any of the SPs' information technology (equipment or programs) due to the introduction of this relief. SP participants continued to use Caseware™ even for engagements other than audit engagements.

5.4.6 Physical settings

5.4.6.1 Office space/design

With the exception of two SP participants, all the other SP participants clearly stated that the said relief resulted in no change to their office space.

As a result of the introduction of the said relief, one SP participant decided to leave the SAP in which he had been a partner and to form a SP. It was cost effective to base the practice's office at home, since the SP has no other full time employees (refer to section 5.4.1 and 5.4.3.5). He explained as follows: “...*simply because of overhead costs. I spend very little time in the office; I'm physically at the clients a lot of the time*” (C1P1, 105:105).

Another SP participant supported the above discussion by stating that when he cancelled his accreditation as a training office with SAICA soon after the introduction of the mandatory audit relief (refer to 5.4.3.5 and 5.4.3.10), his practice no longer needed the office space previously occupied. He then moved out of that office space and based the practice's office at his home. He elaborated: “...*[and if] I work with a consultant...that has his own office [I] can do his work there*” (C1P3, 109:109).

5.4.6.2 Summary of physical settings

The physical settings in which the majority of the SP participants practiced remained unchanged after the introduction of the said relief. Two of the SP participants did, however, scale down from formal business settings, since it was more cost effective for their practices to function from their offices at home.

5.4.7 Organisational performance

5.4.7.1 Income streams

With the exception of one SP participant, all the SP participants remarked that their practices had experienced a decrease in their income from audit

engagements. From the data collected on the audit profiles in Table 5.4, it was evident that five of the SP participants experienced a decrease in their practices' auditing services as a percentage of total income. Some of the SP participants responded as follows, substantiating the above statements: "...the direct impact before I started filling the gap, was approximately a 40% drop in fees" (**C1P1, 111:111**); "...income from audits [has] decreased by approximately 50%" (**C1P5, 73:73**).

The majority of the SP participants acknowledged, as is also evident from Table 5.4, that their income from other services had increased; however one SP participant pointed out that he "*filled the gap, but not the whole 40%*" (**C1P1, 111:111**). This SP participant (Participant 1) reported a decrease of between 25%-50% in his practice's income as a result of the mandatory audit relief. Another SP participant, whose practice experienced an overall decrease of 10-25% in total income since the introduction of this relief (refer to Participant 2 in Table 5.4), expressed concern. He stated that this change "*will have an even bigger impact in the future*" (**C1P2, 82:82**).

Only one SP participant mentioned a significant increase in his practice's income since re-registering with the IRBA as a RA after the introduction of the mandatory audit relief (refer to 5.4.1 and Table 5.4). This was a direct result of an increase in his client base (refer to 5.4.3.3) due to the fact that his practice focused more on performing category A (high risk) audit engagements, which resulted in a major increase in the number of audit engagements performed (refer to 5.4.3.4) and ultimately increased his practice's income significantly.

5.4.7.2 Expenditure

The majority of the SP participants responded that there had been no change in their practices' expenditure as a result of the introduction of the mandatory audit relief. One SP participant mentioned that his practice "*had to cut expenditure*" (**C1P3, 237:237**) where possible when he started to lose income due to the decrease in the number of audit engagements that his practice undertook. One way of achieving this was by moving out of a formal office setting and, instead,

practicing from home (refer to section 5.4.6.1). A similar approach was also followed by another SP participant (refer to section 5.4.6.1).

5.4.7.3 Summary of organisational performance

From the discussion above, it was evident that this relief had an impact on all the SP participants' organisational performance. With the exception of two SP participants, all the others reported a decrease in their practices' income with regard to audit engagements. One SP participant, who experienced a significant increase in his practice's income, declared that this was the result of an increase in the number of category A (high risk) audit engagements that he performed. The majority of the SP participants also remarked that they expanded to other service offerings that resulted in an increase in income. Regarding the expenditure of the SP practices, the majority of the SP participants noted no change as a result of the said relief. Two SP participants, however, decided to reduce overhead costs by setting up home offices instead of renting office space.

5.4.8 Sustainability

5.4.8.1 Practice sustainability

The vast majority of the SP participants stated that they had ensured sustainability in their SP practices by expanding to other service offerings (refer to section 5.4.3.4). This led to increased income from services offered, other than auditing. One SP participant supported this statement as follows: "*exploring other means of generating income*" (C1P2, 90:90). In support of the above notion, other SP participants made further remarks. One SP participant stated that in ensuring the sustainability of his practice, he also "...*buil[t] a relationship with clients by providing more of a financial [management] and advisory role to ensure add[ed] value to [his] clients*" (C1P5, 82:82). Another SP participant added that his SP practice often reduced fees for audit engagements to ensure the sustainability of the practice in a very competitive market.

One SP participant mentioned that his practice's main focus, on maintaining sustainability, was to *“save on the cost side rather than to make money”* (C1P6(2), 76:76). He elaborated that this was achieved by using his home office, reducing expenditure on luxury items and employing only the minimum number of staff required (refer to sections 5.4.6.1 and 5.4.7.2).

Another SP participant pointed out that 12 years ago he made a deliberate decision to focus on industry specialisation as a suitable model for his practice to ensure its sustainability. He identified a specific industry, in this case the fuel industry, *“got [sufficient] knowledge”* concerning that industry and then *“focused [on] that market”* (C1P7, 27:27). He supported this statement as follows: *“If you look at my client base, 70% is coming from one industry...it has been working like a charm for us”* (C1P7, 151:151).

5.4.8.2 Future role of auditors

Five of the SP participants were of the opinion that in future the role of auditors will continue to be important as *“the services of a registered auditor [will] always [be] in demand”* (C1P1, 125:125). Without contradicting this view, some of these SP participants acknowledged that the demand for auditing services provided by registered auditors has reduced, that registered auditors operating as SPs are now also *“mov[ing] to a more advisory and possible management accountant”* (C1P5, 86:86) functions, and that such a tendency will continue in future. Another SP participant responded that although some assurance engagements, such as trust account audits, will still be performed manually, in his view *“auditing will probably follow the technology route [in future]”* (C1P4, 84:84). A SP participant agreed that with the involvement in other services *“the role of the auditor is becoming bigger”*, but pointed out that while the auditor's responsibilities will increase in future, he believed that the PIS for mandatory audits will also be raised to allow more companies to benefit from the mandatory audit relief, and that this will increase *“affordability for the smaller guys [companies]”* (C1P6(2), 80:80) to make use of other service offerings.

In contrast with the above, two of the SP participants were sceptical about auditors operating as SPs, SAPs and MAPs. They predicted that the future role of auditors will remain solely with the Big 4 audit practices. One SP participant elaborated by stating: “*small audit practices will become extinct*” (C1P2, 94:94). The main reasons provided by him related to the cost required to run a small practice that has become substantial and to the fact that SPs have failed to secure a niche market. He stated: “...*the CA qualification has become a title, with no distinction from bookkeepers*” (C1P2, 94:94). The other SP participant supported the previous opinion that auditors will only remain with the Big 4 audit practices. He referred to the complex tax system of South Africa as an example where clients need SPs to assist them in complying with the necessary regulation. In his opinion, SP clients however preferred the services of an accountant rather than an auditor. He stated, “...*[when the client of a SP must] choose between an auditor and an accountant, they will choose an accountant at any given time*” (C1P7, 81:81).

5.4.8.3 Other matters

One SP participant pointed out that section 90 of the 2008 Companies Act was “*unbelievably irritating*” (C1P6(2), 82:82), as it prohibits the auditor from also compiling the financial statements for his audit clients. According to this SP participant, this change forced clients to appoint an accountant to compile the financial statements, while the accountant might not necessarily have the necessary financial knowledge. This resulted in him, as the auditor, ending up advising the accountant on how to make adjustments to the financial statements while he (the auditor) then only performed an audit engagement. The SP participant was outspoken that this was an “*impractical arrangement*” and furthermore “*is...a distrust in the integrity of an auditor, saying he may not compile financial statements*” (C1P6(2), 82:82).

5.4.8.4 Summary of sustainability

Based on the views expressed by SP participants and the information provided (refer to Table 5.4) all of the SP’s practices were sustainable. The majority of SP

participants achieved this by expanding on their practices' service offerings other than audit engagements (Table 5.4 also refers). One SP participant decided to focus his practice's service offerings towards a specific industry (the fuel industry). Furthermore, the majority of the SP participants believed that the role of auditors will continue to be very important in future, not only to provide audit services, but also with regard to advisory and management accounting services to the SPs' clients. Two SP participants however, were concerned about the future of auditors in SPs, SAPs and MAPs as they predicted that the audits of the future will remain with the Big 4 audit practices. A SP participant was especially concerned about the future role of SPs. Reasons for his scepticism were the high cost required to run a small audit practice and the fact that SPs have not secured a niche market, but are competing with accountants who could offer services at more affordable rates. One SP participant also pointed out that section 90 of the 2008 Companies Act created an impractical arrangement which challenges the sustainability of his SP.

5.5 FINDINGS AND INTERPRETATION: CASE 2 (SAP)

5.5.1 Introduction

Case 2 comprises the views expressed by the participants from the four SAPs that complied with the selection criteria as determined by the researcher and explained in Chapter 4 section 4.4.3 and Chapter 5 section 5.2. Each SAP participant was requested to complete a questionnaire which served as an audit practice profile. Table 5.5 offers a summary of the profiles of the four SAPs, selected as participants for this study, before the introduction of the 2008 Companies Act (prior to change) and at the time of completion of the questionnaire (current).

Table 5.5 Profiles of small audit practices (SAPs) selected as units of analysis: Case 2

Participant	P8		P9		P10		P11	
Date of incorporation	2006		2004		1965		1995	
	Prior to change ¹	Current ²						
Number of partners	2	4	2	2	3	3	1	2
Staff composition								
▫ Number of managers	2	5	2	2	3	3	1	1
Number of trainee accountants								
▫ SAICA	8	15	0	0	8	6	0	0
▫ SAIPA	0	0	3	3	2	2	0	0
Qualifications of staff (excluding partners)								
▫ Number of CAs(SA)	2	2	0	1	2	2	0	0
▫ Number of post-graduate staff	2	2	0	0	1	1	0	0
▫ Number of graduate staff	2	8	1	2	7	5	1	1
▫ Other, studying towards Accounting degree	2	3	3	3	3	3	0	0
Number of assurance clients	400	230	50	36	87	68	35	8
Services (% of total income)								
▫ Auditing	70%	50%	80%	45%	35%	30%	35%	20%
▫ Accounting – clients subject to audits by other firms	10%	15%	0%	40%	0%	0%	20%	35%
▫ Accounting – clients not subject to audits	5%	10%	11%	6%	38%	30%	0%	0%
▫ Tax	10%	15%	5%	5%	10%	12%	40%	40%
▫ Forensic	0%	0%	0%	0%	0%	0%	0%	0%

Participant	P8		P9		P10		P11	
Date of incorporation	2006		2004		1965		1995	
	Prior to change ¹	Current ²						
▫ Advisory	0%	0%	1%	2%	10%	20%	0%	0%
▫ Payroll	0%	0%	1%	1%	5%	5%	3%	3%
▫ Secretarial	5%	15%	2%	1%	2%	3%	2%	2%
Impact of change on income								
▫ Increase	✓							
▫ Decrease			✓		✓			
▫ No change							✓	
Extent of above change								
▫ Less than 10%					✓		✓	
▫ 10%-25%	✓							
▫ 25%-50%			✓					
▫ 50%-75%								
▫ More than 75%								

¹ Prior to change = before the introduction of the 2008 Companies Act

² Current = at the time of completion of the questionnaire (Annexure A)

From the above profile table (Table 5.5) of SAPs in Case 2, it is notable that the SAP of Participant 8 is the largest with 5 managers, 15 SAICA trainees and a total number of 230 assurance clients. It is also clear that this practice has grown remarkably since the introduction of the 2008 Companies Act. Only one SAP (represented by Participant 11) does not train SAICA or SAIPA students. Furthermore, it is evident in Table 5.5 that the given type of relief impacted differently on the four SAPs with reference to income. The SAP of Participant 8 is the only one that has experienced an increase (between 10% and 25%) in income since the introduction of the said relief. Participants 9 and 10 reported that the income of their practices decreased owing to this audit relief. In the case of Participant 10, the decrease in his SAP's income was less than 10%, while for the SAP of Participant 9, income decreased by between 25% and 50%. Participant 11 indicated that there had been no change in the income of his SAP since the introduction of the 2008 Companies Act. Table 5.5 indicates that there

has been a shift in all SAPs from providing auditing services towards offering other types of services.

This section proceeds with a discussion of the findings from the views expressed by SAP participants with specific reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance and sustainability.

5.5.2 Need for an audit

5.5.2.1 *The need for an audit*

The majority of the SAP participants believed that there was a definite need for an audit for companies in which there is a public interest. One of the SAP participants elaborated, stating that there will always be a place for an audit and that no reliance can be placed on financial statements without it. According to this participant, *“if there is no audit, nobody can rely on the financial statements” (C2P9, 9:9).*

Two SAP participants firmly stated that for smaller companies, such as small family businesses, an audit is *“senseless” (C2P11, 28:28; C2P10, 13:13)*. These participants held similar beliefs regarding the audit of a property company of which the main income stream is rental income and of a company where *“the directors and shareholders are the same” [persons] (C2P10, 13:13)*.

Some SAP participants also revealed that from their clients' perspectives, an audit is regarded as a very important part of the business, especially because a large number of these clients do not have a financial background and are therefore not competent to evaluate and interpret financial statements. One SAP participant added that his clients find the audit function necessary for the users of the financial statements, especially financial institutions and SARS. Another stated that directors and shareholders believe that an audit adds value and provides them with certainty.

The above arguments are supported by the following views expressed by SAP participants: *“My clients see this as a compulsory function for banks firstly, and secondly the SARS” (C2P8, 13:13)*; *“...the shareholders and directors just want certainty” (C2P10, 33:33)*; *“...they do feel that there [is] much more value” (C2P10, 37:37)*.

5.5.2.2 Mandatory audit relief

All the SAP participants supported the notion of the removal of the statutory audit for specific companies, especially those with no or limited public interest. Two SAP participants made it clear that although they agree with the introduction of the mandatory audit relief in the Companies Act, they feel that the PIS of 350 for mandatory audits is too low. This was evident from one SAP participant’s statement: *“...but I think they must raise the score” (C2P10, 27:27)*. The other SAP participant who concurred in this regard recommended that a PIS of 750 would have been more realistic for mandatory audits: *“the 750 would have been more realistic...but the 350 is too low” (C2P11, 42:42)*. No further justification was provided for the suggested PIS of 750.

Some of the SAP participants also commented on the factors taken into consideration when calculating the PIS. One participant held a strong belief that attributing points to the PIS, for the average number of employees of the company in the financial year, was not justified (Chapter 2, section 2.5.2.2 refers). He argued that the number of employees should not carry too much weight when determining the PIS because an employee *“can resign and walk away right now” (C2P11, 42:42)*. He recommended that one point for every ten employees would result in a more accurate indicator. He also expressed concern regarding the turnover factor and added that this factor has impacted differently on different industries. He validated this concern by using the example of a company operating as a car dealer and selling each car at a value of R1 million, resulting in that company accumulating a PIS of 350 very quickly, despite this not necessarily being a true reflection of a significant public interest. He recommended that should the 350 benchmark score not be increased, half a point should perhaps rather be allocated for every R1 million (or part thereof) in

turnover while two points should be allocated for every R1 million (or part thereof) in third party liability for a more accurate reflection of a company's public interest.

The above recommendations are supported by the following statements from this SAP participant: *"You know there are car dealers with one car valued at one million rand. You know, with that turnover you draw quickly to 350 points, which I don't think is public interest" (C2P11, 38:38). I think creditors should count maybe two points. And turnover, half a point. Then the 350 is still all right" (C2P11, 46:46).*

5.5.2.3 Independent review

The majority of the SAP participants believed that the option to replace an audit with an independent review does not necessarily benefit their practices. They argued that the amount of work needed to conduct an independent review closely resembles the amount of work needed for an audit. For them the same amount of time and effort is required although the heading on the written report, provided upon completion of the engagement, is different. These SAP participants reasoned that in terms of an independent review they are still required to report on the financial statements and make sure these are a true reflection of the company's financial position and operations for that year; therefore in their view, the time and effort needed and the manner in which the work is performed are equivalent to those required for an audit.

The above statement is supported by the following response: *"The thing is, what I found with independent reviews, basically you do an audit. Because you want to sign off the financials, you want to make sure what is in [those] financials is what happened during the year and is a true reflection of it. The fact that it is an independent review just changed the heading on ... the audit report" (C2P9, 11:11).*

A major challenge of the independent review as an alternative to an audit, according to some SAP participants, was the fact the client has the expectation of a reduced fee. According to these SAP participants, their clients argue that the

independent review involves less comprehensive procedures than an audit and only gives a moderate level of assurance as opposed to a reasonable level of assurance, as is the case with an audit (refer to Chapter 2, section 2.5.2.2); therefore the amount of work done by the auditors is (allegedly) reduced, which should be reflected in lower fees.

One SAP participant illustrated this point by stating that his practice attempted to negotiate 80% of the previous audit fee to conduct an independent review: “*And we try and go in at 80 percent, because the work stays exactly the same. But then they still complain*” (C2P9, 13:13).

SAP participants also pointed out that another difficulty caused by clients choosing to make use of the mandatory audit relief by opting for an independent review of a particular financial year, is that an audit of the client’s financial statements might be required, based on the PIS, in the following financial year. This would, as a result, effectively mean that an audit needs to be performed in retrospect on the opening balances in the financial statements as these were not previously audited, but only reviewed, resulting in an increased financial burden for the client. The remark from the SAP participant was as follows: “*And the problem which we found is, if you did an independent review and the next year they want an audit, they complain because you want to go back and fix the prior year*” (C2P9, 13:13). One SAP participant stated that pointing out this possible dilemma to his clients was one way of convincing the majority of his clients, who could make use of the mandatory audit relief, to continue to have their financial statements audited voluntarily. He believed this would minimise the impact on the fees earned by his audit practice.

5.5.2.4 Summary of the need for an audit

The majority of the SAP participants agreed that there was definitely a need for an audit for companies in which a public interest exists, but for smaller companies in which there is limited or no public interest (property companies or small family businesses) an audit was perceived to be without merit. According to some of the SAP participants their clients’ perception is that an audit adds more

value than an independent review and could be useful to financial institutions and SARS.

All SAP participants supported the change in the Companies Act regarding the mandatory audit relief, but the majority of them claimed that the current PIS of 350 for mandatory audits is too low. Some criticism was expressed concerning the factors (size of workforce and turnover) contributing to the PIS and a call was made for these to be revisited to reflect a more realistic view of the public interest in a company.

Although, in theory, an independent review involves less comprehensive procedures than an audit, the majority of the SAP participants did not support this notion. According to them the amount of time and effort put into these engagements, is equivalent to the extent of work required for an audit. This creates a challenge because clients expect the fees to be significantly reduced when an independent review is performed. The year-on-year fluctuation of the PIS was identified as a challenge and a reason for clients to demand voluntary audits.

5.5.3 Organisational arrangements

5.5.3.1 Goals

The majority of the SAP participants indicated that their practices' goals have not shifted as a result of the mandatory audit relief. Despite this, one SAP participant admitted that at first, his audit practice was very concerned about its possible impact and consequently altered the practice's goals. The participant stated: *"It certainly changed. We were at first very concerned about it, that it will have a major impact"* (C2P8, 21:21). This SAP participant acknowledged that his practice had revised its practice budgets and invested more in the taxation department (by increasing the number of staff to address the increased risk related to an increase in taxation audits). The same SAP participant also reported that his practice had expanded its accounting department by appointing not only competent staff to prepare financial statements, but also staff members with the proficiencies to provide other accounting related services, thereby changing the

focus of the practice. He added that the main drive behind these changes was to *“make up for the additional potential revenue which we thought we [were] going to lose” (C2P8, 21:21)* due to the mandatory audit relief. To date, the practice has not experienced the anticipated loss in income. Another SAP participant verified this statement by saying that although his audit practice has not changed its goals, *“we [he and his partners] were just looking to see what was going to happen” (C2P10, 41:41)* and determine how the introduction of the mandatory audit relief would affect the practice in order to adjust its goals accordingly. Aside from a minor decrease in audit personnel and audit fees, this participant’s practice did not experience any impact of note as a result of this relief. As per his response: *“We waited for the impact, but there wasn’t actually any impact” (C2P10, 41:41).*

From the information presented in Table 5.5 and the views expressed by SAP participants as explained in sections 5.5.3.3 and 5.5.3.4, the service offerings of SAPs have altered and these practices have positioned themselves for such change (refer to section 5.5.3.4). One could therefore argue that the goals of these practices have shifted as a result of the mandatory audit relief, but as discussed above, this was not perceived as such by the SAP participants.

5.5.3.2 Strategies

As indicated above (refer to 5.5.3.1), one of the SAP participants mentioned that his practice was *“at first very concerned about it, that it will have a major impact” (C2P8, 21:21)* when referring to the introduction of the mandatory audit relief. As discussed in detail under the type of services (refer to 5.5.3.4), this SAP participant added that his practice realised that its *“overall service and the overview should change” (C2P8, 21:21)*. One of the practice’s strategies implemented to ensure that the practice was able to continue competing with other SAPs, was to concentrate on independent review and compilation engagements and focus its attention on these engagements as opposed to audits. The implementation of this strategy goes hand in hand with the decision taken by this SAP participant’s practice to focus on, and expand, its other services (taxation, statutory, consulting and accounting), enabling diversification.

During the interview he responded as follows: “...we can no longer remain competitive on an audit basis with other firms out there for the same old type of service...we had to have a strategy change approach with regard to the compilation and review and to pressure our customers in that direction to reduce our risk so we can be competitive on our fees” (C2P8, 83:83). The information presented in Table 5.5 relating to this participant (Participant 8) provides a clear indication of this shift; audit work now only represents 50% of the practice’s income where previously it amounted to 70%.

Another strategy his (Participant 8) practice executed since the introduction of the mandatory audit relief, was to focus more strongly on obtaining contract work in the public sector. He elaborated that the motivation was the fact that the practice’s risks are limited when delivering these services, its trainees obtain exposure to the public sector during their traineeships and they can claim productive hours for these services, which contributes positively to the practice’s fee income. He remarked: “We attempted to [over] the last two to three years [do] more contract work. Simply, especially in the public sector...our risks are limited and where we give our people exposure for a three to five months period to the public sector. And the money is good for us” (C2P8, 109:109).

Another SAP participant responded that his practice notified its clients of the change required to the company’s MOI in order for a company to avail itself of the mandatory audit relief brought about in the Companies Act; however, a strategic decision was made not to enforce this change on the practice’s clients. The result is that the majority of his practice’s clients still require audits, and consequently his practice minimised the impact of the relief on its fee income (refer to 5.5.7.1): “We haven’t, and we are not trying to enforce it on them, because we are losing income. So basically, if you call that strategy, ...we told them that they must change and have a MOI, but if they are not doing it, we are not enforcing it on them” (C2P9, 25:25).

This SAP participant added that one way of encouraging the practice’s clients to retain the audit voluntarily when they do change their MOIs, is by pointing out that if they choose to opt for an independent review for any particular financial year

and an audit might be required again in future, based on the PIS, this will result in an additional financial burden for them (refer to 5.5.2.3). He asserted: “...and they [clients] want an audit in future, it is going to be three years back where they need to go back and do it, physical audit, and it is going to be expensive. So you try and convince them to stay [as audit clients]” (C2P9, 27:27). The SAP participant also mentioned another strategy considered by his practice which was to expand the practice’s client base, but this proved to be difficult because an increase in the client base is usually a result of “word of mouth”; therefore it was decided that his practice should “rather look at the ones [it has] and try and convince them [to remain audit clients], to keep [its] income” (C2P9, 107:107). From the information presented in Table 5.5 it appears as if the abovementioned strategy succeeded, but only partially, because for this SAP (Participant 9) fee income from auditing services as a percentage of its total fee income decreased from 80% before the 2008 Companies Act to 45% in 2015.

Another SAP participant indicated that his practice made the strategic decision to immediately contact its clients to explain the changes to the Companies Act with specific regard to the mandatory audit relief and obtain a clear picture of “...who wants to stay and should still have to be audited...and then who wants to be audited and who doesn’t” (C2P10, 149, 151) so his practice could determine the impact. This SAP participant mentioned other strategies followed by his practice. One strategy implemented was to appoint more SAIPA qualified staff members to assist with the independent reviews. Another strategy, seeing that auditors are not allowed to perform both the audit engagements and do the compilation of the financial statements for the same client (refer to section 5.5.8.3), was for his practice to enter into an agreement for “the compilation of the financial statements with another firm” (C2P10, 111:111), thereby overcoming the restriction.

5.5.3.3 Client profile/size

With regard to the client bases of the SAPs, the majority of the SAP participants confirmed that the mandatory audit relief did not have any impact on the profiles or size of their practices’ clients even though information provided by the

participants on the profile of their SAPs revealed that income from audit engagements as a percentage of total income decreased. For Participants 9 and 10, the impact of the relief resulted in a decrease in practice income. One SAP participant nonetheless mentioned that his practice expanded its client base by way of providing a wider offering of accounting services: *“Yes I did expand my client base, just because I added the accounting component” (C2P8, 29:29).*

Although all SAP participants agreed that their practices did not lose any of their clients due to the mandatory audit relief, the majority of the SAP participants acknowledged that the focus on the type of service offerings has changed as a consequence of the said relief. One SAP participant explained that such a shift was needed because some clients opted not to be audited, while another SAP participant alleged that some of his clients changed their legal form, thus resulting in a need for a different service.

According to one SAP participant, the relief did not impact on his practice’s client base because a high percentage of these clients were from the pension funds industry. He added that his practice managed to secure regular fee income (including audit fees) from this market, resulting in a stable client base. This SAP participant therefore perceived the focus on this industry as a factor that could have contributed to the practice not being exposed to the same threats as other SAPs, owing to the practice’s client profile.

This participant explained: *“...we have a relatively strong pension fund practice and it boils down to fees. The bigger firms charge a minimum fee for pension fund services. We can charge a much lower fee but once again, if you deliver good quality work at a lower fee, the fund managers automatically move the funds over to you. We are in a relatively good market and it is extremely profitable for us” (C2P10, 61:61).*

5.5.3.4 Type of services

Despite the fact that one of the SAP participants indicated that the mandatory audit relief had a minor impact on the types of services offered by his practice,

the majority of the SAP participants held contrasting views. They acknowledged that they had experienced a change in the type of service offerings at their practices as a result of the mandatory audit relief, which is reflected in the practices' profile information contained in Table 5.5.

The aforementioned SAP participant (Participant 11) indicated that the focus of his practice has altered from offering audit services to accounting compilation services (only 20% of the fee income of the practice stems from auditing services (refer to Table 5.5)). He mentioned that by the end of the 2015 financial year, his practice's target is for almost all of its clients to have adopted a revised MOI, enabling them to make use of the mandatory audit relief and requesting a compilation report. Although he pointed out that the practice's risk in relation to its clients will remain the same, this change will significantly reduce the risk of the practice failing firm inspections performed by the IRBA: *"...and my risks are naturally less. You know I have a very low risk in terms of IRBA, but not towards my client, there the risk stays the same"* (C2P11, 76:76).

The other three SAP participants also acknowledged a notable decrease in the audit work provided by their practices. One of them explained that the shift in service offerings, from formal audits towards independent reviews, was carried out to minimise the audit practice risk and not necessarily to take advantage of the mandatory audit relief. All SAP participants however agreed that the said relief forced their practices to be more focused, and expand in offering other services.

Some SAP participants furthermore elaborated, saying that their practices strive towards more effective diversification of services (for instance, establishing a taxation division, statutory division, consulting division and accounting division). It therefore appears that there is a market for small audit practices to provide a wide spectrum of services to clients who could make use of the mandatory audit relief. This view was supported by a SAP participant who maintained that although income from auditing is still an important contributor to his practice income, his practice is exploring other ways of generating income: *"Auditing does bring in a lot of money, but the thing is being [a] small to medium [practice], there*

is not so [much] which you can [earn], you can't get big fees from small to medium clients. You need to get other ways of getting money" (C2P9, 169:169).

5.5.3.5 Structure

The majority of the SAP participants maintained that the introduction of the mandatory audit relief did not impact the structure of their practices. The following views substantiate this argument: *"None" (C2P11, 68:68); "So my structure hasn't changed a bit" (C2P9, 35:35).* One of the SAP participants did, however, mention that since the introduction of the relief, separate divisions had been established within his practice which led to a much more structured way of distributing roles and allocating responsibilities: *"...the statutory division to distribute duty roles, [and] responsibilities where we in the past kept most of the duties with the clerks to perform it, we now have in different hubs" (C2P8, 31:31); "More structured" (C2P8, 33:33); "Put in divisions" (C2P8, 35:35).*

5.5.3.6 Change in human resources

Discussions, as part of the interviews, on the matter of how the mandatory audit relief affected the SAP's human resources resulted in conflicting views. Two of the SAP participants clearly stated that it did not bring about change in the human resource practices, while the other two participants identified that their audit practices had experienced changes in this regard. The two SAP participants whose practices experienced change indicated that the given relief led to an increase in the number of staff members appointed in their practices' accounting departments and that personnel who were more qualified were also appointed for this function. They both explained that whereas in the past their practices had appointed CAs(SA) to do audit work, they currently, rather, appoint staff members who have completed their traineeship based on their academic degrees rather than their professional qualifications. These staff members are selected because they are deemed to be competent enough for the work in the practice's accounting department and, at the same time, because they demand lower salaries than CAs(SA), which is much more cost-effective. Another interesting remark from one of the two SAP participants was that his practice did not struggle

to retain staff members because the SAIPA trainees often stay in the practice's employ after finishing their traineeship, whereas the SAICA trainees tend to leave the SAP at the end of their traineeship.

The above discussion was supported by the following responses from two SAP participants: *"But my accounting departments have grown a lot. So I have appointed more staff directly after internship, based on degrees..." (C2P8, 21:21)*; *"...we have appointed more people with degrees as we would have employed CAs in the past, as a result of [this] I did not really have a goal any longer with regard to a CA to remain in the firm...we [retained] more people with degrees to handle the volume of work" (C2P8, 39:39)*; *"...we appointed more qualified personnel in the accounting department" (C2P10, 73:73)*; *"...the SAIPA trainees actually stay in our employ and the audit [SAICA trainees] leaves our employ" (C2P10, 51:51)*.

5.5.3.7 Administration

Although all of the SAP participants confirmed that they did not make any major changes from an administrative point of view, some other observations ensued. One SAP participant mentioned that as a result of the mandatory audit relief, the demand for the other service offerings by his practice increased, resulting in an additional administrative burden on the practice. For example, monthly invoicing is now required compared to the annual audit invoicing of clients in the past. Consequently, more staff were assigned to the administrative accounts department, which increased the cost: *"...more and more monthly invoices generated compare[d] to only the one-time audit bill on annual basis. So there is certainly a cost element involved, we had to increase" (C2P8, 43:43)*. Another SAP participant expressed an opposing view, although not related to the mandatory audit relief, that his practice had reduced its administrative personnel as a result of technological developments over time: *"Yes look, our admin decreased a bit, not just because of the impact of the Act but also due to technology" (C2P10, 73:73)*; *"Yes, more technology" (C2P10, 81:81)*.

One SAP participant raised the fact that the audit includes a massive, in his opinion “*most ridiculous*” (C2P11, 180:180) administrative component because a comprehensive audit file has to be prepared to meet the IRBA requirements. He stated that this administrative burden shifts the audit focus as it is a tedious exercise to compile such a file, while the priority should be placed on the assurance that the financial statements are free from material misstatement. He commented as follows: “...and it is useless for me. Because to me it means that the audit component faded, it is not priority. The priority is that the financial statements are correct, [isn't that so?]. And any faults are rectified, doesn't matter, my materiality figure is R1” (C2P11, 182:182).

5.5.3.8 Systems, policies and procedures

The mandatory audit relief did not result in any systems or policy changes for any of the SAP participants. Three of the SAPs, all of whom are also accredited as training offices, experienced an alteration in their in-house training as a result of the mandatory audit relief. The 2008 Companies Act brought about more opportunities for independent review engagements and compilations; hence SAPs had to adjust their training programmes for trainees, accordingly. The focus shifted to the difference between performing audit, independent review and compilation engagements: “...[what] the process will look like, an audit report, how does a review report look, what should we do here, what procedures we need” (C2P8, 45:45); “...you try and teach them the difference between what is a compilation [and] what is [an] independent review” (C2P9, 43:43).

5.5.3.9 Challenges

One of the SAP participants stated that his practice's biggest challenge since the introduction of the mandatory audit relief, was to find enough SAICA trainee accountants each year: “*Well our biggest challenges is to get clerks each year*” (C2P8, 49:49). Another SAP participant added that although his practice managed to obtain enough SAICA trainee accountants every year, concerns were expressed by prospective SAICA trainee accountants during recruitment interviews as to whether a SAP would be able to provide the necessary training

following the introduction of the mandatory audit relief. As a result, many of these SAICA trainees would then rather apply to the larger audit practices.

This was evident from the SAP participant's response: *"...what we did notice is that when this thing came to light [the mandatory audit relief], the audit clerks you interviewed, you know they were concerned about the training that they would get at this small firm. And everyone went for the big firms because they want their training"* (C2P10, 83:83).

This SAP participant elaborated that the only way his practice overcame this challenge and ensured that sufficient trainee accountants were appointed every year, was to appoint undergraduate applicants (although his practice preferred trainees with postgraduate degrees) who were studying towards a degree after hours: *"So we actually had to employ personnel who weren't graduated and were studying after hours, it is all that was available actually"* (C2P10, 101:101).

Another challenge mentioned by one of the SAP participants was caused by clients choosing to make use of the mandatory audit relief by opting for an independent review for one particular financial year, despite the fact that an audit of the clients' financial statements might be required, based on the PIS, in the following year. As discussed in sections 5.5.2.3 and 5.5.3.2, this would require a retrospective audit of the opening balances in the financial statements as these had not been previously audited, but only reviewed, and thus could result in an increased financial burden for the client.

5.5.3.10 Training office

The majority of the SAP participants agreed that being accredited as a training office with SAICA involves a large amount of paperwork, resulting in a huge administrative burden. Some of the views expressed by the SAP participants include: *"It is a lot to have that administration"; "...having a clerk is very expensive. The [regulation] of it makes it ten times more expensive"* (C2P11, 86; 88); *"...it is much more expensive to train an audit clerk, especially taking into account the amount of administration involved, than a SAIPA clerk"; "We have to*

send them on courses and expose them to everything that is not necessarily related to SAIPA” (C2P10, 55; 53); “No never ever”; “...I’m not going to employ another employee just to control all those paperwork for SAICA”; “It is more expensive to do SAICA versus SAIPA definitely” (C2P9, 53; 35; 61).

The majority of the SAP participants added that the training process for SAICA trainees is more demanding and far more expensive than for SAIPA trainees. These were the reasons offered by two of the SAP participants as to why their practices will not be interested in training SAICA trainees. This is supported by the data in Table 5.5 which illustrates that the SAPs of Participants 9 and 11 had no SAICA trainees in their employ prior to or since the introduction of the 2008 Companies Act. One of the SAP participants whose practice is not accredited as a training office with SAICA motivated this as follows: *“the paperwork is endless, which you need to complete and comply with” (C2P9, 55:55)*. He stated that his practice is still involved in the training function as an ATC with SAIPA. Although trainees from his practice could not meet the formal SAICA training requirements and receive recognition for completion of a SAICA accredited traineeship, he still regarded his trainees as being in a *“fortunate position...I don’t give them SAIPA training, I give them SAICA training” (C2P9, 63:63)*. The other SAP participant whose practice is not an accredited training office with SAICA, although accredited as an ATC with SAIPA in the past, clearly stated that appointing trainees results in *“having no continuity in [one’s] business” (C2P11, 86:86)*; because the *“regulations also made it unbearable” (C2P11, 63:63)* for his practice, the decision was taken not to be involved in the training function anymore.

Despite the above views, the other two SAP participants held contradictory opinions on whether it is worthwhile to be accredited as a training office with SAICA. While they acknowledged the concerns expressed above about the administrative and cost implications, they both continue to function as training offices with SAICA as well as ATCs with SAIPA. One SAP participant pointed out that although his practice is accredited to train both SAICA and SAIPA trainees, they preferred to train SAICA trainees, but experienced a shortage of these graduate trainees, which he perceived as the practice’s main challenge (refer to

section 5.5.3.9). This forced his practice to appoint more SAICA trainees, who had not completed their undergraduate studies and had to study after hours: *“We also got more clerks on a[n] undergraduate level, but as a result of the shortage” (C2P8, 57:57)*. He added that it was quite noticeable during the interviews with prospective trainees that the majority of them preferred to choose the SAIPA route as part of their practical training as this was the route advised by universities. This participant expressed his concern as follows: *“...last year it was quite noticeable that I have done a lot more interviews; many indicated that they would rather take the SAIPA. I to date today do not know why it is, but it seems to me that universities have an influence, some universities it is pro it or recommend it in certain sectors such as we have experienced it and I mean, we cannot understand why it is, why it happens” (C2P8, 53:53)*.

5.5.3.11 Ownership

Based on the information in Table 5.5, it is evident that the number of partners in SAPs has either increased or remained the same since the introduction of the mandatory audit relief. One of the SAP participants made it clear that although the number of partners in his practice had increased, this was undertaken for the sustainability of the practice. The other SAP participant who experienced an increase in the number of his audit partners, stated that his practice’s staff were promoted through the practice’s structures to partner level. For this SAP participant, this was a direct result of the systematic growth since the introduction of the mandatory audit relief (which caused an increase in the number of additional types of service offerings): *“...they came through the ‘rank’ and because as a result of the systematic growth we have experienced, we have had a need to bring them in as junior partners” (C2P8, 65:65)*. Although there was no change in the number of partners in the SAP of Participant 9 (refer to Table 5.5), one of the managers had recently qualified as a CA(SA) and registered as an auditor and although he has not officially been admitted as a partner, he was fulfilling the role of a junior partner in the practice. This SAP participant elaborated that there was a clear need for shared responsibility and assistance with regard to the signing off of financial statements at senior level: *“...my senior passed his Board exam, ...he is now also a chartered accountant and I do rely a*

little bit more on him. And I have changed my letterhead to say that I'm assisted by him" (C2P9, 67:67); "Senior at the practice which will be able to sign off and things like that" (C2P9, 71:71).

5.5.3.12 Summary of organisational arrangements

With the exception of just one SAP participant who mentioned that his practice anticipated the impact of the mandatory audit relief and therefore adjusted its goals, no changes were made to the audit practices' goals by the other SAP participants. It is evident that the focus of this SAP's service offerings has shifted to services other than auditing, and that the SAP's income from other services increased as a result of the relief; furthermore, these findings point towards changes in the goals of the SAPs. An interesting finding is that it appears that the risk of failing firm inspections performed by the regulatory body, the IRBA, has also contributed to this shift in the service offerings of SAPs towards the performance of services other than audit engagements.

Although the types of service offerings have expanded in some practices from audits alone to accounting, taxation, consulting and statutory services, the majority of the SAP participants believed that the mandatory audit relief did not change the profiles or size of their practices' clients. However, it is apparent that a few different strategies were implemented as a result of the introduction of the said relief. The expansion in service offerings other than auditing was one strategy that was put in place by a SAP participant's practice, as well as focusing more on contract work in the public sector or on a specific industry (such as pension funds). Another SAP participant explained how his practice strategised by appointing more SAIPA qualified staff members to assist in the accounting department. His practice furthermore entered into an agreement with another practice to assist with the compilation of the financial statements for its audit clients.

Apart from one SAP participant establishing separate divisions in his SAP, there were no structural changes in the SAPs as a result of the mandatory audit relief. However, two of the four SAP participants indicated an increase in the number of

staff appointed for their accounting departments. One participant mentioned some additional monthly administrative paperwork while the others experienced no major administrative changes.

It was also determined that no changes were made to systems or policies of the SAPs, except in the case of training offices which required changes to their in-house training programmes to include training for independent review and compilation engagements. In this regard, one SAP participant's practice experienced a challenge since the introduction of the given relief. His SAP was not able to attract sufficient SAICA trainee accountants on a yearly basis, which the SAP participant ascribed to the public's negative perceptions of the audit exposure provided by SAPs. Another SAP participant perceived it to be a challenge to convince prospective SAICA trainee accountants that his practice could still provide adequate audit training exposure following the introduction of this relief. It should be mentioned that one SAP participant blamed universities for the shortage of SAICA trainees, based on the belief that universities advised prospective trainees to rather choose the SAIPA route.

It should be noted that two of the SAP participants preferred that their practices be accredited as training offices by SAICA while the other two SAP participants showed no interest in this. The aforementioned SAP participants attributed this to SAICA's strict regulatory requirements, the extent of administrative work required, and the significant cost implications. One of the SAP participants suspended the accreditation of its training office with SAICA and SAIPA to avoid disruptions caused when trainees joined and left the practice after completion of their traineeships.

With reference to possible changes in ownership, two participants were of the opinion that the expansion of services since the mandatory audit relief, as well as the need for assistance and shared responsibility at senior level, resulted in an increase in the number of audit partners. These individuals generally moved through the practice's ranks, being promoted to partner level.

The next section concentrates on the findings and interpretation of the responses from the four SAPs as part of Case 2, regarding social factors.

5.5.4 Social factors

5.5.4.1 Management style

The majority of the SAP participants declared that there was no change in the management style at their practices as a result of the introduction of the mandatory audit relief. One participant mentioned that his practice had adjusted its approach slightly after comparing an independent review engagement file to an audit engagement file. He added that despite this, one still needs to ensure that the financial statements comply with regulations: “...*you had a different approach, because it is an independent review. But at the end of the day, back in your mind, you want to make sure that the set of financials is according to all the regulation[s]*” (C2P9, 81:81).

Another SAP participant pointed out that the biggest change in his practice’s management style, was the fact that he has had more time on his hands since the introduction of the relief. According to this participant, he now has more time to personally focus on clients and there is opportunity for his practice to expand. He alluded to the fact that the IRBA firm inspection policy focused on category A audit clients, being audit clients with the highest risk based on public interest exposure, such as listed entities or retirement funds. The number of IRBA firm inspections at his audit practice decreased considerably after the introduction of the said relief. This resulted in less time and effort being needed for the preparation of audit files for the firm inspections performed by the IRBA: “...*it seems to us that there, I mean in the past regarding the practices’ reviews that we had, and now we get these days, has decreased drastically. The volume of work on our audit clients that we should have done to complete a file...surely reduced*” (C2P8, 71:71).

5.5.4.2 Staff morale at time of change

Two of the SAP participants clearly stated that within their practices there has been no slump in staff morale as a result of the mandatory audit relief. One SAP participant mentioned that some trainees were concerned whether they would “*get adequate training*” (C2P10, 145:145) after the introduction of this relief. He responded that his practice, immediately after the modification in the Companies Act, discussed the outcome with its clients to gain an accurate indication of which clients would still prefer the audit engagement (refer to 5.5.3.2). This enabled his practice to assure the trainees that they would still receive sufficient training exposure: “*...and we could give the clerks peace of mind that...they will receive training*” (C2P10, 177, 179).

Another SAP participant explained that the introduction of the mandatory audit relief had actually led to a positive outcome with regard to the staff morale at his practice. As his practice focused on the expansion of its other service offerings in order to stay competitive, its client base increased, which positively affected morale.

5.5.4.3 Current staff morale

All the SAP participants responded that judging from the current situation, it is evident that the mandatory audit relief has had no effect, one way or the other, on the staff morale at their practices.

5.5.4.4 Summary of social factors

From the above discussion regarding social factors, for the majority of the SAP participants, the management styles in their practices did not change as a result of the introduction of the mandatory audit relief. One SAP participant pointed out that due to a decrease in the number of IRBA firm inspections since the alteration in the Companies Act, he could use his extra capacity to attend to his own clients and to grow his practice.

Although all the SAP participants agreed that the introduction of the mandatory audit relief is currently not affecting the staff morale at their practices, two did mention an impact at the time of the change. One SAP participant noted concern from his practice's trainees as to whether they would still receive sufficient training exposure after the mandatory audit relief was implemented, but adequate steps were taken immediately after the change to ensure this for trainees. The other SAP participant stated that the implementation of the given relief, which led to an expansion of service offerings, resulting in an increase in his practice's client base (refer to 5.5.3.3), had a positive influence on his practice's staff morale.

5.5.5 Technology

5.5.5.1 Information technology programs

All the SAP participants acknowledged that their practices already had information technology programs in place prior to the introduction of the mandatory audit relief and that no major changes to this software were required as a result of the latter.

Aside from one SAP participant, whose practice recently switched over to Draftworx™ purely from a cost saving perspective, the remaining SAP participants' practices were still using Caseware™ as their main auditing software.

Despite being regarded as just a minor change, the majority of the SAP participants pointed out that additional Caseware™ templates were acquired to provide for the independent review and compilation engagements after the introduction of the mandatory audit relief: *“So there was an additional expense to have the software, to be able to do independent review[s] and to have your working papers accordingly. So I do use the system Caseware™ and we had to buy the modules for the independent review and the compilation” (C2P9, 43:43).*

5.5.5.2 Information technology equipment

All the SAP participants responded that the introduction of the said relief had no effect on the information technology equipment used at their practices.

5.5.5.3 Summary of technology

From the above responses it is evident that the SAP participants experienced no major changes in their technology needs as a result of the introduction of the relief. None of the SAP participants experienced any changes to their practices' information technology equipment, while the majority recognised that their practices had to acquire supplementary templates for the existing software for the purposes of independent review and compilation engagements.

5.5.6 Physical settings

5.5.6.1 Office space/design

Two of the SAP participants stated that there had been no change to the office space at their practices since the introduction of the relief. Another SAP participant added that his practice needed more office space as a result of the increase in staff members arising from the growth in its accounting department (refer to 5.5.3.6): *"We have more staff, so naturally more space"* (C2P8, 95:95).

The remaining SAP participant stated that his practice had some additional office space, previously occupied by two retired partners, but this space had been given up when these two partners stepped down. Although this was not a direct result of the relief, the SAP participant admitted that this change in the Companies Act resulted in his practice reconsidering the need for the office space it was using and making some changes in order to operate more efficiently

He pointed out: *"But I have to tell you one thing, something that forced us when this story came out (change in Act), we took another look at your [our] profitability...floor space and similar things...So we did not actually need all those*

offices, we would do everything here. What we did was to place all the desks next to each other. Previously everybody had their own office and that made no sense” (C2P10, 59:63).

5.5.6.2 Summary of physical settings

The physical settings of the majority of the SAP participants’ practices did not change as a result of the mandatory audit relief. One SAP participant revealed that the alteration in the Companies Act resulted in his practice realising that it had excessive office space, which it then addressed by scaling down its physical setting. Another SAP participant stated that as a result of the introduction of the given relief, there was an increase in the number of staff in his practice’s accounting department (refer to section 5.5.3.6), leading to a need for the expansion of his practice’s office space.

5.5.7 Organisational performance

5.5.7.1 Income streams

Although there was originally some concern with regard to the potential decrease in the income streams of SAPs owing to the mandatory audit relief, the SAP participants confirmed that these concerns were unfounded. Two participants argued that although they performed independent reviews or compilation engagements for some of their clients who had previously required an audit, the time and effort required by the participants remained the same and although clients demanded lower fees (refer to 5.5.2.3), fee income remained relatively stable: *“Because you are still going through everything to make sure everything is okay” (C2P11, 116:116); “So the fees shown is very similar” (C2P11, 229:229); “From an audit point of view of many of our customers are advised to make a move towards review, to reduce our risk to the profession side. What we have applied, but with regard to fees, it has not really affected me. We have [more or less] handled the same fee” (C2P8, 15:15).*

Although information provided by SAP participants shows a decrease in income from audit engagements (refer to Table 5.5), these participants still maintained that many of their clients were being audited (either owing to statutory requirements or voluntarily) and therefore the audit practice did not experience a significant decrease in fees. However, concern was expressed by one of the SAP participants that, in the future, he definitely foresees a decrease in his practice's income if more clients opt for just an independent review or compilation engagement: *"In a matter of time it will change, definitely it will. And that is worrying us..." (C2P9, 99:99); "If a new MOI come[s] into effect, they don't need to be audited, so then my income stream will [be] half" (C2P9, 97:97)*. Based on the information presented in Table 5.5, this participant's (Participant 9's) practice has already experienced a decrease in its practice income from auditing services from 80% (prior to the 2008 Companies Act) to 45% in 2015.

Some SAP participants indicated that their practices' income from audit fees decreased for a year or two, but they addressed that gap by substituting these with fees from other types of services (taxation audits, statutory services and accounting services) for which the demand has grown strongly since the implementation of the relief: *"It definitely at one stage, how would I say, my audit stagnated for a year or so. But I substitute[d] it with the [other] type of service [offerings] I deliver (C2P8, 27:27); "No, at the end of the day we did say that a ten percent decrease [on audit fees]" (C2P10, 285:285); "There was an increase in the non-audit, yes" (C2P10, 277:277)*. These tendencies are reflected in the information provided on the practice income distributions as reflected in Table 5.5.

5.5.7.2 Expenditure

One additional although minor expenditure that was incurred by the change, according to the SAP participants, was for the supplementary software templates required for independent review and compilation engagements (refer to section 5.5.5.1): *"The only thing is we had to buy additional software to accommodate for that" (C2P9, 109:109)*. One participant elaborated that the change in service offerings by his practice had increased monthly administrative paperwork, owing

to monthly invoicing as opposed to the annual invoice required for an audit. Although minor, additional costs were incurred as a result of this owing to more staff being assigned to administrative functions (refer to section 5.5.3.7): *“Administrative wise...more staff assigned to handle the volume... So there is certainly a cost element involved, we had to increase” (C2P8, 43:43)*. Other than that, the SAP participants generally had not noted any changes in their expenditure since the said relief was introduced.

The SAP participants, however, drew attention to the massive cost burden carried by their practices resulting from the IRBA firm inspections. Since the SAPs were still undertaking some audits, this cost continued to be incurred and had not changed. The SAP participants expressed their distress that these IRBA firm inspection costs are calculated at a higher percentage of the client’s audit fee for SAPs than for the larger audit practices. This reality penalises the SAPs dramatically: *“I think they quote the smaller guys three and the bigger guys 0.1 percent of the fee, you know which is very expensive for us” (C2P11, 128:128)*.

5.5.7.3 Summary of organisational performance

It was clear from the responses of the majority of the SAP participants that the organisational performance of the SAPs, comprising the practices’ income and expenditure, has not changed dramatically owing to the given relief.

The majority of SAP participants reasoned that most of their clients still pay the same fees, the reason being that the amount of work stays almost exactly the same, irrespective of whether an audit or independent review engagement is performed. Despite the fact that one SAP participant is undoubtedly expecting a decrease in his practice’s income in the future, until now his practice has managed to avoid this eventuality as the majority of its clients still required an audit. However, he admits that this will change once clients alter their MOIs, affording them the opportunity to take advantage of the audit relief. It further appears that SAP participants used other income streams to fill the gap caused by a reduction in audit fee income as a result of the change.

Despite alluding to the major cost burden that the IRBA firm inspections place on SAPs, the participants did not experience any significant change in their expenditure, other than some minor additional costs that were incurred by some SAPs to update software for independent reviews and compilation engagements. One SAP participant reported an increase in his practice's monthly administrative paperwork, which led to additional costs due to more staff being assigned to the administrative function.

5.5.8 Sustainability

5.5.8.1 Practice sustainability

Each of the SAP participants viewed their practice's sustainability differently. One of the SAP participants responded that none of his practice's clients "*would want less services*" (C2P11, 136:136) as a result of the mandatory audit relief, and therefore his practice would be sustainable. He added that taxation was a huge component of the auditor's work, especially because South Africa's taxation system is becoming "*really-really tricky*" (C2P11, 136:136), and this service contributed significantly to his practice's sustainability.

Another SAP participant responded that his practice is fortunately still a young company and is therefore "*not afraid of changes and new methods*" (C2P8, 109:109), which is to its advantage when considering sustainability. He added that the environment in which SAPs function, with a focus on private companies, provides them with "*the opportunities to spot things*" (C2P8, 109:109) and to take proactive steps to make the necessary changes to remain sustainable. Lastly, he mentioned that his practice implemented its strategy to focus more on contract work, especially in the public sector, which, since the introduction of the given relief, has contributed significantly to the practice's income (refer to 5.5.3.2) and, ultimately, its sustainability.

One of the other SAP participants again expressed concern regarding the future impact of this relief once his practice's clients start to implement revised MOIs.

Since the change, the impact on his practice's fees has been minimal (refer to 5.5.7.1) because the majority of his practice's clients still require annual audits. He added that to ensure the future sustainability of his practice in the audit arena, his practice would have to change the nature of its clients. In this SAP participant's opinion, this would not only involve meeting the demands of the Johannesburg Stock Exchange (JSE) as the regulator for companies listed on the stock exchange, but also require the employment of more staff members competent to perform these audits.

The fourth SAP participant summarised the key to his practice's sustainability in two words: "*Great service*" (**C2P10, 109:109**). He stated that by providing a good quality service to clients at the best possible fee, it will be possible for his practice to retain its clients: "*I mean if you provide great service to a client...the client will stay with you*" (**C2P10, 301, 303**). He added two other important factors in retaining his practice's clients, "*communication with clients at all time[s]*" (**C2P10, 303:303**) as well as, from an audit partner's perspective, keeping personal contact with one's clients. He regarded the latter factor to be a huge advantage that a SAP has over the larger audit practices, owing to the manner in which large practices are structured. This could contribute positively to practice sustainability.

5.5.8.2 Future role of auditors

All the SAP participants maintained that auditors still have a major role to play and that this will not alter in the years to come. As one SAP participant stated: "*There will always be a market for auditors. You just need to go and look for that niche market somewhere*" (**C2P9, 135:135**). Some of the other SAP participants remarked: "*I think there is certainly still a major role we can play*" (**C2P8, 129:129**); "*I don't think it will change because people out there [have] put a lot of value on our services*" (**C2P9, 135:135**); "*I cannot see that it will change, there is definitely a demand for auditors*" (**C2P10, 363:363**).

The SAP participants had various reasons for the above remarks. Two stated that a significant contributing factor is the need for expert taxation advice, which is

seen as a specialist area on its own; professional accountants do not necessarily have this expertise but auditors do: “...*the audit profession does have a strong tax expertise*” (C2P11, 178:178).

Another SAP participant elaborated that the auditor’s role has become much more important in recent times. It involves advisory services as well as the auditor being in a trust relationship with the client. He remarked: “*your client is [no] longer satisfied with only an audit. Your advising role, although it is difficult to maintain independence, plays an increasingly important role in our approach with our customers. The guy takes you in a trust relationship...*” (C2P8, 117:117). He added that because audit is seen as a specialised field on its own, that alone “*plays a very important role*” (C2P8, 127:127) in a SAP and adds additional value for the client.

One SAP participant remarked that there are still a few role-players in the market interested in audited financial statements, including SARS, financial institutions and possible investors. As a result, auditors will still play an important role in future. He also stated that the advantage that SAPs have over the larger audit practices, is that audit fees of SAPs are more competitive, which will ensure an audit market in the future. However, another SAP participant was more critical and pointed out that if an auditor were to stay in the auditing profession and not shift towards the accounting profession, this might lead to an increase in auditor’s fees in future.

5.5.8.3 Other matters

All the SAP participants were very clear in their views regarding the challenges that SAPs faced as a result of section 90 in the Companies Act, which prohibits the auditor from also habitually performing the duties of an accountant or any related secretarial work of his audit client, whether alone or with a partner or employees.

One SAP participant stated that this regulation forced one of his largest clients to appoint another auditor to compile the financial statements. In his opinion, this

only results in additional costs for the client: “...*which is a ridiculous thing in the Companies Act, [a] stupid, [idiotic] idea that is one which doesn’t add to the system, except for costs*” (C2P11, 90:90).

Another SAP participant added that: “...*this is a big hurdle we need to get over*” (C2P9, 153:153). He further mentioned that prior to the introduction of section 90 in the Companies Act, performing accounting and secretarial services for a client and then reporting in an audit capacity on the financial statements for that client, was the primary factor contributing to a SAP’s profitability. Now that the Companies Act prohibits a SAP from providing more than one of these service offerings to one audit client, this is becoming a major problem. Although he recognised the value of having an agreement with another SAP, where one practice performs the accounting services and the other performs the audit for that same client, he also noted the risk that one of the SAPs might end up losing income to the other SAP: “*But you know, it is taking money out of your mouth and feeding somebody else. And everybody needs to make a living*” (C2P9, 171:171).

One of the SAP participants acknowledged that his practice had already entered into such an agreement with another SAP that performed the compilation engagements for his practice’s audit clients; this was mentioned earlier as one of his practice’s strategies (refer to 5.5.3.2).

5.5.8.4 Summary of sustainability

Regarding the sustainability of SAPs, one SAP participant mentioned that considering South Africa’s complex taxation system, the offering of expert taxation advice will ensure that SAPs remain sustainable in future. Another SAP participant mentioned that SAPs will have to adapt to ensure their sustainability and this requires the willingness to change and implement new methods. Although one SAP participant was concerned with the impact that losing audit clients will have on his practice’s sustainability in future, another SAP participant alluded to counter measures which SAPs should take: the delivery of a good quality service and promoting personal contact with clients, as these features would most likely ensure that clients are retained.

All the SAP participants agreed that auditors will play an important role in the future, contributing to sustainability. Specifically, with regard to SAPs, factors such as the demand for taxation expertise, the advisory role played by an auditor as well as the trust relationship between the auditor and his clients and lower audit fees compared to larger audit practices, will contribute to SAPs being sustainable in the future.

All the SAP participants drew attention to the challenges posed by section 90 of the Companies Act, which prohibits the auditor from also habitually performing the duties of an accountant or any related secretarial work, alone or with a partner or employee, for his audit client. One possible alternative to overcome this burden, was for two SAPs to enter into a cooperative agreement, where one SAP performs the duties of an accountant for a client and the other SAP performs the audit for that client. One SAP participant however responded that this arrangement could carry the risk of one of the SAPs losing the client and related income.

5.6 FINDINGS AND INTERPRETATION: CASE 3 (MAP)

5.6.1 Introduction

Case 3 comprises the views expressed by the participants from the three MAPs that complied with the selection criteria, as determined by the researcher and explained in Chapter 4 section 4.4.3 and Chapter 5 section 5.2. Each MAP participant was requested to complete a questionnaire which served as an audit practice profile. Table 5.6 is a summary of the profiles of the three MAPs, selected as participants for this study, before the introduction of the 2008 Companies Act (prior to change) and at the time of completion of the questionnaire (current).

Table 5.6 Profiles of medium audit practices (MAPs) selected as units of analysis: Case 3

Participant	P12		P13		P14	
Date of incorporation	2001		1989		1987	
	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²
Number of partners	2	4	4	5	3	4
Staff composition						
▫ Number of managers	4	4	4	5	5	4
Number of trainee accountants						
▫ SAICA	4	14	25	25	17	12
▫ SAIPA	5	2	5	10	5	2
Qualifications of staff (excluding partners)						
▫ Number of CAs(SA)	2	4	2	2	3	2
▫ Number of post-graduate staff	7	11	2	4	5	4
▫ Number of graduate staff	0	7	0	0	17	14
▫ Other, studying towards Accounting degree	2	1	0	0	3	3
Number of assurance clients	175	116	400	460	229	208
Services (% of total income)						
▫ Auditing	23%	26%	70%	60%	44%	30%
▫ Accounting – clients subject to audits by other firms	0%	0%	2%	3%	4%	2%
▫ Accounting – clients not subject to audits	12%	5%	12%	15%	24%	30%
▫ Tax	7%	7%	5%	5%	7%	10%
▫ Forensic	0%	0%	3%	5%	0%	0%
▫ Advisory	44%	52%	3%	4%	17%	24%
▫ Payroll	2%	4%	1%	2%	1%	1%
▫ Secretarial	12%	6%	4%	6%	3%	3%
Impact of change on income						
▫ Increase				✓		
▫ Decrease						✓

Participant	P12		P13		P14	
Date of incorporation	2001		1989		1987	
	Prior to change ¹	Current ²	Prior to change ¹	Current ²	Prior to change ¹	Current ²
□ No change		✓				
Extent of above change						
□ Less than 10%		✓				
□ 10%-25%					✓	
□ 25%-50%			✓			
□ 50%-75%						
□ More than 75%						

¹ Prior to change = before the introduction of the 2008 Companies Act

² Current = at the time of completion of the questionnaire (Annexure A)

From the above profile table (Table 5.6), it is apparent that the MAP of Participant 13 is the largest in this study with 5 partners, 5 managers, 35 trainees (25 SAICA and 10 SAIPA) and a total number of 460 assurance clients. Although all three of the MAPs train both SAICA and SAIPA trainees, it is evident that they all tend to focus more on SAICA trainees. Despite the MAP of Participant 12 experiencing a decrease in the number of its assurance clients, the auditing service component of total income shows an increase. In contrast, the MAP of Participant 13 experienced an increase in the number of assurance clients, but reflected a decrease in the auditing services component. The third MAP (Participant 14) experienced a decrease in both the number of assurance clients and the income from auditing services since the introduction of the 2008 Companies Act. With reference to total income, in Table 5.6 it is evident that the mandatory audit relief again impacted differently on the three MAPs. The MAP of Participant 12 revealed that there has been no change in the income of his MAP since the introduction of the 2008 Companies Act. Participant 13 on the other hand, reported an overall increase (between 25% and 50%) in his practice's income, while Participant 14 reported that the income of his practice decreased (between 10% and 25%) owing to the said relief. Table 5.6 indicates that there has been a shift in the MAPs of Participant 13 and Participant 14, from providing auditing services to other types of services, while the advisory services reported by Participant 12 currently contributed more than 50% of his MAP's income.

This section proceeds with a discussion of the findings from the responses of MAP participants with specific reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance and sustainability.

5.6.2 Need for an audit

5.6.2.1 *The need for an audit*

All of the MAP participants concurred that for companies in which there is a public interest, there certainly is a need for an audit. Although all of the MAP participants recognised its importance, they also observed that for smaller companies, such as owner-managed or property companies, an audit of the financial statements neither “*make[s] sense*” (C3P12, 14:14) nor “*add[s] value*” (C3P14, 282:282) to the financial statements.

One MAP participant elaborated on the above statements, saying that the need for an audit, especially for these smaller companies, should be determined based “*on the size of the entity*” (C3P12, 14:14). Another MAP participant added that the need for an audit with reference to these companies, should not be a statutory requirement but should rather be “*market driven*” (C3P13, 15:15). He believed that if an audit was required by the market, the client might better understand the need and the cost benefit of the audit. He substantiated this view as follows: “*...once the audit is market driven [the client] will also understand the need, which means that you can now distinguish between a need for an audit and a compulsory audit*” (C3P13, 15:15). Adding to the aforementioned view, the third MAP participant mentioned that should small companies feel the need for an audit, for instance if they were “*concerned about something*” (C3P14, 282:282), they should voluntarily opt for an audit.

5.6.2.2 *Mandatory audit relief*

Without exception, all three MAP participants were in favour of the introduction of the mandatory audit relief. Two of the MAP participants agreed that a large

number of their clients, who no longer required a statutory audit, welcomed it. One MAP participant explained that these clients benefited from reduced costs, while another MAP participant added that these clients perceived that an audit added little value to their companies. It was also noted that prior to the change in the audit regulations, *“people who did not need to be audited, were audited”*, but with the introduction of the mandatory audit relief, *“there is a better playing field [now]”* (C3P13, 238:238).

One of the MAP participants supported the factors taken into consideration in determining the PIS: the average number of employees, third party liability, and turnover (refer to section 2.5.2.2 in Chapter 2). However, he stated that the PIS of 350, an indicator from when an audit is required, is too low. He responded: *“...looking mainly at the employees and looking at the debt in the business and looking at the turnover...are all relevant factors...but I think [the score] is too low”* (C3P14, 14:14). He suggested that the PIS for mandatory audits should be raised to above 750, reasoning that a large number of companies with a PIS of less than 750, do not represent businesses *“of such public interest”* (C3P14, 18:18).

5.6.2.3 *Independent review*

The majority of the MAP participants acknowledged the substantial difference in the time spent and the extent of work performed for an audit when compared to an independent review engagement. One MAP participant added this is reflected in the fee charged by his practice for an independent review engagement represented by approximately 80% of the audit fee. He supported this statement with the following: *“...based on...[a] theoretical calculation that we did between what we think the time spen[t] for [an] audit versus the time spen[t] for [an independent] review...[a] discount of twenty percent”* (C3P13, 19:19). Another MAP participant explained that an audit engagement involved *“a lot more transactional work”* (C3P14, 42:42) in contrast with an independent review engagement where *“more balance sheet work”* (C3P14, 42:42) is performed. In his experience, the majority of his MAP’s clients, who qualified for mandatory audit relief, opted to have an independent review engagement performed instead.

5.6.2.4 Summary of the need for an audit

In summarising the need for an audit, all the MAP participants clearly confirmed that for companies with a public interest, there is such a need. However, they believed that audits for smaller companies did not add any value to the financial statements of these companies. According to the MAP participants, the size of the company and market demand should be considered when deciding on the need for a financial statement audit for a small company. All three MAP participants were in favour of the said relief due to the cost benefit and the marginal value added by an audit to specific smaller companies. One MAP participant also advised that the PIS, as an indicator for when an audit is required, should be raised from 350, which he considered to be too low, to above 750. All MAP participants indicated that the time spent and the amount of work performed during an audit engagement, were much more than those of an independent review engagement. This was ascribed to more extensive transactional work for audits, while for an independent review engagement the emphasis was on balance sheet related work. A MAP participant experienced that the majority of his MAP's clients, who qualified for mandatory audit relief, opted for an independent review engagement to be performed. This may be supported by the acknowledgement of one MAP participant that the fee charged by his firm for an independent review represented approximately 80% of the audit fee.

5.6.3 Organisational arrangements

5.6.3.1 Goals

All the MAP participants declared that the introduction of the relief resulted in a change in their practices' goals. One MAP participant stated that his practice modified these after the introduction of this relief in order to focus "*more on [independent] review and compilation [engagements]*" (C3P14, 26:26). Consequently, as mentioned with regard to this MAP's strategies (refer to 5.6.3.2), more senior and better qualified staff members were appointed (also

refer to 5.6.3.6); hence he added: “...it is a more efficient way...of achieving the end goal for the business” (C3P14, 26:26).

It was noted by the second MAP participant, that with the introduction of the relief, his MAP had immediately realised that the practice was obliged to identify ways to overcome the shortfall in audit fees. He explained: “We knew that we couldn’t go on as previously...we knew that we [were] going to lose audit fees and we knew that we had to replace those audit fees with some sort of fees” (C3P13, 37:37). Consequently, the MAP shifted its goals to supplement this shortfall “with other high level fees” (C3P13, 27:27) (from work requiring expert knowledge), as well as continuing with audit engagements.

The third MAP participant stated that as a result of the mandatory audit relief, his MAP experienced a decrease in the number of audit engagements performed (see Participant 12 in Table 5.6), and this was the driving factor in altering his practice’s goals. His practice diversified and focused more on the provision of different service offerings. He mentioned, however, that his practice had already considered this shift towards other service offerings for a number of years prior to the introduction of this relief, since “recovery on [audit] fees...is generally lower than in other service lines” (C3P12, 22:22), but acknowledged that its introduction “definitely...forced” (C3P12, 26:26) this change.

5.6.3.2 Strategies

The MAPs of all participants modified their goals after the introduction of the said relief (refer to 5.6.3.1), which consequently led to a change in their strategies. The one MAP participant stated that his practice had to align its strategies according to the new goals after this event and “diversif[ied] in terms of focusing on the different service lines” (C3P12, 22:22). Another MAP participant noted that the strategy put into place by his practice, was to appoint larger numbers of permanent qualified staff members (refer to 5.6.3.6), with the belief that this would assist in achieving the practice’s new goal of increased focus on compilation engagements.

In order to achieve its new goal of replacing the shortfall in audit fees with other high level services based on expert knowledge, one MAP decided on a strategy to compile financial statements specifically compliant with IFRS. He elaborated: *“so we didn’t try to replace audit fees with [ordinary] compilation fees” (C3P13, 21:21)*. In addition, this MAP participant stated that his practice anticipated that not all audit practices would continue to perform audit engagements after the introduction of the mandatory audit relief. Consequently, some companies would require new auditors. His MAP thus took another strategic decision to deliberately *“stay in audit” (C3P13, 27:27)* with the intention of performing these new audit engagements. During the interview he remarked: *“And we were lucky to get those audits” (C3P13, 27:27)*.

5.6.3.3 Client profile/size

Two of the MAP participants reported that their client bases remained stable, because they did not lose any clients as a result of the introduction of the mandatory audit relief, but acknowledged that they had lost income from audit fees. One MAP participant added that where necessary, a clear split was made between a client for compilation services and for independent review engagement services, even if the same client required both services. Furthermore, this MAP participant’s practice in the main was still largely made up of family owned businesses that comprised large manufacturing companies in different industries.

The other MAP participant supported the above statement, stating: *“we still have the client, but...not...necessarily the audit fee” (C3P13, 21:21)*. This MAP participant commented on the change in his practice’s client profiles, saying that his practice deliberately decided to move away from providing assurance services to very small clients and shifted its focus to bigger clients. As indicated in section 5.6.3.2 the MAP targeted clients in need of expert knowledge (compilation of IFRS compliant financial statements) and audit work. He explained: *“the assurance services definitely moved towards the bigger private equity clients” (C3P13, 75:75)*. This MAP participant concluded by mentioning that his MAP had also obtained the audits of two JSE listed companies since the

change. He nevertheless pointed out that although his practice acquired the additional accreditation required from the JSE to perform these audits, his practice was still uncertain whether it “[wanted] to play [in] that market” (**C3P13, 79:79**) since it was much more challenging for a SAP or MAP to do so.

The third MAP participant remarked that his practice experienced a decrease in the number of audit clients since the change in regulation. He stated that the introduction of the mandatory audit relief and the distinction drawn by the IRBA between high risk and lower risk entities, resulted in an increase in audit fees, which caused a decrease in audit clients. This MAP participant also added that his practice could “now [be] sitting with maybe fewer clients [but] with better recoveries on audit fees” (**C3P12, 46:46**). He did however remark that in general, his practice had increased its number of clients for service offerings other than audits, especially for advisory services, which is also evident from Table 5.6 (Participant 12).

5.6.3.4 Type of services

One of the MAP participants (Participant 12), who experienced a decrease in his practice’s number of audit clients (refer to 5.6.3.3), reported an increase in his practice’s advisory services (refer to Table 5.6). This participant explained: “considering [that] audits [were] very time consuming and labour intensive...the moment the number [of audit] clients...reduced...there [was] an increase in our advisory section” (**C3P12, 37:37**).

Another MAP participant stated that a strategic decision was taken to compensate for the shortfall in audit fees, as a result of the mandatory audit relief, with other high level services based on expert knowledge, such as fees from compiling IFRS compliant financial statements (refer to 5.6.3.2). This MAP also anticipated that the decrease in audit engagements, arising from the introduction of this relief, would lead some smaller audit practices to decide that it was no longer worthwhile “to keep a whole infrastructure to audit those few remaining clients” (**C3P13, 29:29**) and that these practices would consequently rather focus on advisory services. As a result, the MAP took another deliberate

strategic decision to continue performing audit engagements (refer to 5.6.3.2), with the objective of *“pick[ing] up those audits...[that] came into the market” (C3P13, 31, 29)*. Another observation from the same MAP participant, whose practice communicated with its clients to identify their needs, was that clients: *“had needs, which we didn’t previously fulfil. So we discussed that with them and out came needs that they had. And based from those discussion[s] we could convert some of the needs into fees” (C3P13, 57:57)*. Some of these needs, which the MAP then addressed by diversifying its service offerings, included VAT audits, PAYE audits and budget projections. The same MAP participant added that about 30% of his practice’s clients that had previously required a compulsory audit of their financial statements, but for whom an audit was no longer necessary, opted for a voluntary audit. Finally, this MAP participant mentioned that although some of the previous compulsory audits were converted into independent review engagements, there has been no further growth in demand for these.

The third MAP participant (Participant 14) responded that the introduction of the mandatory audit relief resulted in a decrease in the number of audit engagements performed by his MAP, which provided the opportunity for the expansion of other service offerings, such as compilations, taxation and advisory services (also refer to Table 5.6). The same MAP participant elaborated, stating that the increased comprehensiveness of his practice’s taxation services had resulted in the practice *“hav[ing] a department that is geared up to manage the process” (C3P14, 80:80)*. He furthermore stated that his MAP’s advisory services had expanded since the introduction of the mandatory audit relief, with a specific focus on *“property consulting and management” (C3P14, 82:82)*.

5.6.3.5 Structure

All three MAP participants indicated that their practices have been restructured as a result of the said relief. One MAP participant mentioned that his practice had split into two entities; one entity acting as a *“specialist audit firm” (C3P14, 90:90)*, and the other focusing on the consulting and accounting divisions of the practice.

He described this as follows: “we have actually...split our office into, call it ‘the auditing company’ and our ‘accounting company’. So we have split offices, split partners, management, auditing and the others” (C3P14, 188:188).

The second MAP participant similarly indicated that his practice decided to divide its existing accounting division to enable one section to focus only on the compilation of IFRS compliant financial statements, while the other concentrated on other accounting services. The third MAP participant explained that his practice’s structure has changed to establish “growth in the firm as a whole which needed different parties taking responsibility” (C3P12, 46:46). In line with this MAP’s strategy to diversify and focus on increasing the different service lines, it was necessary for it to appoint more partners to oversee the supplementary service offerings that were introduced in addition to the existing audit service offerings. This is reflected in the increase from two to four partners for Participant 12 in Table 5.6.

5.6.3.6 Change in human resources

All three of the MAP participants remarked that it was necessary to appoint more staff members in some divisions of their practices as a result of the implementation of the mandatory audit relief. Two MAP participants elaborated with regard to the increase in numbers of trainees appointed in their practices. One (Participant 13) mentioned that his practice experienced this in the number of SAIPA trainees appointed, while the other (Participant 12) indicated that his practice had appointed ten more SAICA trainees since the introduction of this relief (refer to Table 5.6). This MAP participant explained that due to the expansion in the other service offerings, especially the advisory services, a SAICA trainee had more knowledge than a SAIPA trainee and was therefore better qualified to assist with all the different service lines. Although this significant increase in the number of SAICA trainees might appear to be an anomaly, prior to it the number of SAICA trainees in this MAP was significantly smaller in comparison to the number of SAICA trainees in the other MAPs in this study (refer to Table 5.6).

At a management level, the same two MAP participants also pointed out that both their practices had to move towards appointing audit managers who were more highly qualified, who would be able to manage the larger audit clients as well as higher risk audit engagements more adequately. Consequently, these two MAPs appointed more CAs(SA) as audit managers than prior to the change, when managers had completed an undergraduate degree and a SAICA traineeship, but were not necessarily qualified CAs(SA). The two MAP participants substantiated their views as follows: *“your managers have to be up-skilled...now you kind of need a qualified [CA(SA)] person as an audit manager. The high risk audits get dealt with by qualifieds [CAs(SA)] and the low risk audit[s] get run by maybe a SAICA articles with only degrees” (C3P12, 125:125); “...we knew that we will need CAs[(SA)] as managers...not anything less. So we had to staff up on that” (C3P13, 137:137).*

The third MAP participant, who observed that the structure of his MAP had evolved since the introduction of the relief by splitting the practice into an auditing entity and an accounting entity (refer to 5.6.3.5), also experienced a shift in his MAP’s human resources. In line with his MAP’s strategy (refer to 5.6.3.2) and expansion in other service offerings (refer to 5.6.3.4 and Table 5.6), his practice appointed *“more permanent qualified staff [members]” (C3P14, 48:48)* specifically for the accounting side of the practice, where trainees used to perform the bulk of these other services prior to the introduction of the said relief. These permanent employees were also more *“high[ly] qualified” (C3P14, 94:94)*, such as Professional Accountants (South Africa) registered with SAIPA, and focused more on the *“accounting and consultancy division” (C3P14, 92:92)* of the practice.

5.6.3.7 Administration

The MAP participants voiced different views regarding the impact of the relief on the administration component of their practices. One indicated that the change had a positive impact on the administration component of his practice. He noted that prior to this event, retaining all the necessary documentation and records relevant to the audits performed and for the purpose of submitting an annual

return to IRBA, “*was quite an administrative nightmare*” (C3P12, 62:62). The above processes, together with the massive administrative burden associated with a firm’s inspection by the IRBA, have been significantly reduced, due to the said relief.

Another MAP participant held a contrasting view that the introduction of the mandatory audit relief resulted in “*a bigger admin burden*” (C3P14, 102:102) for his practice. He explained that, as a result of the change, the MAP had been restructured into two different entities: one focusing on the auditing services, while the other focused on all other service offerings (mainly accounting services) (refer to 5.6.3.5). This resulted in an additional administrative burden for the practice as a whole.

5.6.3.8 Systems, policies and procedures

None of the MAPs experienced any major changes in their systems or policies as a result of the mandatory audit relief. However, since all of these MAPs are accredited as training offices with SAICA, some adjustments were made to the training programmes of their trainees. As a result of the said relief and the resultant increase in demand for independent review and compilation engagements, the training programmes of the MAPs required modification to include these engagements. One MAP participant explained: “*In terms of developing trainees, obviously with independent reviews kicking in...there has been supplementary training in terms of those competencies*” (C3P12, 70:70). This same MAP participant added that due to the expansion of other service offerings since the introduction of this relief, specifically advisory services, competencies relevant to the performance of valuations had to be added to the practice’s in-house training programmes.

The two other MAP participants added that since the introduction of the mandatory audit relief, their practices had invested significantly in their training programmes. Both these MAP participants were specifically referring to the cost of outsourcing parts of their practices’ training programme where it was believed the in-house capacity was insufficient. They substantiated the above as follows:

“a lot more money [was invested] into training and getting the people to learn the processes” (C3P14, 182:182); “So we outsourced a lot of our training. We made use of ‘W.Consulting’...’Protect-a-Partner’ and...specialists where necessary” (C3P13, 177:177).

5.6.3.9 Challenges

One major challenge experienced annually by all three of the MAPs since the introduction of the mandatory audit relief, was to attract enough SAICA trainees who have completed their postgraduate studies (BCom Honours (CTA) degrees). The main reason for this, according to the MAP participants, was that in recent times these students were more inclined to apply for traineeships at the Big 4 or larger audit practices. This created a shortage of prospective SAICA trainees for the MAPs. One MAP participant pointed out that prior to the said introduction, his MAP had no problem attracting such SAICA trainees: *“at one stage we used to get CTA’s which was fantastic” (C3P14, 120:120)*. These participants mentioned that the only way their practices could overcome this shortage of SAICA trainees, was to appoint applicants who had only attained undergraduate degrees. One of these participants also mentioned that he foresees that MAPs might need to pay a much higher salary to attract applicants with postgraduate degrees as SAICA trainees.

The above challenge was supported by the following statements made by some MAP participants: *“[it] became more difficult lately because obviously the Big 4 [audit practices]...reap up your top students to start off[f] with...[our practice has to] accept students like undergraduates and they haven’t even attempted CTA” (C3P12, 105, 109); “There is not enough CTAs. The larger firms take all the CTAs. So we are actually getting the trainees [with] the BComs and the BCom Honours...I think there will be less SAICA students for the smaller firms, unless you [are] prepared to pay a much higher salary” (C3P14, 124, 114, 130).*

One MAP participant elaborated that since the mandatory audit relief, *“the first question SAICA students and trainees asked” (C3P13, 43:43)* during the

recruitment of staff, was whether or not his practice, as a MAP, had enough audit exposure to train them sufficiently. He added the perception of applicants, created by the media and some universities, was that the small and medium-sized practices would not have the audit exposure to train SAICA trainee accountants after the introduction of this relief. He elaborated: “...*the media created this perception that audits in small [practices] will fall away and will die. And the small audit firm will die. That was enhanced by communications in the classroom by the major universities...And the perception of trainees was that you could only get audit training with the super four [Big 4]*” (C3P13, 187, 189, 191). To address this problem, the MAP participant further explained that much additional time and effort was required from his practice to attract SAICA trainees. This took the form of arranging open days at the practice’s offices, attending open days at universities and offering vacation work for any prospective SAICA trainees.

Another major challenge, mentioned by one of the MAP participants, related to the inspections performed by SAICA on the assessment of the SAICA trainees. The objective of these inspections was to determine whether or not the SAICA training requirements were met by the training office. He explained that these inspections by SAICA “*puts a tremendous burden on the practice*” (C3P12, 86:86) in terms of administration and preparation time: “*it literally took two of us out [of production] for a month in terms of getting the SAICA preparation done*” (C3P12, 86:86). Lastly, with regard to SAICA trainees, one MAP participant also mentioned that although his practice could currently still provide sufficient audit exposure to its SAICA trainees, he anticipated that in the future, his practice would perform fewer audits due to its focus on independent review and compilation engagements; hence the number of SAICA trainees might decrease.

Another challenge was raised by one of the MAP participants as a result of the introduction of the said relief. He remarked that to convince his practice’s audit clients, who could make use of this relief, to remain with the practice, it had proposed other valuable services to these clients and thereby replaced the audit fees that were forfeited by other high value fees. Convincing these clients proved

to be a major challenge and took a lot of the directors' time. He added: *"it took [an] enormous amount of time from the directors...we had to plough in a lot of time into our clients to get to that point...that was stressful"* (C3P12, 86:86).

5.6.3.10 Training office

All three of the MAPs were registered, both as training offices accredited by SAICA as well as ATCs accredited by SAIPA, and all MAP participants foresaw that their practices would remain accredited as such in the short term. One MAP participant supported his practice's decision to continue to be accredited with SAICA, by arguing, *"that's what gives credibility because you know the people that you employ are on their way to becoming CAs[SA] so the quality of their work automatically increased and the value that they add definitely"* (C3P12, 90:90). This statement was supported by the increase, from 4 to 14, of SAICA trainees that the practice employed since the introduction of the mandatory audit relief (refer to Participant 12 in Table 5.6). This MAP participant however admitted that the process to train SAICA trainees involved a much greater administrative burden than that of SAIPA trainees. Although his MAP was also accredited as an ATC by SAIPA, he stated that the number of SAIPA trainees has decreased over time and is currently minimal (only 2) (refer to Table 5.6).

Another MAP participant stated that since the introduction of the relief, the number of SAICA, as well as SAIPA, trainees, appointed by his practice has decreased. He elaborated: *"because all our audits were decreasing, our SAICA [trainees were] decreasing"* (C3P14, 136:136); *"SAIPA [trainees] has decreased because we have moved into the area of more permanent staff"* (C3P14, 134:134) (refer to 5.6.3.6). This participant added that although his MAP will continue to stay accredited as a training office with SAICA in the future, it would reassess its accreditation with SAIPA as an ATC and might consider cancelling its accreditation sometime in future since it had appointed more permanent qualified staff to perform the work (refer to 5.6.3.6).

5.6.3.11 Ownership

All three of the MAPs experienced an increase in the number of partners in their practices since the introduction of the audit relief. This is also evident from the information displayed in Table 5.6 regarding the profiles of the MAPs. Two of the MAP participants indicated that although the number of partners in their practices increased, this was due to “*succession planning*” (C3P14, 160:160) to ensure the sustainability of these MAPs. Another remark from one of these two MAP participants was based on the fact that his practice had “*been approached by larger firms to merge but [they] have decided to remain the family auditor that [they] are with [their] own identity*” (C3P14, 154:154). The third MAP participant added that his practice was “*looking at a merger at the moment*” (C3P14, 102:102). He stated that the main reason for this was that BEE levels had to be revisited. The drive behind this merger was to strengthen the practice’s advisory role, which was a result of the introduction of the relief.

5.6.3.12 Summary of organisational arrangements

With reference to the impact of the said relief on the goals of MAPs, all the MAP participants stated that their goals had changed, which consequently led to a change in the MAPs’ strategies. MAPs had shifted their focus to income generated from independent review engagements, and compilation engagements and in the case of one MAP, the compilation of specifically IFRS compliant financial statements (requiring expert knowledge) to cover the shortfall in audit fees. This MAP also decided to keep its focus on audit engagements to capitalise on audit work previously done by other audit firms who had discontinued their assurance services as a result of the mandatory audit relief. In addition, it was also mentioned by one MAP participant that the increase in other service offerings demanded a diversification of the practice to focus on and provide for these other types of service offerings. It therefore appears that all MAPs extended their service offerings as a result of the mandatory audit relief.

With reference to a possible change in the client profile/size as a result of the given relief, two MAP participants reported that their client bases remained stable

but that the income from audit fees had decreased. The other MAP participant mentioned that his practice had moved away from very small audit clients and targeted larger clients in need of IFRS expertise and assurance services. This MAP gained two JSE listed companies as clients as it was accredited as a JSE service provider, but this step was treated with caution by the MAP participant. The client base of the third MAP had decreased, but with more high risk category audits the practice experienced a better recovery rate on audit fees; therefore the impact on the MAP's income was negligible. The latter could also be ascribed to the increase in the number of clients for other service offerings of this MAP. One MAP participant also mentioned how stressful and time consuming it was to convince clients who qualified for the mandatory audit relief to remain with the practice and make use of these other service offerings.

There were significant changes to the types of services delivered by MAPs due to the introduction of the said relief. Two of the MAPs experienced a decrease in the number of audit engagements performed since the change and therefore expanded on other service offerings, especially with reference to advisory services. As the third MAP participant reported, his practice made the deliberate decision to continue its focus on performing audit engagements as well as to supplement a decrease in audit fee income, with other high level services, requiring expert knowledge such as IFRS compliant financial statements. This participant also added that his MAP offered additional services based on clients' needs; these included independent review engagements, VAT audits, PAYE audits and budget projections. Although this MAP was performing independent review engagements for clients who made use of the mandatory audit relief, the MAP participant reported that this market was not growing.

From the responses of MAP participants, it appears that all MAPs, although not to the same extent, had been restructured as a result of this relief. The restructuring of MAPs was informed by the changes in goals, strategies, client profile/size, type of services, etc. as a result of the mandatory audit relief. Existing entities were split into divisions with a specific focus. One MAP even decided to divide its existing accounting division into two, where one section was

responsible for the compilation of IFRS compliant financial statements, while the other section concentrated on other accounting services. The second MAP participant similarly indicated that his practice had chosen to split into two entities where one entity concentrated on auditing and the other on consulting and accounting services. These decisions led to a change in the human resources of MAPs. All MAP participants reported the need for more staff members as a result of the mandatory audit relief and provided explanations about the allocation of staff. One MAP needed to employ better qualified staff members (also at manager level) in order to carry out independent review and compilation engagements. All three of the MAPs reported an increase in the number of owners since the introduction of the mandatory audit relief, while for two of them, the increase in partners was as a result of succession planning. The other MAP appointed more partners to oversee the expanded service offerings. It was also mentioned by two MAP participants that more trainees were appointed. In the one MAP, more SAIPA trainees were employed and in the other, more SAICA trainees. The participant of the second MAP perceived SAICA trainees to be more knowledgeable than SAIPA trainees and therefore deemed them better qualified to assist with the different service lines and with the offering of expert advice (IFRS compliant) and assurance engagements. It should be mentioned, though, that this specific MAP had previously employed fewer SAICA trainees than the other MAP participants. Another MAP permanently employed Professional Accountants (South Africa) registered with SAIPA in the accounting division of this practice.

MAP participants held diverse views about the impact of the mandatory audit relief on the administrative duties within their practices. In one, the administrative burden was significantly reduced by this relief due to a decrease in IRBA firm inspections and reporting requirements. In contrast, another MAP participant alluded to the fact that the said relief resulted in an increased administrative burden because of the restructuring of his practice into two entities, as already mentioned above.

MAPs have not experienced any major changes in their systems or policies as a result of this relief. Training programmes, specifically with reference to

independent reviews and compilation engagements, had to be adjusted due to the introduction of the 2008 Companies Act. In-house training programmes had to be aligned towards advisory services, and also to address competency needs for the performance of valuations in one MAP. Two MAPs had to outsource some of their training programme components due to internal capacity limitations.

Since the introduction of the audit relief regulation all MAPs have experienced challenges. A major challenge experienced annually by all three of the MAPs since this event, was the recruitment of sufficient numbers of SAICA trainees who had completed their postgraduate studies (BCom Honours (CTA) degrees). It appears that since the introduction of the relief, these students have preferred to do their traineeship at the Big 4 or larger audit practices. One MAP participant blamed the media and universities for cautioning students small and medium-sized audit practices might not survive as SAICA training offices and could not offer them adequate audit training exposure as a result of the mandatory audit relief. This negative publicity might force MAPs to pay much higher salaries and spend additional time attracting potential SAICA trainees. One MAP participant reported initiatives taken by his practice presenting open days at the office, attending open days at the universities and offering vacation work to prospective SAICA trainees. The MAPs were all registered as training offices accredited by SAICA and SAIPA, and for the immediate future MAPs planned to remain as such. Although two MAP participants acknowledged a decrease in the number of trainees (SAIPA trainees in the case of one MAP and in the case of the other MAP, both SAICA and SAIPA trainees), one MAP participant argued that employing prospective CAs(SA) contributed to making the practice credible. In contrast, another cautioned that his practice's accreditation with SAIPA as an ATC might be cancelled in future due to the appointment of more permanent qualified staff. The burden of SAICA inspections on the assessment of trainee accountants was mentioned as a challenge by one participant.

5.6.4 Social factors

5.6.4.1 Management style

From the views expressed by the three MAP participants, it can be deduced that the mandatory audit relief did not severely impact on the management style in their practices. However, one MAP participant explained that before the 2008 Companies Act, all audits done by his practice were managed by a person who had only completed an undergraduate degree and the SAICA traineeship and then remained within the practice. However, the situation altered and the MAP subsequently used qualified CAs(SA) to manage high risk audits. He stated: “*The high risk audit[s] get dealt with by qualifieds [CAs(SA)] ...*” (C3P12, 125:125). Another MAP participant also mentioned that his MAP’s management style had changed because of the need for “*specialising more on partner level*” (C3P13, 143:143).

5.6.4.2 Staff morale at time of change

One MAP participant confirmed that at the time of the change in the Companies Act, the partners immediately communicated with staff members on the way forward. He believed that this was the reason that the morale of staff did not slump. This MAP participant made the following interesting remark: “*I think the hype was actually overrated in a sense*” (C3P12, 137:137). Another MAP participant confirmed that the staff morale did not decrease at the time of the announcement of the mandatory audit relief, noting that “*...our staff are guided by the partners in management...we continued with the processes we had in place...*” (C3P14, 173:173) and that for him it is an ongoing process. The third MAP participant reported a different experience. He confirmed that the stability of his practice was affected at the time of the change. “*We knew that we couldn’t go on as previously. We knew that we had to restructure. We knew that we [were] going to lose audit fees...*” (C3P13, 37:37).

5.6.4.3 Current staff morale

All MAP participants indicated that the staff members in their practices felt positive. One participant maintained that staff members are guided by the leadership of the practice (the partners) and it was clear that the managers in his practice were prepared to deal with any possible change. However, this MAP participant mentioned that when his practice used the services of an outside sub-contractor (such as an external auditor), the managers needed to be sensitive because *“there are more people around the table that you have to accommodate”* (C3P14, 174:178). The same MAP participant further stated that the change happened *“slowly”* (C3P14, 172:172) and therefore it was not necessary to reduce staff while, if circumstances had been otherwise, the morale of staff could have been negatively impacted. The MAP participant, who experienced a change in the staff morale at the time of the announcement of the mandatory audit relief, was of the opinion that the practice was stable and morale was the same as it had been before the change. One MAP participant was of the opinion that the staff morale in his practice had definitely improved since the change because the work pressures within the MAP had decreased. He explained: *“so the morale in a sense has definitely increased, because the labour has decreased”* (C3P12, 133:133).

5.6.4.4 Summary of social factors

From the views above it may be concluded that the mandatory audit relief did not have a significant impact on the social factors of the MAPs. The management style of these audit practices did not alter greatly. Instead, the change was more evident in the management structure. For example, one MAP's high risk audits were allocated to audit managers who held the CA(SA) designation. It was furthermore pointed out by two MAP participants that owing to a proper change management process which involved sufficient communication and well prepared managers at the time of the change, the morale of staff members did not slump at the time of the announcement of the mandatory audit relief. In the case of one MAP participant, the morale of the staff in fact improved after the introduction of the relief. The MAP which had experienced a period of instability at the time of

the change managed the process properly; therefore the morale of staff returned to what it had been before the said relief.

5.6.5 Technology

5.6.5.1 Information technology programs

Without exception, all the MAP participants acknowledged that they have been using Caseware™ all the time and no additional software had been implemented since the relief was introduced.

5.6.5.2 Information technology equipment

The MAP participants stated that there was no adjustment in their practice's information technology equipment as a result of the change in the Companies Act.

5.6.5.3 Summary of technology

All three MAP participants confirmed that there was no difference in information technology programs or equipment as a result of the introduction of the mandatory audit relief.

5.6.6 Physical settings

5.6.6.1 Office space/design

Two of the three MAP participants indicated that the physical settings of their practices remained unchanged. One other explained how the practice “*split [the] office into...the auditing company and [the] accounting company*” (**C3P14, 188:188**). This view relates to the structure of a practice in section 5.6.3.5. This MAP participant admitted that increased office space was needed as a result of the split.

5.6.6.2 *Summary of physical settings*

Except for one of the three MAP participants who needed additional office space for the two separate divisions when the practice was split, there was no alteration in the physical setting as a consequence of the mandatory audit relief.

5.6.7 *Organisational performance*

5.6.7.1 *Income streams*

One MAP participant remarked that his practice experienced a decrease in the number of its audit clients as a result of the said relief; however (as stated in section 5.6.3.3), the remaining *“audits [became] more specialised than...in the past” (C3P12, 170:170)*. These audits were classified as high risk ones by the IRBA, which resulted in an increase in the audit fees charged to clients. He further elaborated that as a result of the decrease in audit engagements, the practice had more capacity to focus, and expand on, its advisory services; hence the increase evident in Table 5.6 (Participant 12). He substantiated this as follows: *“Like audit and advisory...which [were] complementing each other nicely because your fee quality goes up and frees up hours to increase your advisory” (C3P12, 165:165)*.

Another MAP participant mentioned that the number of audit engagements in his practice decreased as a result of the mandatory audit relief. This led to a decline in the MAP’s income from audit fees (refer to 5.6.3.4), and even though there was evidence of a growth in income from other service offerings (such as advisory services) this MAP experienced an overall drop in income after the mandatory audit relief. The third MAP participant reported that the income of his practice from audit fees had initially decreased with the introduction of the mandatory audit relief, but as a result of *“deliberate marketing of the audit services” (C3P13, 133:133)* (refer to 5.6.3.2) income from both audit engagements as well as other service offerings of the MAP had increased (refer to Participant 13 in Table 5.6).

5.6.7.2 Expenditure

All of the MAP participants stated that they incurred additional salary costs with the increase in the staff employed by their practices (refer to 5.6.3.6). One declared that other than the additional salary costs, his practice was not burdened with any other major expenses by the introduction of this relief.

The remaining two MAP participants added that their practices had invested much more in their training programmes for trainee accountants, especially with regard to outsourcing some of the training (refer to 5.6.3.8), which resulted in an additional cost to their MAPs. Both these MAP participants also elaborated on the huge cost burden of IRBA firm inspections. Although not introduced as a new expense resulting from the mandatory audit relief, these MAPs argued: *“That has changed. Much higher. The IRBA reviews [are] very expensive” (C3P14, 224:224); “dramatically increased in practice review cost” (C3P13, 163:163)*. One of these MAP participants added that his practice’s income from audit fees dropped, while the expenses incurred for IRBA firm inspections increased, and therefore regarded the IRBA firm inspections *“as a ratio [which] had a negative impact” (C3P14, 240:240)*.

The other MAP participant whose practice invested more in its training programme indicated that the additional investment arose due to the practice’s deliberate strategy of earning high level fees by compiling IFRS compliant financial statements while at the same time retaining the practice’s focus on audit engagements. Consequently, the directors in this MAP participant’s practice were forced to reinvest the practice’s profits in the practice rather than take dividends in order to cover the costs of training. During the interview, he elaborated: *“So there was a huge impact. We had a lot of the dividends that needed to be paid out [that] were kept back and we invested it [the dividends] to gain the skills for [IFRS financial statements], skills for the bigger audits, skills to get the JSE listing...” (C3P13, 157:157)*.

5.6.7.3 *Summary of organisational performance*

From the above views regarding the impact of the relief on organisational performance, it was evident that although the MAPs still focused on audits to varying degrees, all the MAP participants experienced a growth in their practices' income streams from other service offerings. A MAP participant revealed that although the number of audit engagements of his practice lessened, this was not reflected in the income of the MAP, because these were regarded as high risk audits which allowed for larger fees to be levied and, furthermore, the practice's income was supplemented by income from advisory services. One MAP participant remarked that his practice had increased the number of its audit clients, including JSE listed companies, as well as focusing on services that generated high level fees such as compiling IFRS compliant financial statements. This had resulted in a need for more skills within the MAP, which was funded by the MAP reinvesting dividends instead of distributing them to directors. The MAPs also incurred additional expenditure with regard to salaries due the appointment of additional staff where required. It was also mentioned that the mandatory audit relief created a need for additional training programmes and, in particular, that the outsourcing of some of this training added to their expenses, as did the increase in the fees for firm inspections by the IRBA.

5.6.8 Sustainability

5.6.8.1 *Practice sustainability*

Two of the three MAP participants stated that they believed the way to ensure the future sustainability of their MAPs is the diversification of service offerings. Although one confirmed that his practice will continue operating as an audit practice in the future and will be able to adequately train SAICA trainee accountants, this MAP's "*drive is mostly on the advisory [services] at the moment*" (C3P12, 182:182). A second added that his practice planned on focusing on non-audit services to ensure sustainability of the MAP. He elaborated: "*We are focusing on non-auditing company increase. So we want to*

do more consultations, more tax work, more accounting work, more compilations” (C3P14, 258:258).

This MAP participant further commented that by focusing on these non-audit services his MAP could potentially be exposed to direct competition with professional accounting practices that have partners registered with SAIPA rather than SAICA, and who are not registered auditors. These professional accounting practices may provide exactly the same non-auditing services as the MAP but at a much lower fee. In the opinion of this MAP participant, his practice is not threatened by this competition because of the value encompassed in the expertise and experience of a CA(SA) registered with SAICA. He reasoned as follows: *“but I still think that people come to the better firms, they will come to Chartered Accountants, if they understand what the Chartered Accountant is doing before they go to a bookkeeper or a SAIPA” (C3P14, 260:260).* He added, *“in our profession we sell trust” (C3P14, 270:270).*

The third MAP participant acknowledged that sustainability is a constant challenge for small and medium-sized audit practices. He mentioned two reasons: a practice driven constraint (through the IRBA firm inspections) and a market driven constraint (created by perceptions in the media). Nonetheless, he acknowledged that there is a need for auditing to be performed not only by larger audit firms or the Big 4. He added that his MAP still delivers a high quality service at lower cost than the large firms or the Big 4. According to him, his practice offers the services of trusted *“auditors for audit clients and trusted business advisors for the non-audit clients” (C3P13, 240:240)* although he realised that they *“need to step up...and make sure...that [they] give [the clients] really good quality service” (C3P13, 234:234).*

5.6.8.2 Future role of auditors

All three MAP participants unanimously confirmed that there is still a future for auditors. One participant asserted that although audits might become more specialised, the demand for auditing will remain, and even increase. Therefore “I

would recommend anyone to stay in the profession...it is still a good business” (C3P14, 164:164).

The same MAP participant elaborated on his thoughts about the important role of computers in future. *“Computer audit is going to become...the future of auditing” (C3P14, 274:274).* He predicted that there will be an increase in internal auditing in the corporate sector. In his opinion, audit work will be performed continuously and results will be available on a monthly basis.

Another participant stated that the responsibility and pressure on the auditor to report accurately will also increase in future. He was convinced that the pressure will result in a drop in the number of Registered Auditors (RAs) registered with the IRBA; however, *“there will definitely be a need [for RAs]” (C3P13, 225:225).* He was furthermore certain that compulsory as well as voluntary audits will increase in the future. Remuneration will be the driving factor for CAs(SA) to proceed to qualify as RAs.

5.6.8.3 Other matters

A concern voiced by one of the MAP participants, was the challenge and impact of section 90 of the Companies Act, mentioned earlier. He elaborated that this practice now *“need[s] two professionals to do the same job” (C3P14, 50:50).* He further stated that this resulted in higher costs for clients since the MAP would still be performing the audit engagement, but the compilation of the financial statements had to be outsourced to another professional. He furthermore cautioned that *“once you have another professional involved then the chances are good that eventually you are going to lose the audit” (C3P14, 50:50).*

5.6.8.4 Summary of sustainability

All MAP participants believed that the sustainability of MAPs will be constantly challenged in the future so that an expansion of service offerings such as consultation, taxation, accounting, and compilation services would be required. However, this diversification of service offering does not necessarily exclude a

MAP from continuing to offer audit services. One participant was of the opinion that audits might become more specialised and the need for compulsory and voluntary audits would continue. He was confident that clients would still prefer the high quality services of CAs(SA) registered with SAICA to the services of those registered with SAIPA due to their experience and expertise. Therefore, the MAP participants believe that there is still a future for auditors. One participant provided his views on the important role that computers might play in the future of auditing and also predicted an increase in demand for internal auditing services in the corporate sector, referring to continuous auditing, thereby allowing for regular reporting by auditors. Another MAP participant took the view that remuneration will most likely be the driving force to limit the decline in the number of CAs registered with the IRBA. A further concern voiced by one of the MAP participants, was the challenge and impact of section 90 of the Companies Act. This section prohibits the auditor from habitually performing the duties of an accountant or any related secretarial work for his audit clients, which implies that two professionals (accountant and auditor) are needed to perform financial statement work, resulting in additional costs for clients and a potential loss of clients and income for MAPs.

5.7 FINDINGS AND INTERPRETATION: CROSS-CASE ANALYSIS

5.7.1 Introduction

This section proceeds with a cross-case analysis with reference to the findings of the three cases identified for this study: SPs, SAPs and MAPs. The analysis was carried out in terms of the following themes: need for an audit; organisational arrangements; social factors; technology; physical settings; organisational performance and sustainability. Where applicable, reference was made to the relevant sections of the literature review as presented in Chapters 2 and 3. Thereafter, a final conclusion is drawn for this chapter.

5.7.2 Need for an audit

5.7.2.1 *The need for an audit*

All the small and medium-sized audit practices that participated in this study confirmed that there is a need for an audit because it provides assurance on the credibility of the financial statements. This finding is in line with the literature (Chapter 2, section 2.2.1; Mautz, 1975:17) and (Chapter 2, section 2.2.4) that the purpose of an audit is to ensure proper financial reporting to maintain credibility (Hevlund *et al.*, 2010:23; Mentz, 2014:52). One SP participant raised the concern that clients with insufficient financial knowledge to interpret financial statements might be misled by a compilation report, which could be misconstrued as an audit report on the related financial statements. However, some SP, SAP and MAP participants highlighted that, particularly in the case of smaller companies (such as owner-managed companies; family businesses) in which there is no or limited public interest, an audit might not be worth the cost and its value proposition could be questioned. Despite this observation, some SAP participants pointed out that where the management of a client does not have a financial background and lacks the competence to evaluate and interpret financial statements, an audit may add value to the client's business. SAP participants elaborated that an audit may do so; for example, in the case where a loan is required from a financial institution. This is in line with the literature (Chapter 2 section 2.5.1), which states that bankers regard "full statutory accounts as the most important source of documentary evidence and information when making lending decisions" (Seow, 2001:66). Therefore, two SP participants mentioned that the circumstances should determine the need for an audit, while MAP participants added that the size of the company as well as the market demand are two criteria that should be considered when determining the need for an audit of smaller companies.

5.7.2.2 *Mandatory audit relief*

The majority of the SAP and MAP participants were in favour of the introduction of the said relief, whereas only a minority of the SP participants supported this. Two of the SP participants and all MAP participants were of the opinion that this

relief brought about a cost benefit to clients who had opted for it and that no value was lost as an audit added little value to smaller companies and their financial statements. This viewpoint concurs with the literature (Chapter 2, section 2.5.1) which mentioned that an audit was costly and an unnecessary regulatory burden for small companies (Keasey *et al.*, 1988; Hevlund *et al.*, 2010:34). However, one SP participant was concerned that the mandatory audit relief could lead to fraudulent financial statements, to the detriment of the end user. This concern supports the results of a study conducted in 2006 in the UK (Woolf, 2007) where it was found that the companies that most need a statutory audit, may opt for an exemption, resulting in accounts containing errors. SP and SAP participants expressed concerns regarding the factors taken into consideration when calculating the PIS. Specific reference was made to the weight that the average number of employees of the company in a financial year carries in determining the PIS, as this was not believed to reflect a similar level of public interest. In addition, the turnover factor was not considered to be an accurate measure in its current form. It was suggested that the turnover indicator should be industry specific and that profit margins may be more indicative of public interest than turnover. A further recommendation was for the weighting of third party liability to be increased. Regulation 26(2) of the Companies Regulations 2011 (RSA, 2011) outlines the annual calculation of the PIS (Chapter 2, section 2.5.2.2). There was consensus amongst the SAP and MAP participants that the PIS of 350 for mandatory audits (Chapter 2, section 2.5.2.2) is too low and it was suggested that this should be raised to above 750. A MAP participant claimed that there is limited public interest in many companies with a PIS lower than 750.

5.7.2.3 Independent review

A SP and a MAP participant mentioned that the majority of their practices' clients, who qualified for mandatory audit relief, opted for independent review engagements to be performed and that the main drive behind their decisions was cost-saving. The majority of the participants in the SAP case did not view an independent review as providing much relief. For them, the amount of time and effort needed for an independent review is similar to the work done for an audit, while their clients expected fees to be reduced. In contrast to the above opinion

of SAP participants, and in accordance with ISRE 2400 (IAASB, 2013: ISRE 2400 (revised)), MAP participants acknowledged that the amount of time and work performed for an independent review engagement is substantially less than for an audit engagement (Chapter 2, section 2.5.2.2). In substantiating his opinion, one MAP participant pointed out that an audit engagement involves much more transactional work, while the independent review engagement entails more balance sheet work. This was illustrated by one MAP participant who explained that the fee charged by his practice for an independent review engagement represents approximately 80% of the (comparative) audit fee. Participants from both SPs and SAPs were concerned that the variation in the PIS each year could result in an audit engagement where the opening balances in the financial statements had not been audited previously; an audit would then need to be performed in retrospect. This possibility in some instances served as motivation for clients who qualified for mandatory audit relief to continue with an audit.

5.7.3 Organisational arrangements

5.7.3.1 Goals

Stainbank (2008:13) is of the opinion that the relaxation of the audit requirement will mean that smaller audit practices will need to refocus their businesses as many of their clients will no longer require an audit. The majority of the SP participants believed that the mandatory audit relief impacted on the goals of their practices, especially with regard to income generation and service offerings. Reference was made to an increase in accounting, taxation and advisory services as avenues to generate income that might have been forfeited, if it had not been for the relief. This view was supported by all the MAP participants. One reported that his practice elected to focus more on independent review and compilation engagements. To achieve this goal, more senior, and qualified staff were appointed. Another MAP's goals were changed to focus on other income, specifically targeting high level fees based on expert knowledge to cover the shortfall in audit fees. The third MAP participant stated that his practice, as a direct consequence of the introduction of the said relief, diversified and focused

more on different service offerings. It therefore appears that all MAPs extended their service offerings as a result of the relief; this implies a change in their goals.

Although the majority of the SAP participants commented that the goals of their practices did not alter as a result of the mandatory audit relief, it was also clear from the information presented by them (Table 5.5) as well as views expressed on their clients' profile/size (section 5.5.3.3) and the type of services delivered (section 5.5.3.4), that the service offerings of SAPs have changed and that these practices did position themselves for such changes. One SAP participant mentioned that although a deliberate decision was made to modify the goals of his practice and some actions were taken (expanding the tax and accounting divisions), the anticipated impact of the mandatory audit relief had not materialised. It could therefore be concluded that participants from the majority of all small and medium-sized audit practices which participated in this study, revealed that as a result of the said relief, their practices' goals have changed because their service offerings have been extended.

5.7.3.2 Strategies

The vast majority of all small and medium-sized audit practices that formed part of the cases in this study, modified the strategies of their practices due to the mandatory audit relief. One such strategy mentioned by most of the participants is the shift in focus, away from audit engagements towards providing non-audit services such as accounting, advisory and taxation services. This change in strategy is in line with the literature reviewed in Chapter 3, section 3.5.2 where Goyal (2007:73) stated that in the continually evolving business environment small and medium-sized audit practices have extended their services to "advisory" and "consultation" areas to cater to the business needs of SMEs (the clients). Ramirez (2009) also mentioned that the role of the traditional accountant is slowly shifting towards that of an advisor.

Two SAP participants explained that their practices, as a result of the mandatory audit relief, focused more on independent review and compilation engagements. As a result of this strategic decision, another SAP participant's practice appointed

more SAIPA qualified staff members to assist in the accounting department. This was also mentioned as a strategy by one MAP participant who decided to appoint more permanent qualified staff members in order to carry out the compilation engagements. Another explained how his practice decided to focus on work requiring expert knowledge, such as the compilation of specifically IFRS compliant financial statements, in order to generate a higher level of income. In addition, this MAP participant furthermore strategised to tender for audits foregone by audit practices that, as a result of the mandatory audit relief, had decided they would no longer offer audit services.

It was also noted by a SP participant that although his practice was no longer performing audit services, he decided to remain registered as an auditor with the IRBA. According to him, clients tend to respect and value the services offered by a CA(SA) who is also a registered auditor, due to that person's high level of expertise. Such a notion supports the belief of Ramirez (2009:384) concerning the particular importance that small practitioners attach to their Chartered Accountant qualification. Another SP participant deregistered as an auditor with the intention of providing non-audit services. In 2014, he again registered as an auditor and since then his practice has directed its attention predominantly to category A audit engagements, which carry a high level of risk and generate more substantial audit fees. Another SP participant referred to a strategic decision made to issue EME certificates through his SP to sustain the practice's income. One SAP furthermore took a deliberate decision to turn its attention to gaining contract work from the public sector, which provided the audit exposure needed for trainees and assured income from fees. Another SAP participant stated that this practice encouraged its current clients to continue to demand voluntary audits, as this would eliminate the future need to audit the opening balances in the financial statements in retrospect if in the case where only just an independent review engagement was performed in prior years. Due to the Companies Act restrictions, a SAP also entered into an agreement with another practice for the compilation of the financial statements in cases where his practice would be performing the audit and was thereby prohibited from also compiling the financial statements.

5.7.3.3 *Client profile/size*

It was clear from the responses of the majority of participants in all three cases that although the types of services needed by their practices' clients have altered (chapter 3, section 3.5.2) since the introduction of the mandatory audit relief, there was no decrease in their practices' overall client size.

Only one SP participant commented on a decrease in his practice's client base where clients moved their business to accounting practices to incur lower monthly fees. Another such participant reported an increase in his practice's client base, which he ascribed to the effect of the said relief which resulted in fewer young registered auditors entering public practice and some registered auditors closing their audit practices. Due to the non-registration or resignation of IRBA members, more clients were referred to his practice. SAP participants acknowledged that although no clients were lost as a result of this relief, the focus of their practices' service offerings has changed. For one SAP participant, wider offerings in accounting services led to an increase in his practice's client base. Barrett *et al.* (2005:22, 23) refer to commercialisation that provides for a wider range of services in response to clients' needs. Although one MAP participant experienced a decrease in the audit client base, this was compensated for by the provision of more high risk category audits, which offered a better recovery rate for audit fees. The same MAP participant added that the number of clients demanding services other than audits had increased. In this regard reference can be made to Lander *et al.* (2013) who identified the clients' demand for more specialised services as a main driver that influences organisational practices.

Another SAP participant believed that his practice's focus on a specific industry (pension funds), resulted in a stable client base and fee income, and that this was the reason why the mandatory audit relief did not affect his practice. Two of the MAP participants also stated that their practices' client bases had remained stable since the audit relief, but there was a decrease in income from audit fees.

Two MAP participants explained how their client profiles shifted as a result of this relief. One made a distinction between compilation service clients and

independent review engagement clients, even if the same client required both services; this change was reflected in the client base of the MAP. Another MAP participant mentioned that his practice deliberately moved away from the very small clients and targeted larger ones in need of expert knowledge to compile financial statements compliant with IFRS or for the provision of assurance services. This MAP also acquired two JSE listed companies as clients, after being accredited as a service provider by the JSE, but due to the challenging environment the practice was not yet convinced that it should expand further into this market in future.

5.7.3.4 Type of services

The majority of the small and medium-sized audit practices identified as cases for this study experienced a decrease in the number of audit engagements performed since the introduction of the said relief. It is evident that there were significant changes in the types of services delivered by all three cases.

For SPs, the potential drop in income and sustainability was managed by the expansion and diversification in other service offerings. Examples were accounting and taxation services, contractual work for other audit practices, more factual findings reports, BEE services, the issuing of EME certificates, advisory services and assisting financial planners and attorneys. According to Cosserat (2004), auditors are expected to provide value added services, such as advisory services. This is corroborated by Grant (2006) who noted that in the UK audit practices shifted their focus to deliver value added services, other than audits, to their clients.

All the SAP participants reported an alteration in the focus of their service offerings as a result of the said relief and the risk of failing firm inspections performed by the IRBA. It appeared as if SAPs diversified their services to also include other services such as accounting, taxation, consulting and statutory services. Similarly to SPs and SAPs, two of the MAPs focused on and expanded their other service offerings due to a decrease in the number of audit engagements experienced since the regulatory change; both practices expanded

on their advisory services. One MAP participant reported that his practice was specialising in taxation services, and property and management consulting services.

The largest MAP participating in the study (consisting of 5 partners, 5 managers and 35 trainees) made a deliberate strategic decision to continue performing audit engagements, while at the same time compensating for the reduction in audit fee income by compiling IFRS compliant financial statements to earn additional high level fees. This MAP also decided to offer some additional services, such as independent review engagements, VAT audits, PAYE audits and budget projections after the introduction of the mandatory audit relief, based on the needs and demands of its clients. This decision supports the literature (Chapter 3, section 3.5.2) which identifies one of the factors driving change in audit practices as “...changes in client demands...[clients] demand more and different services” (Lander *et al.*, 2013:132,133). This participant further reported that his practice performed independent review engagements for clients who made use of the mandatory audit relief, but that this stream of income was not growing.

5.7.3.5 Structure

The majority of the SP and SAP participants did not experience any alteration in their practices' structures as a result of the relief. An exception to this finding came from two SP participants who made use of fixed agreements with other practices when their practices needed to provide other services. One SP participant, who previously had been a partner in a SAP, modified the structure of his practice to a SP after the introduction of this relief. Another was forced to dissolve his partnership due to his partner leaving the auditing profession after the Companies Act of 2008 was introduced; he now practices as a SP.

One SAP participant observed that the introduction of the audit relief resulted in his practice functioning in a more structured way between different divisions. In this regard Lander *et al.* (2013:141) suggest that firms should re-evaluate their organisational structure as one way to respond to changing factors, of which the

change in the mandatory audit relief is an example (Chapter 3, section 3.5.2). In line with the literature mentioned and as a result of the relief, two MAPs split their existing entities into two divisions, each with a specific focus. For the one MAP, a specific entity was established to focus on auditing whilst another entity specialised in consulting and accounting services. For the other MAP, the one new section in its practice focused on the compilation of IFRS compliant financial statements while the other section concentrated on other accounting services.

The third MAP participant explained that his practice took a holistic view to grow the whole practice by appointing more partners to oversee the expanded service offerings as a result of the mandatory audit relief.

5.7.3.6 Change in human resources

Although this relief did not impact on the human resource practices of the majority of SPs, two of the four SAP participants and all three MAP participants experienced an adjustment in their practices' human resource practices due to it. It can therefore be deduced that the change in the Companies Act of 2008 had varying effects on the human resources of the small and medium-sized audit practices included in this study.

Three of the SP participants pointed out that they have always functioned without other full time employees in their practices and continued to do so after the introduction of the mandatory audit relief. Two of these SP participants entered into service agreements with other parties to meet the clients' needs for supporting services. According to one of these participants, this ensured high quality services. It is therefore clear that in the case of SPs, the said relief did not impact on the human resources of their practices.

Two of the four SAP participants indicated that there was an increase in the number of staff appointed in their accounting departments. However, as these staff do not require the CA(SA) qualification because they do not perform audit work, staff members with lower qualifications could be appointed, which proves to be cost-effective. One MAP participant also stated that his practice had appointed

more staff members, registered as Professional Accountants (South Africa) with SAIPA, in permanent positions since the introduction of the relief, specifically in the accounting division to assist with the accounting service offerings. One SAP participant further alluded to retention opportunities following traineeship with regard to Professional Accountants (South Africa) registered with SAIPA, but expressed an opposing view with regard to CAs(SA).

It was clarified, in the case of two MAPs (one of which appointed more CAs(SA)), that more CAs(SA) had been allocated to the role of audit manager since audit managers who were more highly qualified were required to adequately manage the bigger audit clients as well as higher risk audit engagements. In addition, these two MAPs also appointed more trainees; in the one case more SAIPA trainees and in the other, more SAICA trainees. The latter MAP participant argued that SAICA trainees have more knowledge than SAIPA trainees; therefore they were better qualified to assist with the practice's different service lines, especially with the expansion of the practice's advisory services (this MAP initially employed far fewer SAICA trainees compared to the other MAP participants). In the case of one SP, it was decided that in future, new appointments of SAICA trainees would not be made, as it was argued that, due to the relief, this SP would no longer be able to offer these trainees sufficient audit exposure. In contrast with the SPs, it appears that with regard to the change in human resources as a result of the implementation of the said relief, the MAPs needed more staff members (also CAs(SA)) in some divisions of their practices.

5.7.3.7 Administration

Porras (1987:54) asserts that for the development of all relevant resources, the provision of information and the coordination of data, organisations require administrative systems. Although the mandatory audit relief did not bring about administrative changes to the greater majority of the small and medium-sized audit practices who participated in this study, there were some exceptions. One MAP participant suggested that the relief resulted in an administrative burden because his practice was forced to restructure its practice into two entities, while a SAP participant was of the opinion that his practice also experienced additional

monthly administrative paperwork. A SAP participant mentioned that changes in technological developments could provide some respite with respect to general office administration.

It was furthermore pointed out by one SAP participant that compiling working papers for an audit file as per the IRBA's requirements is a heavy administrative burden that could shift the focus away from providing assurance, which is the main objective of an audit. In contrast, on a positive note, one MAP participant stated that prior to the mandatory audit relief it was difficult retaining all the necessary documentation and records for IRBA purposes. This administrative burden had been significantly reduced by the said relief.

5.7.3.8 Systems, policies and procedures

Lander *et al.* (2013:141) suggests that practices should make choices about their governance and management control systems in response to organisational change.

With regard to systems, policies and procedures, the majority of participants experienced no differences in their practices as a result of the mandatory audit relief. However, one SP participant mentioned that his practice transformed the way in which it functions by allocating audit engagements only to those staff members who needed audit exposure in terms of their SAICA training requirements. For this SP, the change in the Companies Act had obviously caused a decrease in the audit work, which limited on-the-job training opportunities for staff members other than SAICA trainees. Another SP participant mentioned that his practice had standardised its audit methodologies and with the use of a software tool, compliance could be monitored – this has resulted in an improvement of audit quality.

Participants of SAPs and MAPs, registered as training offices, also referred to some modifications made to their in-house training programmes to include training relevant to independent review and compilation engagements. This view was aligned to that of the MAP participants whose practices, which are also

training offices, adjusted their training programmes based on the impact of the changes to the audit regulation. The expansion of other service offerings by MAPs such as advisory services, including the performance of valuations, required the enhancement of in-house training programmes to develop the relevant competencies required to perform these services. Two MAPs also pointed out that training programme components were outsourced where it was clear that the internal training capacity was insufficient.

5.7.3.9 Challenges

From the discussions with all the participants from the SPs, SAPs, and MAPs it is clear that the given relief has caused several challenges to small and medium-sized audit practices. Participants from all the cases referred to the challenges pertaining to SAICA training as a direct consequence, which brought about a drop in the audit engagements of small and medium-sized audit practices. In turn, this decrease led to a reduction in training opportunities offering audit exposure for SAICA trainees. This is similar to the effect of the audit deregulation in the UK (Fearnley *et al.*, 2000:305).

SAP participants mentioned how they struggled to attract SAICA trainee accountants and according to one SAP participant, it was difficult to convince prospective SAICA trainee accountants that his SAP would still be in a position to provide adequate audit training hours owing to the introduction of the mandatory audit relief. This challenge was partially overcome by another SAP participant's practice where undergraduate trainee accountants were appointed, although trainees with postgraduate degrees would have been preferred. All three of the MAP participants explained how challenging it is to attract enough SAICA trainee accountants who have completed their postgraduate studies (BCom Honours (CTA) degrees). They were of the opinion that since the introduction of the relief, these students preferred to do their traineeship at the Big 4 or larger audit practices. One MAP participant blamed the media and universities for spreading the message that small and medium-sized audit practices might not have adequate audit exposure to provide the training required by SAICA trainee accountants as a result of the mandatory audit relief. The consequence of such

negative publicity is that MAPs might, in future, be compelled to pay much higher salaries to attract SAICA trainees. Much more time is also required than in the past for MAPs to recruit prospective SAICA trainees. One MAP participant mentioned initiatives taken by his practice in this regard; arranging open days at the office, attending open days at universities and offering vacation work to prospective SAICA trainees. Some MAP participants also experienced SAICA training office inspections in relation to the assessment of trainees as a major burden on their practices. Participants from SPs experienced difficulty in meeting the SAICA training office requirements; therefore the majority of the SP participants' practices no longer functioned as training offices.

Another challenge expressed by some SP and SAP participants of the study, was the possible need for the performance of an audit engagement on financial statements previously only subject to an independent review. One SP and one SAP participant specifically referred to the increased financial burden to clients caused by the year-on-year fluctuation of the PIS when an audit of the financial statement opening balances needs to be performed in retrospect.

Further challenges mentioned by SP participants included clients complaining about the higher fees charged by the SPs compared to those charged by SAIPA registered accountants for the same non-audit services. As a result, this placed the SP's practices under enormous pressure to lower their fees in order to stay competitive. Furthermore, IRBA firm inspections were also experienced as a major challenge for SPs. Not only was the cost burden a challenge but also the amount of time and work that the IRBA firm inspections demands. Another challenge identified by one SP participant was that SARS required audited information which was no longer readily available; together with the complex and time consuming processes at the SARS office, this poses a significant challenge.

The final challenge mentioned by a MAP participant was that due to the possibility of the mandatory audit relief for certain clients, MAPs attempt to convince clients to remain with the practice by proposing other valuable service offerings. The effort required was deemed to be unwarranted owing to its time consuming and stressful nature.

5.7.3.10 Training office

It was clear that in all cases, the mandatory audit relief impacted negatively on the accreditation of the small and medium-sized audit practices that participated in this study as SAICA and/or SAIPA training offices. Although all three of the MAPs were, and planned in the short term to stay, registered both as training offices accredited by SAICA as well as ATCs accredited by SAIPA, one MAP participant admitted that the number of SAIPA trainees in his practice had reduced over time and was minimal at the time of the interview. Another MAP participant confirmed that both the number of SAICA and SAIPA trainees in his practice had decreased. Although his practice would remain accredited as a training office with SAICA, the practice's accreditation with SAIPA as an ATC might be cancelled in future due to the appointment of more permanent qualified staff.

There were contradictory views between the SAP participants as to whether or not it was worthwhile for their practices to be accredited as a training office with SAICA. Two of the SAP participants still preferred this, but the practices of the other two SAP participants took the opposing view. Negative factors supporting the latter decision were raised by these participants; and included the fact that SAICA has strict regulatory requirements for audit practices accredited as training offices, the process involves a large amount of administrative paperwork and entails a significant cost burden for the SAP. These factors, together with the limited audit exposure offered by SPs (due to the decrease in their audit engagements) resulted in only one of the seven SPs being accredited as a training office with SAICA. Fearnley *et al.* (2000:305) reported that in the UK the mandatory audit relief negatively affected the auditing profession because not all small audit practitioners would continue to be in the position to train audit staff (chapter 2, section 2.5.1.2). A SP participant added that the cost and administrative burden associated with being accredited as a training office with SAICA was more onerous than that relevant to an ATC accredited by SAIPA. Although one MAP participant also complained about the administrative burden that increased due to the employment of SAICA trainees, he responded that these trainees contributed to the credibility of the practice.

Another challenge faced by the SAP participants was the shortage of prospective SAICA trainees, which one SAP participant attributed to the influence of some universities that advised prospective trainees to rather choose the SAIPA route.

The majority of SP participants and one SAP participant acknowledged that their practices were neither accredited as a training office by SAICA nor as an ATC by SAIPA. The SAP participant decided against becoming either a SAICA or SAIPA training office because of the disruption when trainees join and leave the practice.

5.7.3.11 Ownership

Taking the responses of all the participants into consideration makes it evident that some audit practices have decided to increase their ownership, while others remarked that there was no change in this respect. Two SP participants revealed that there was a decrease in ownership of their practices as a result of the mandatory audit relief. As mentioned, one SP participant, who previously had been a partner of a SAP, left practice to establish a SP since the introduction of the relief. The other SP participant explained that he previously had a partner in his practice, but due to the change in the Companies Act, his partner decided to move out of the auditing profession and his practice now operates as a SP. None of the other SP participants reported differences in their practices' ownership.

Participants from all three of the MAPs as well as from two SAPs confirmed an increase in ownership as a result of the said relief. For two of the SAP participants, the expansion of services since this event, as well as the need for assistance and shared responsibility at senior level in the practice, resulted in an increase in the number of audit partners by way of an internal promotion process. Two of the MAP participants stated that the number of partners in their practices increased after the implementation of the mandatory audit relief as a result of succession planning that aimed to ensure the sustainability of these practices.

One MAP participant indicated that his practice planned to merge with another audit practice to ensure that the requirements of the profession's BEE charter would be met. He mentioned that he wanted to strengthen the practice's advisory

role as a result of the introduction of the mandatory audit relief. One of the other MAP participants mentioned that his practice was approached by larger audit practices to merge, but his MAP has decided against this. These findings are in line with the study performed by Bröcheler *et al.* (2004:643), indicating that higher levels of staff education in small or medium-sized audit practices (as in the case of the MAPs considered in this study) make them more attractive for take-overs.

5.7.4 Social factors

5.7.4.1 Management style

It could be concluded that the said relief did not have a major impact on the management style of small and medium-sized audit practices. Some MAP participants described how the management structure in their practices had altered, resulting in only qualified CAs(SA) being allocated as audit managers for high risk audits and an increased specialisation at partner level. One SP participant observed that in terms of his practice's management style, it was an on-going process. One SAP participant drew attention to the fact that he has more time on his hands to attend to clients personally because of the reduction in time taken to prepare for IRBA firm inspections.

5.7.4.2 Staff morale at time of change

In the view of the majority of the SP, SAP, and MAP participants there was no major impact on the morale of their practices' staff at the time of the implementation of the given relief. Two MAP participants reported that specific steps were taken to involve staff at the time when the relief was introduced; for these two MAPs, no change was reported. It appears as if more uncertainty was experienced in the third MAP where staff involvement was not as explicit. McDonald and Siegal (1993) state that employee attitudes towards a pending change in an organisation can affect the morale of staff. One SAP also noted some uncertainty amongst his practice's trainees regarding the opportunity for adequate training exposure after the mandatory audit relief was implemented. After discussions with clients (refer to section 5.5.3.2), his practice was able to

assure trainees that such exposure would be provided. This provides further evidence in support of the literature that an employee may perceive the change as less threatening (Rush *et al.*, 1995) if he perceives that the organisation cares for his well-being and is supportive of his concerns (Eisenberger *et al.*, 1986). An exception to the general finding that the introduction of the mandatory audit relief had minimal or no impact on staff morale was expressed by one SAP participant who believed that the relief had positively influenced his practice's staff morale due to an expansion of service offerings which resulted in an increase in the practice's client base.

5.7.4.3 Current staff morale

Without exception, all participants confirmed that the mandatory audit relief had no long-lasting effect on the morale of staff members in their practices. As a matter of fact, one MAP participant stated that the morale of the staff has improved since the introduction of the relief, which he ascribed to reduced work pressures within the MAP. The MAP, which experienced a period of instability at the time of the change, was nonetheless managed properly; therefore the morale of staff returned to what it had been before the relief.

5.7.5 Technology

5.7.5.1 Information technology programs

The majority of participants from the small and medium-sized audit practices acknowledged that the introduction of the mandatory audit relief did not have a significant impact on their information technology programs. The majority of the SP participants as well as all the MAP participants continued using Caseware™ as auditing software and in the case of the SPs, Caseware™ was also used for engagements other than audit engagements. The only change to the information technology programs for the majority of SAPs was the additional Caseware™ templates they had to purchase for the purposes of independent review and compilation engagements. One SP introduced software that standardised audit

methodologies which is claimed to have increased this SP's effectiveness. Sayana (2003) confirmed that in performing audits, auditors have to make use of computer tools (software) to achieve the goals of auditing.

5.7.5.2 Information technology equipment

All the participants responded that the introduction of the mandatory audit relief had no effect on the information technology equipment (hardware) used in their practices.

5.7.6 Physical settings

5.7.6.1 Office space/design

Only a small number of the SP, SAP and MAP participants mentioned that their practices have experienced a change in office space/design since the mandatory audit relief. Two audit practices, one SAP and one MAP have expanded their office space. In the case of the SAP this was necessary because more staff members were appointed in the accounting department. In the MAP's case, the participant admitted that increased office space was needed as a result of a split in the practice, providing for an auditing company and as well as an accounting company. Porras (1987:67) is of the opinion that one of the most important organisational components to consider is creating a physical design that matches the type of work to be done and the ways individuals must work to accomplish their tasks most effectively (refer to Chapter 3, section 3.4.4). Apart from the increase in office space as mentioned above, another SAP participant acknowledged that his practice did reassess the need for individual offices and downsized its office accordingly. For two SPs, it proved to be more cost effective after the introduction of the relief to scale down their office settings and to either use their clients' business settings or practice from home. In a study on small and medium-sized audit practices in the Netherlands, it was agreed, that while from a cost reduction perspective it is sensible to have fewer offices, it is necessary to still be able to have face-to-face contact with clients (Lander *et al.*, 2013:141)

(refer to Chapter 3 section 3.4.4). The other participants in this study indicated that the physical settings of their practices remained unchanged.

5.7.7 Organisational performance

5.7.7.1 *Income streams*

Based on the views of the participants in this study it became evident that none of the SAPs or MAPs have experienced a decrease in their income as a result of the relief. Although the majority of SPs experienced a decrease in the income from audit engagements, they focused on expanding the practices' other service offerings in an attempt to minimize the effect of the loss.

The income of one SP participant's practice increased due to the fact that the SP focused on category A (high risk) audit engagements. This notion was underscored by a MAP participant when he mentioned a decrease in the number of audit engagements performed, but the retention of audits; that audits became more specialised, generating higher audit fees. The result was an increase in the practice's income from audit engagements while at the same time creating capacity for it to expand its advisory services, resulting in greater income.

Overall no major change was noted by the SAP participants regarding their practices' income. One SAP participant remarked that many of his practice's clients still required their financial statements to be audited and therefore still paid the usual audit fees. All SAP participants argued that the extent of the work performed remained the same, but that their practices' service offerings expanded (including independent reviews, taxation audits, statutory services and accounting services) and therefore their practices' fee income remained relatively stable. MAP participants concurred with the SAP participants' comments, as mentioned above. All MAPs experienced an increase in their practices' income from service offerings other than audits. One MAP that was still focusing on audit engagements, ultimately experienced a significant increase in its income due to an increase in demand for both its audit services and other service offerings, after the practice made a concerted effort to market its audit services. One SAP

participant expressed a concern that the current status quo would change in future and that he expected a significant drop in his practice's income once clients start to opt for mandatory audit relief. Nevertheless, from the above, it is clear that most SAPs have already used other income streams to fill the gap caused by the reduction in audit fee income as a result of the mandatory audit relief.

5.7.7.2 Expenditure

It was mentioned by the majority of the SP and SAP participants that this relief caused no major changes in the expenditure of their practices. Two SPs attempted to cut down on overhead costs by moving their practices to home offices. Only minor additional costs were reported by SAP participants to have been incurred with regard to software templates and increased monthly paperwork.

In contrast to the responses from SPs and SAPs, all MAPs had incurred additional salary expenses due to the appointment of additional staff members as a result of the mandatory audit relief. In addition, two of the MAP participants added that their practices incurred significant expenditure in relation to the training of staff, particularly due to the outsourcing of some of the training. Both of these MAP participants perceived that the cost of firm inspections by the IRBA increased. The SAP participants also noted the significant cost burden of the IRBA firm inspections for their practices. One of these MAP participants remarked that his practice increased the number of its audit engagement clients by attracting larger clients, including JSE listed companies, while also focusing on earning high level fees from services such as compiling IFRS compliant financial statements. This required more skills in his practice and forced the directors to forfeit dividends in order to invest in training programmes that could provide his staff with the necessary skills.

5.7.8 Sustainability

5.7.8.1 *Practice sustainability*

It is clear that small and medium-sized audit practices take varying approaches to ensure the sustainability of their practices. One significant approach specifically mentioned by SPs and MAPs refers to the expansion and diversification of service offerings such as consultation, taxation, accounting and compilation services. However it was mentioned that this does not exclude MAPs from practicing as auditors. The participant from one SP held a contrasting view, claiming that eliminating unnecessary costs (such as office rental, luxurious items and excessive staff) in his practice rather than trying to increase income (by expanding or diversifying service offerings) ensured that the SP remained sustainable. One MAP participant acknowledged that his decision to focus more on non-audit services put his MAP in direct competition with professional accounting practices that have partners who are registered with SAIPA, but not SAICA. Nevertheless he was confident that clients would still prefer to make use of the high quality services of CAs(SA) registered with SAICA.

For three participants, a focused service offering or a service offering targeted towards a specific market, was believed to contribute to their practices' sustainability. One SP made a deliberate decision to focus his practice's service offerings towards the fuel industry. A SAP participant explained that a large component of his practice's service offerings to its clients comprises taxation services, and with South Africa's complex taxation system, this was contributing significantly to his practice's sustainability. Another SAP participant noted that his practice focused on contract work, particularly with the public sector, which sustained his practice since the implementation of the mandatory audit relief.

One of the SAP participants expressed concern regarding the impact on his practice's sustainability if all of his practice's current clients, who are still required to have an audit performed, should revise their MOIs and opt for independent review or compilation engagements, when this option becomes available to them.

Another SAP participant was of the opinion that delivering a good quality service at a reasonable price, as well as partners maintaining personal contact with their clients, would promote client retention, thus ensuring sustainability.

One MAP participant acknowledged that, as a result of the mandatory audit relief, sustainability would remain a constant challenge for small and medium-sized audit practices owing to the cost and administrative burdens of firm inspections performed by the IRBA and perceptions of MAPs created by the media. In his view, MAPs could still offer a high quality service at a reduced cost when compared to the Big 4 or larger audit firms.

5.7.8.2 Future role of auditors

All participants from SAPs and MAPs and the majority of SP participants stated that the role of auditors will continue to be very important in the future. MAP participants elaborated that in their opinion, audits might become more specialised and the need for compulsory and voluntary audits will remain and even increase in future. This supports the finding of the study performed in the UK by Collis *et al.* (2004) which found that the majority of the companies included in the sample that could have gained from the audit exemption, still chose to have their financial statements voluntarily audited. For these companies the benefits of having their accounts audited, outweighed the cost (refer to chapter 2 section 2.5.1.2).

Various reasons for the future role of auditors were mentioned by the participants in this study. One SP participant elaborated that auditors of SPs will in future play an important advisory and management accountancy role for their clients. Another SP participant predicted that the PIS for mandatory audits will increase in future, allowing even more small companies to make use of other services offered by SPs. A SAP participant stated that an auditor from a SAP, aside from performing an audit, also plays an important advisory role and has a strong trust relationship with the client, which is needed in the ever-changing business environment.

It was mentioned by a SP participant that future auditors will be required to rely on technology developments. This prediction was supported by a MAP participant who shared his thoughts on the significant role which computers might play in the future of auditing. Matthews (2013:142) mentions the most significant change to the audit process was the introduction of the computer. He pointed out that auditors eventually had to come to terms with the technological change as best as they could (Matthews, 2013:143). Matthews referred to the spin-off effects of this technological change (refer to Chapter 2 section 2.2.2.5).

One SAP participant maintained that various parties, including SARS, financial institutions and potential investors rely on audited financial statements and therefore auditors will play an important role in future. Another SAP participant held a more critical view, he cautioned that auditors' fees might increase in future making it worthwhile to remain in the auditing profession and this could have negative consequences. One SAP participant's view was more positive; he regarded the services of larger audit practices to be very expensive, and believed that SAPs could offer such services at more affordable rates. A MAP participant also referred to an increasing pressure on the auditor in future to report accurately which might result in a decline in the number of RAs registered with the IRBA. In his opinion remuneration will be the driving factor for CAs(SA) to proceed to qualify as RAs.

Two SP participants raised their concerns about the future role of the small auditor specifically pertaining to the high cost of practicing as a SP and the challenge to secure a niche market. This participant also reasoned that the SP's clients' biggest need was to obtain assistance for taxation purposes. Keeping in mind that nothing distinguishes SPs from accountants since the introduction of the mandatory audit relief, SP's clients (smaller companies) might prefer the more affordable services of an accountant, rather than those offered by a SP.

5.7.8.3 Other matters

Other matters related to the sustainability of the small and medium-sized audit practices were reflected upon by the participants. Participants from SPs, SAPs,

and MAPs referred to section 90 of the Companies Act (refer to Chapter 3, section 3.2.3.4), which prohibits the auditor from also habitually performing the duties of an accountant or any related secretarial work of his audit client (alone or with a partner or employees) (RSA, 2009). This was considered as an impractical arrangement and a challenge for small and medium-sized audit practices. Furthermore, a SP participant described this as “*a distrust in the integrity of an auditor, saying he may not compile financial statements*” (**C1P6(2), 82:82**). One MAP participant explained that as a result two professionals (accountant and auditor) are needed to perform the same work which leads to additional costs for clients and a potential loss of clients and income for MAPs. Some SAPs acknowledged that this challenge may be overcome to some extent by entering into a cooperative agreement with another SAP, where one SAP performs the accounting work and the other the audit work. Nevertheless, concerns were expressed over the additional costs incurred by clients and the potential loss of income for some SAPs as a result of these agreements.

5.8 CONCLUSION

Chapter 5 reflected in detail on the findings obtained from the collected data during semi-structured interviews with participants from the three cases: SPs, SAPs, and MAPs. The profile of each case and its participants were presented. Thereafter the views shared by participants on their perceptions and their experiences in relation to the impact of the mandatory audit relief on small and medium-sized audit practices were discussed. A cross-case analysis followed and where applicable, reference was made to the relevant sections of the literature review.

In the final chapter, Chapter 6, the previous chapters are revisited. This is followed by a discussion on the achievement of the research objectives of this study. A summary of the findings from the three cases is reflected upon as well as the contributions made by this study to various role-players in the field of auditing. Recommendations, where appropriate, are made and suggestions for further research are presented. A final overall conclusion is then drawn.

CHAPTER 6

CONCLUSIONS AND RECOMMENDATIONS

6.1 INTRODUCTION

The 1973 Companies Act (RSA, 1973) subjected the financial statements of all companies to annual statutory audits. As part of the corporate law reform in South Africa, this Act (RSA, 1973) was replaced by the 2008 Companies Act (RSA, 2008), which came into effect on 1 May 2011. As noted, the later Act exempted specific companies from mandatory annual audits of their financial statements, which had an impact on small and medium-sized audit practices. This qualitative research study investigated the said impact.

In this final chapter, Chapter 6, the previous chapters are revisited and summarised. This is followed by a brief discussion of the findings from the cross-case analysis of SPs, SAPs and MAPs. Thereafter, the focus is on a discussion of the achievement of the research objectives of the study. The contributions made by this study to various role-players in the field of auditing are presented and recommendations, where appropriate, are made. Further research is suggested and a final, overall conclusion completes the chapter and dissertation.

6.2 SUMMARY OF PREVIOUS CHAPTERS

Chapter 1 introduced the study, which aimed to investigate the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. Important terms in this study were defined, which included the following: audit, audit practice, registered auditor, professional services, sole proprietor and organisation. An overview of the literature was presented with reference to the two main areas which were further elaborated on: the origin, regulation and deregulation of auditing (Chapter 2) and organisational change and audit practices (Chapter 3). This was followed by the problem statement and the objectives of the study. The research methodology, with reference to the research approach, research design, population and sampling, data collection,

trustworthiness of data, data analysis and ethical aspects, was also reflected on in this chapter. Furthermore, reference was made to the significance of the study as well as its limitations and delimitations.

The first part of the literature review of the study was presented in Chapter 2. It commenced by focusing on the origin of and need for auditing and by clarifying the concept of auditing. An overview of the history of auditing was presented with reference to the following periods: Prior to 1840, 1840-1900, 1900-1960, 1960-1990, and 1990 onwards. Agency and stakeholder theories were discussed as the theoretical underpinnings for this study. As an introduction to the main topic of the study, audit deregulation in South Africa, an overview of the literature on the origins and initial development of audit regulation in the UK, USA and South Africa was presented. The development of corporate structures in South Africa was largely influenced by the UK, which was also the first country to remove mandatory audits for SMEs. It became clear from the literature review that auditing in the USA during the 1900s developed much more rapidly than in the UK. It was therefore necessary to include both a UK and US perspective in the discussion on audit regulation. In addition, the regulation of the auditing profession in South Africa was examined. The audit deregulation process in the UK, followed by the same process in South Africa, was presented in the last part of Chapter 2. The first sub-objective, to determine the need for a statutory audit and regulatory reform in relation to mandatory audit relief, as well as the fourth sub-objective, to investigate how mandatory audit relief impacts on small and medium-sized audit practices, were contextualised in this chapter.

Chapter 3 commenced by focusing on the concept of the organisation as well as an explanation of small and medium-sized audit practices as organisations and more specifically, small and medium-sized audit practices in South Africa. The main focus of this chapter was organisational change. The literature review provided a definition of the latter, a framework for it as well as approaches to change. Organisational change is regarded as a process that has wide implications for an organisation's strategy, processes, people and structure. Specific reference was made to three categories of approaches to it: change characterised by the rate of occurrence, change characterised by how it comes

about and change characterised by scale. Different types of change have been discussed but for the purpose of this study, two types of changes were emphasised: Type I and Type II changes. A process-orientated change theory at organisational level was suggested for this study. The Stream Organisation Model of Porras (1987), with specific reference to its four organisational components (organising arrangements, social factors, technology, and physical settings) or the interrelated subsystems of an organisation, was identified as a basis for determining the said impact of mandatory audit relief on small and medium-sized audit practices, considering these as a type of organisation. Reference was made to the meaning of the concept of professionalization as an introduction to the section on organisational change in audit practices, which was followed by a discussion of the factors that drive such change. The relief from mandatory audits introduced by the regulatory reform may be regarded as such a factor, which consequently required these audit practices to decide on how to respond to a changing environment. Continuity planning in practices of this type therefore also received coverage in the literature review. The second sub-objective, to determine the nature of small and medium-sized audit practices, and the third sub-objective, to examine organisational change at organisational level as well as in audit practices, were contextualised in this chapter.

In Chapter 4, the research methodology used in this study was discussed in detail. A qualitative research approach was followed, the reasons being outlined in the chapter. The research design was explained and reference was made to the paradigm, the strategy, the method and the analysis of the data. The paradigm is regarded as a worldview, a research philosophy, a framework of beliefs, values and methods, within which research takes place. Ontology and epistemology were noted as two major ways of thinking about research philosophy; constructivism was identified as the philosophical worldview in this study. For the purpose of this descriptive research, a multiple-case study strategy was followed with semi-structured interviews as the data collection method. The population and units of analysis were mentioned and a detailed discussion followed where the method of selection of cases (and targeted participants) with specific reference to the reasons and criteria, were clarified. Small and medium-sized audit practices in the Pretoria region, according to predetermined criteria,

were identified as cases for the study and their managing partners (also selected in accordance with predetermined criteria) were targeted as participants. To ensure reliability in qualitative research, examination of trustworthiness is essential; therefore it was emphasised that credibility, transferability, dependability and confirmability are four criteria that must be met to generate confidence in the research findings. This study complied with all the ethical requirements, as set out in the chapter. The data analysis process was outlined in terms of data analysis preparation, identification of themes, coding and categorising data and finally integrating the latter. The tool ATLAS.ti™ was used to assist in the data analysis.

Chapter 5 reflected in detail on the findings obtained from the data collected during semi-structured interviews with participants from the three cases: SPs, SAPs and MAPs. The profile of each case and its participants were presented. Thereafter, the views shared by participants of their perceptions and their experiences with regard to the impact of mandatory audit relief on small and medium-sized audit practices were discussed. A cross-case analysis followed and, where applicable, the reader was referred to the relevant sections of the literature review. The main objective of this study, to determine the impact of mandatory audit relief on small and medium-sized audit practices in South Africa, was achieved in this chapter.

6.3 SUMMARY OF FINDINGS

6.3.1 Need for an audit

All small and medium-sized audit practices, which participated in this study, confirmed that there is a need for an audit because an audit provides assurance on the credibility of the financial statements. Two criteria that should be considered when determining the need for an audit for smaller companies are the size of the company and the market demand, as reflected in the public interest in such companies. The majority of SAP and MAP participants and some SP participants, were in favour of the introduction of the mandatory audit relief,

especially because it brought about a cost benefit. However, in contrast to SP and MAP participants, SAP participants believed that the time and effort needed for an independent review is similar to the work done for an audit.

It was mentioned that the mandatory audit relief could lead to fraudulent financial statements - to the detriment of the end user. In addition, the argument was advanced that small company audits could add value; for example, where the management of the client does not have a financial background and lacks the competence to evaluate or interpret financial statements. In such circumstances, clients could be misled by a compilation report which might be misconstrued as an audit report on the related financial statements. Participants expressed concerns regarding the appropriateness of factors taken into consideration when calculating the PIS, such as the size of the company's workforce and turnover, owing to the influence of these factors on the public interest. Recommendations were made that the measure of turnover should be more industry specific and that profit margins may be more reflective of public interest than turnover. It was also suggested that third party liability could be more heavily weighted. The PIS of 350 for compulsory audits was regarded as too low and it was suggested that this should be raised to above 750.

6.3.2 Organisational arrangements

Goals and strategies

The majority of the participants of all three cases identified for this study believed that the mandatory audit relief impacted on the goals of their practices, especially with regard to income generation and service offerings. The greater majority of small and medium-sized audit practices experienced a decrease in the number of audit engagements performed since the introduction of the mandatory audit relief. Consequently, they have decided to change their practices' strategies regarding income generation and service offerings. This resulted in a shift in focus away from audit engagements towards providing non-audit services, including independent review and compilation engagements. Deliberate strategic decisions were taken; the following serve as examples shared by participants:

- The appointment of more SAIPA qualified staff to assist with accounting services.
- The appointment of more permanent qualified staff to perform compilation engagements.
- The offering of expert knowledge to compile IFRS compliant financial statements.

An interesting strategy that emerged as a result of the mandatory audit relief was where one MAP strategized to tender for audits forgone by audit practices that, as a result of the mandatory audit relief, had decided no longer to offer audit services. A SP participant converted his practice to one that was solely an accounting practice, but decided to remain registered as an auditor with the IRBA, to offer services performed by a CA(SA) and RA.

Client profile/size

Although the majority of the small and medium-sized audit practices indicated that the types of services needed by their practices' clients have changed since the introduction of the mandatory audit relief, there was no decrease in their practices' overall client size. Reasons mentioned by SP participants for the increase in their practices' client bases include:

- Fewer young registered auditors entered public practice.
- Some registered auditors closing their audit practices.
- Non-registration or resignation of IRBA members.
- A wider offering in accounting services.

Some small and medium-sized audit practices experienced a decrease in the audit client base, but managed to keep their client bases and fee income stable by, for instance, focusing on a specific industry (e.g. pension funds) and providing more high risk category audits.

Examples of how the client profiles changed as a result of the mandatory audit relief include:

- Distinguishing between compilation service clients and independent review engagement clients.
- Moving away from the very small clients and targeting larger clients who were in need of expert knowledge to compile financial statements compliant with IFRS.

Types of services

It was evident that there were significant changes in the types of services delivered by the SP, SAP, and MAP Participants as a result of the mandatory audit relief. The following are examples of such service offerings:

- Accounting and taxation services.
- Contractual work for other audit practices.
- Factual findings reports.
- BEE services.
- Issuing of EME certificates.
- Advisory services.
- Assisting with financial planners and attorneys.
- Consulting and statutory services.
- VAT and PAYE audits.
- Budget projections.
- Independent review and compilation engagements.

In addition to the above, the largest MAP participant reported that his practice continued performing audit engagements and also offered professional expertise for compiling IFRS compliant financial statements.

Structure

Although the majority of the SP and SAP participants had not experienced any change in their practice structures as a result of the mandatory audit relief, changes were made in some cases. Examples were where practices:

- Provided and acquired other services through fixed agreements with other practices.
- Dissolved a partnership and practiced as a SP due to one partner leaving the auditing profession.
- Functioned in a more structured way between different divisions.
- Split existing entities into divisions, each with a specific focus.
- Appointed more partners to oversee the expanded service offerings.

Human resources

The change in the Companies Act of 2008 impacted variously in this study with regard to the human resources of SPs when compared to SAPs and MAPs. In the case of SPs, the mandatory audit relief did not result in any noteworthy change with regard to their human resources. Conversely, as a result of the decrease in audit work performed by some SAPs and MAPs, the following changes were noted:

- An increase in the number of staff appointed in the accounting departments.
- The additional staff appointed in accounting departments required lesser qualifications than CAs(SA); for example, Professional Accountants (South Africa) registered with SAIPA or persons with university degrees but no professional qualifications.
- More permanent staff appointments.
- More CAs(SA) in management positions.
- More SAIPA and SAICA trainees.

Administration

The mandatory audit relief did not impact on the administration of the vast majority of the small and medium-sized audit practices who participated in this study. However, certain exceptions were mentioned:

- The restructuring process (for example, creating different divisions) in some practices is an administrative burden.
- The compilation of working papers for an audit file as per the IRBA's requirements was regarded as a heavy administrative burden that could shift the focus away from providing assurance, which is the main objective of an audit.
- Changes in technological developments could provide some relief with respect to general office administration.

In contrast, on a positive note, it was mentioned that prior to the mandatory audit relief it had been difficult retaining all the necessary documentation and records for the IRBA's purposes. This administrative burden was significantly reduced by the relief, which led to a decline in IRBA firm inspections.

Systems, policies and procedures

Participants acknowledged that there had been no significant changes in the systems, policies and procedures of their practices as a result of the said relief. One practice had standardised its audit methodologies and, with the use of an electronic tool, could monitor compliance – resulting in an improvement of audit quality. Some audit practices that are registered training offices, referred to changes made to their in-house training programmes to include training relevant to independent review and compilation engagements as well as changes made to work allocation to trainees to ensure that SAICA trainees obtain sufficient audit exposure. The expansion of other service offerings such as advisory services, including the performance of valuations, required the enhancement of in-house training programmes to develop the relevant competencies required to perform

these services. Training was outsourced in cases where practices lacked the capacity to provide the necessary training in-house.

Challenges

From the discussions held with all the participants from the SPs, SAPs and MAPs it became clear that the mandatory audit relief has caused several challenges to small and medium-sized audit practices. The challenges they mentioned were:

- A reduction in audit exposure training opportunities for SAICA trainees.
- Difficulties in attracting SAICA trainee accountants who have completed their postgraduate studies (BCom Honours (CTA) degrees). Much more effort and time has to be spent on initiatives to recruit prospective SAICA trainees who rather prefer to do their traineeship at the Big 4 or larger audit practices. The media and universities were also blamed for creating the perception that small and medium-sized audit practices might not have sufficient audit exposure to train SAICA trainee accountants as a result of the mandatory audit relief. In some instances undergraduate trainees were appointed.
- Difficulties in meeting the SAICA training office requirements (most SPs no longer function as such).
- Increased financial burden caused by the year-on-year fluctuation of the PIS when an audit needs to be retrospectively performed on the opening balances in the financial statements.
- Pressure to decrease fees in order to stay competitive with SAIPA registered accountants for the same non-audit services.
- Cost burden, time and work that are demanded by IRBA firm inspections.
- SARS' need for audited information which is no longer readily available, together with complex and time consuming processes at the SARS office.
- Stressful and time consuming attempts to convince clients to remain with the practice by proposing other valuable service offerings.

Training office

It was clear that in all cases, the mandatory audit relief had a negative impact on the accreditation of the small and medium-sized audit practices that participated in this study as training offices. In several cases the number of SAICA and SAIPA trainees has decreased since the introduction of the mandatory audit relief, to such an extent that the majority of SPs were no longer accredited as SAICA trainee offices. Some negative reasons why small and medium-sized audit practices considered not remaining accredited as training offices with SAICA are:

- SAICA has strict regulatory requirements for audit practices accredited as training offices.
- The training process involves a large amount of administrative work.
- Training of SAICA trainees entails a significant cost burden.
- Acting as a training office with SAICA was more onerous than serving as an ATC with SAIPA.
- Insufficient audit engagements to provide SAICA trainees with the required audit exposure.
- Universities that advised potential trainees to rather choose the SAIPA route.
- The disruption caused in the practice when trainees join and leave the office (even in the case of a SAIPA training office).

Ownership

From the participants' responses it is evident that some audit practices have decided to increase their ownership and others considered merging with other audit practices, while for a third group, there was no change in their practices' ownership. The following reasons were mentioned as the driving force for an increase in the ownership of audit practices:

- The expansion of services.
- The need for assistance and shared responsibility at senior level in the practice.

- Succession planning in order to ensure sustainability.

A MAP participant considering the option to merge with another firm put forward the profession's BEE charter and the need to strengthen the firm's advisory role as further reasons for the increase in ownership.

6.3.3 Social factors

Management style

It may be concluded that the mandatory audit relief did not have a major impact on the management style of the small and medium-sized audit practices in this study. A small number of participants described how the management style, with specific reference to the management structure, has changed. The following examples were mentioned:

- One participant had more time to attend to clients himself.
- More qualified CAs(SA) had to be allocated as audit managers for high risk audits.
- Increased specialisation at partner level.

Staff morale at time of change and currently

From the responses of the participants of SPs, SAPs, and MAPs, it was clear that the mandatory audit relief had no major impact on the morale of their staff. It was explained how specific steps were taken to involve staff at the time when the relief was introduced; in such cases there was no change in staff morale. It was also necessary to assure trainees that adequate training exposure would be provided after the audit relief was implemented. It was even mentioned that the morale of staff has improved since the introduction of the said relief, which is ascribed to reduced work pressure.

6.3.4 Technology

It was evident that the vast majority of small and medium-sized audit practices made no major changes to their information technology (equipment and programs) as a result of the introduction of the mandatory audit relief. The majority of the small audit practices had to acquire supplementary templates for the existing software, Caseware™, for the purposes of independent review and compilation engagements, while sole proprietors still continued to use Caseware™, even if the SPs did not offer any audit engagements.

6.3.5 Physical settings

Only a small number of participants from SPs, SAPs, and MAPs mentioned that their practices have experienced a change in office space/design since the introduction of the mandatory audit relief. The following examples were adduced:

- Expansion of office space due to more staff appointments and, as a result of a split in the practice, providing for an auditing company as well as an accounting company.
- Downscaling of office settings and using clients' business settings or home offices.

6.3.6 Organisational performance

Income streams

The participants' responses made it evident that none of the SAPs or MAPs have experienced a decrease in their practices' income as a result of the mandatory audit relief. Several small and medium-sized audit practices experienced an increase in their practices' income streams from service offerings other than audits, while some also still focused on audit engagements. Although the majority of SPs experienced a decrease in the income from audit engagements, they also focused on expanding their practices' other service offerings in an attempt to

increase the overall income and cater for the loss from audit engagements. A concern was expressed by one SAP participant who expected a significant drop in his practice's income once clients start to opt for mandatory audit relief.

Expenditure

It was mentioned by the majority of SP and SAP participants, that the introduction of the mandatory audit relief caused no major changes in expenditure in their practices. Only minor additional costs related to the acquisition of software templates to accommodate the independent review and compilation engagements and increased monthly paperwork in the accounts department were reported. Two SPs attempted to cut down on overhead costs by moving their practices to home offices.

In contrast to the SP and SAP experiences mentioned above, all MAPs incurred additional expenses due to:

- The appointment of additional staff members.
- The training of staff, particularly pertaining to the outsourcing of some of the training.
- The increased cost of firm inspections by the IRBA.
- Investing in training programmes for additional skills needed.

6.3.7 Sustainability

Practice sustainability

The findings indicated clearly that small and medium-sized audit practices participating in this study took varying approaches to ensure the sustainability of their practices. The different approaches are mentioned below.

- One significant approach specifically referred to was the expansion and diversification of service offerings such as consultation, taxation, accounting

and compilation services. However, it was mentioned that this does not exclude small and medium-sized practices from practicing as auditors.

- Focusing more on non-audit services put one practice in direct competition with professional accounting practices that have partners who are registered with SAIPA, but not SAICA. Nevertheless, the participant in his response was confident that clients would still prefer to make use of the high quality services of CAs(SA) registered with SAICA.
- For a few participants, a focused service offering (taxation), a service offering targeted at a specific market (e.g., the fuel industry) or a service offering focusing on contract work in the public sector, contributed to their practices' sustainability.
- A SAP participant was of the opinion that offering a good quality service at a reasonable price, as well as maintaining a trust relationship with clients, would promote client retention and ensure sustainability.
- A contrasting view focused on eliminating unnecessary costs (such as office rental, luxury or non-essential items and excessive staff) rather than trying to increase the income (by expansion or diversification of service offerings) to ensure sustainability.

In conclusion, it was acknowledged that sustainability, as a result of the audit relief, would remain a constant challenge for the small and medium-sized audit practices in this study.

Future role of auditors

The majority of participants stated that the future role of auditors will continue to be very important. The following remarks were made with reference to this:

- Audits might become more specialised.
- The need for compulsory and voluntary audits will remain and might even increase in future.
- In future, auditors will play an important advisory and management accountancy role for clients.

- The PIS will increase over time, allowing even more small companies to make use of other services.
- Aside from performing an audit, an auditor will also play an important advisory role due to the auditor's strong trust relationship with the client.
- Future auditors will be required to rely on technology developments as a result of the significant role which computers might play in the future of auditing.
- Various parties, including SARS, financial institutions and potential investors rely on audited financial statements and will continue to do so; thus auditors will continue to play an important role.
- Auditors' fees might increase in due course, making it worthwhile for auditors to remain in the auditing profession and this could have negative consequences.
- The services of larger audit practices are very expensive and it is believed that smaller audit practices could offer such services at more affordable rates.
- Anticipated increased pressure on the auditor to report accurately might result in a decline in the number of RAs registered with the IRBA. Remuneration will therefore be the driving factor for CAs(SA) to go on to qualify as RAs.
- A concern was raised about the future role of the small auditor, specifically pertaining to the high cost of practicing as a SP and the challenge of securing a niche market. It was also mentioned that the greatest need of SPs' clients was to obtain assistance for tax purposes. Bearing in mind that since the introduction of the mandatory audit relief, nothing currently distinguishes SPs from accountants, SPs' clients (smaller companies) might prefer the more affordable services of an accountant, rather than those offered by an SP.

Other matters

Other matters related to the sustainability of the small and medium-sized audit practices were reflected upon by the participants. Participants from SPs, SAPs, and MAPs referred to section 90 of the Companies Act 71 of 2008, which

prohibits the auditor from also habitually performing the duties of an accountant or any related secretarial work of his audit client (alone or with a partner or employees) (RSA, 2008). As a result, two professionals (accountant and auditor) are needed to perform the same work, which leads to additional costs for clients and a potential loss of clients and income for small and medium-sized audit practices. It was argued that this challenge may to some extent be overcome by entering into a cooperative agreement with another small audit practice, where one performs the accounting work and the other the audit work. Nevertheless, section 90 of the Companies Act was considered an impractical arrangement and a challenge for small and medium-sized audit practices.

6.4 ACHIEVEMENT OF THE RESEARCH OBJECTIVES

In concluding the study, it is necessary to determine whether the research objectives have been achieved. The objectives of this study were driven by the research problem statement that very limited research had been undertaken on the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. The main objective of the study was to determine this impact. The study devised four sub-objectives to achieve the main objective and to address the identified problem statement. These were as follows:

- Sub-objective 1: to determine the need for a statutory audit and regulatory reform in relation to mandatory audit relief.
- Sub-objective 2: to determine the nature of small and medium-sized audit practices.
- Sub-objective 3: to examine organisational change at an organisational level as well as in audit practices.
- Sub-objective 4: to investigate how mandatory audit relief impacts on small and medium-sized audit practices with reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance, and sustainability.

Table 6.1 Achievement of the research objectives

Objectives	Literature	Findings
Main objective: To determine the impact of mandatory audit relief on small and medium-sized audit practices in South Africa	Chapter 2 Sections: 2.5.1 2.5.2	Chapter 5 Sections: 5.4, 5.5, 5.6, 5.7 Conclusion: The mandatory audit relief as introduced by the Companies Act 71 of 2008 definitely impacted on small and medium-sized audit practices in South Africa. With regard to the themes and sub-themes under investigation in this study, the impact was experienced differently by SP, SAP and MAP participants.
Sub-objective 1: To determine the need for a statutory audit and regulatory reform in relation to mandatory audit relief	Chapter 2 Sections: 2.2.2 2.2.3 2.2.4	Chapter 5 Sections: 5.4.2, 5.5.2, 5.6.2, 5.7.2 Conclusion: All small and medium-sized audit practices which participated in this study emphatically confirmed that there is a need for an audit because it provides assurance on the credibility of the financial statements. Some participants perceived that small company audits could add value, for example where a client does not have the competence to interpret financial statements or the level of assurance provided by compilation reports. The majority of the participants were in favour of the mandatory audit relief for companies with limited public interest especially because it brought about a cost benefit. However, it was mentioned: <ul style="list-style-type: none"> • that the mandatory audit relief could lead to fraudulent financial statements, to the detriment of the end user; • that the PIS score of 350 for compulsory audit is too low and should be raised to above 750; • that factors (such as turnover and the number of employees) taken into consideration in calculating the PIS are not necessarily truly reflective of public interest; and • (by SAP participants) that the time and effort needed for an independent review is similar to the work done for an audit.
Sub-objective 2: To determine the nature of small and medium-sized audit practices	Chapter 3 Sections: 3.2.2 3.2.3 3.2.4	Chapter 5 Sections: 5.2, 5.4.1, 5.5.1, 5.6.1 Tables: 5.1, 5.2, 5.4, 5.5, 5.6 Conclusion: From the literature, it was difficult to find a practical definition of small and medium-sized practices, as well as the economic importance of the small audit segment. However there are several common characteristics that describe small and medium audit firms.

Objectives	Literature	Findings
		<p>The IRBA, the audit regulator in South Africa, stipulates a practice classification for all of the practices that it registers based on two criteria: size and race. For the purpose of this study the IRBA classification was used as a basis to identify the small and medium-sized audit practices for the study.</p>
<p>Sub-objective 3: To examine organisational change at organisational level as well as in audit practices</p>	<p>Chapter 3 Sections: 3.3 3.4 3.5 Table 3.1 Table 3.2</p>	<p>Chapter 5 Sections: 5.4, 5.5, 5.6, 5.7 Conclusion: Change should be acknowledged as an integral component of the organisation. From the literature it became clear that the introduction of the mandatory audit relief was a factor which led to change in small and medium-sized audit practices. The findings revealed that those audit partners who regarded and accepted change as being a common feature of daily functioning such as leadership, altered their forms of practice and consequently, not only survived the change, but used it and prospered.</p>
<p>Sub-objective 4: To investigate how mandatory audit relief impacts on small and medium-sized audit practices with reference to the need for an audit, organisational arrangements, social factors, technology, physical settings, organisational performance, and sustainability</p>	<p>Chapter 2 Sections: 2.5.1 2.5.2 Chapter 3 Sections: 3.5.2 3.5.3</p>	<p>Chapter 5 Sections: 5.4, 5.5, 5.6, 5.7 Conclusion: The mandatory audit relief significantly impacted on the small and medium-sized audit practices included in this study with regard to the following themes and/or sub-themes:</p> <ul style="list-style-type: none"> • Goals and strategies. • Types of services. • Human resources of SAPs and MAPs. • Challenges. • Training offices. • Income streams. • Sustainability. <p>The mandatory audit relief did not have a significant impact on these small and medium-sized audit practices with regard to the following themes and/or sub-themes:</p> <ul style="list-style-type: none"> • Client profile/size. • Structure. • Human resources of SPs. • Administration. • Systems, policies and procedures. • Ownership. • Social factors. • Technology. • Physical settings. • Expenditure.

6.5 CONTRIBUTIONS OF THE STUDY

The literature review revealed a lack of research with reference to the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. The findings of this study contribute to the existing body of knowledge and provide valuable information to the following role-players in the field of auditing in the ways described below:

- Current and potential small and medium-sized audit practitioners could put into practice the positive findings from SPs, SAPs and MAPs in order to manage the negative impact of the relief on their practices.
- The DTI, as the South African regulator for corporate law, should consider the practical impact and positive benefits and/or challenges experienced by the SPs, SAPs and MAPs as a result of the implementation of the relief as introduced by the Companies Act 71 of 2008, for the purposes of future regulatory change.
- The findings could assist the IRBA, as the regulatory body responsible for regulations and standards in the auditing profession in South Africa, with future amendments, evaluating its firm inspection policy and the IRBA competency framework regarding the auditing profession.
- SAICA, which is responsible for determining competencies and training of CAs(SA), might take into consideration the responses from the SPs, SAPs and MAPs which are accredited, and practice, as training offices regarding the impact of the said relief. Where necessary, such information could assist SAICA to evaluate the current training requirements and consider amendments, to adapt continuing professional development offerings for small and medium-sized audit practitioners and to inform possible changes to the SAICA competency framework.
- Educators could integrate the insight from the findings into the practical application of the knowledge content to ensure that students are well prepared to qualify as CAs(SA) and registered auditors. Educators should furthermore avoid creating negative perceptions regarding the inability of

small and medium-sized practices to provide sufficient training for prospective CAs(SA).

- The study clarifies concerns and uncertainties of prospective trainees regarding the impact of mandatory audit relief on small and medium-sized audit practices that will enable them to make informed decisions in selecting audit practices for their required practical training.

6.6 RECOMMENDATIONS

From the findings of the study, a number of recommendations are made which can be beneficial to the different role-players in the field of auditing. The role-players are: small and medium-sized audit practitioners; the DTI as the South African regulator for corporate law; the IRBA as the regulatory body responsible for regulations and standards in the auditing profession in South Africa; SAICA, which is responsible for determining the competencies and training requirements of CAs(SA); universities and educators of prospective CAs(SA) and audit trainees. Recommendations for each of the role-players are mentioned below.

6.6.1 Small and medium-sized audit practitioners

With regard to small and medium-sized audit practitioners, the following recommendations are made in general for SPs, SAPs, and MAPs:

- Apart from performing audit engagements, the expansion and/or diversification of other service offerings are recommended. Such services were described above.
- Small and medium-sized audit practices, in order to keep the client base and fee income stable, could consider focusing on a specific industry.
- Changes in technological developments could be considered to provide relief with respect to general office administration.
- Changes should be made to in-house training programmes to align staff training in accordance with all service offerings.

Further recommendations follow with specific reference to each of the three cases: SPs, SAPs and MAPs.

SPs

- The future role of the small auditor, specifically pertaining to the high cost of practicing as an SP focusing exclusively on auditing, is questionable. It is therefore recommended that SPs should secure a niche market (focus on a specific industry or specific service offering) and/or adjust their business models to remain competitive in providing other service offerings.
- To ensure sustainability, SPs should consider cost savings, for example to make use of home office space rather than incurring office rental expenses.

SPs and SAPs

- It is recommended that smaller audit practices (SPs and SAPs) should consider changing their practice structures, particularly where an expansion in service offerings has been implemented. Suggestions in this regard are: providing other services through fixed agreements with other practices or functioning in a more structured way between different divisions, with a specific focus.

SAPs and MAPs

- From the findings it was clear that it may not be feasible for SPs to remain accredited as training offices with SAICA; however, training provided by SAPs and MAPs could be comparable with that of the larger audit practices. It is therefore recommended that MAPs, in particular, should remain as accredited training offices with SAICA, provided that audit exposure of trainees is properly planned and the MAPs business models are accordingly aligned.

- SAPs and MAPs could improve awareness about their training offerings, for example by arranging open days at their offices, attending open days at universities and offering vacation work to prospective SAICA trainees.

MAPs

- It is furthermore recommended that bigger audit practices (MAPs) need to structure themselves in accordance with their types of service offerings.
- MAPs could strategize to tender for audits foregone by audit practices that, as a result of the introduction of the mandatory audit relief, decided not to offer audit services any longer.

6.6.2 The DTI

The DTI, as the South African regulator for corporate law that ensures a regulatory framework to promote growth, innovation, stability, good governance and international competitiveness, should consider the size of a company and the market demand as two criteria when determining the need for a small company audit. These could be reflected in the PIS. The following could be considered to adjust the PIS:

- The turnover indicator should be industry specific.
- Profit margins should be considered as an alternative to turnover.
- The weighting associated with the size of the company's workforce in the PIS should decrease.
- The weighting of third party liability to be increased.
- The PIS of 350 for compulsory audits could be raised to above 750.

Section 90 of the Companies Act 71 of 2008 was regarded as impractical and as presenting challenges for small and medium-sized audit practices. It is therefore recommended that section 90 needs to be revisited.

6.6.3 The IRBA

The IRBA, as the regulatory body for the auditing profession in South Africa, should take note of the view of the SAP participants who remarked that the time and effort needed for an independent review is similar to work done for an audit. This view contradicts the general opinion expressed in the other two cases. Therefore the IRBA should consider expanding on CPD offerings, with specific focus on the difference between audits and independent review engagements.

Furthermore, the IRBA should also be aware of the significant administrative burden on small and medium-sized audit practices in preparation for firm inspections. Participants specifically mentioned the cost burden, time and work that are demanded by these. A review of the process to identify areas for revision is therefore recommended.

There is a need to increase the public profile of the small company auditor. The IRBA could promote the role and value of such an auditor as advisor in a public forum to encourage small companies to use the services of SPs, SAPs and MAPs.

6.6.4 SAICA

SAICA, which is responsible for determining competencies and training of CAs(SA), should evaluate the current training requirements and consider amending continuing professional development offerings for small and medium-sized audit practitioners and the SAICA competency framework accordingly.

6.6.5 Educators and prospective trainees

Educators and prospective trainees should take note of the concern mentioned by participants of small and medium-sized audit practices regarding universities that advised potential trainees rather to choose the SAIPA route. It is therefore recommended that information provided to prospective trainees should not be

biased and that potential trainees obtain information from a variety of sources before deciding on a future profession.

6.7 SUGGESTIONS FOR FURTHER RESEARCH

Based on the findings of this study, suggestions for future research include:

- A quantitative study, by means of a survey, to evaluate the impact of section 90 of the 2008 Companies Act on small and medium-sized audit practices could be undertaken. This section prohibits the auditor from also habitually performing the duties of an accountant or any related secretarial work of his audit client (whether alone or with a partner or employees). Although it has been identified as a challenge, the impact of this section on small and medium-sized audit practices has not been quantified.
- An investigation into the economic importance of small audit clients and small audit practices could be performed. Although audit markets have been extensively studied over the past three decades, the research has focused mainly on larger audit firms.
- The longevity of small and medium-sized audit practices as training offices in comparison to larger audit practices should be examined.
- Since this study only focused on the lower end of the audit landscape (small and medium-sized audit practices) the impact of mandatory audit relief on the Big 4 and larger audit practices should be evaluated.
- Research into the impact of mandatory audit relief over a longer period of time should be undertaken, since this study could only investigate a short period (four years) of time.
- An examination of the appropriateness of the current PIS levels in practice as well as the factors taken into consideration to calculate the PIS in order to determine how the PIS should be revised, should be performed.

6.8 OVERALL CONCLUSION

The main objective of this study was to determine the impact of mandatory audit relief on small and medium-sized audit practices in South Africa. The study generated profoundly important information to achieve this objective. In accordance with the consequences of the various amendments to the UK legislation from 1994 to 2015, which introduced and expanded the scope of audit exemption as mentioned in the introduction of this study (Chapter 1), the relief from the mandatory audit as a result of the change in the 2008 Companies Act with reference to certain components of an organisation, impacted significantly on small and medium-sized audit practices in South Africa.

At the beginning of the study, there was a display of interest as to whether mandatory audit relief, as implemented in South Africa in 2011, tipped the scale favourably towards small and medium-sized audit practices. The conclusion drawn was that the unfavourable consequences of the mandatory audit relief impacted most significantly on SPs, and to a lesser extent on SAPs, in comparison to the impact of the positive consequences in the case of MAPs.

The words of Porras (1987:ix) as presented in Chapter 3 have been adapted to conclude this study:

Those who viewed the mandatory audit relief as something to resist and overcome have atrophied and died. Those who seized it, used it, flowed with it, integrated it, and accelerated it, have, by and large, flourished and prospered.

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ANNEXURE A

QUESTIONNAIRE – AUDIT PRACTICE PROFILE

Date of incorporation: _____
mm/yr

Profile of Audit Practice	Prior to 2008 Companies Act	Current
Number of partners		
Staff composition		
<ul style="list-style-type: none"> • Number of Managers 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Division: _____ 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Division: _____ 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Division: _____ 		
<ul style="list-style-type: none"> • Number of Trainee Accountants: 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ SAICA 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ SAIPA 		
<ul style="list-style-type: none"> • Qualifications of staff (excluding partners) 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Number of CA's 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Number of post-graduate staff 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Number of graduate staff 		
<ul style="list-style-type: none"> <ul style="list-style-type: none"> ▫ Other, studying towards Accounting degree 		
Number of assurance clients		
Services (% of total income)		
<ul style="list-style-type: none"> • Auditing 		
<ul style="list-style-type: none"> • Accounting – clients subject to audits by other firms 		
<ul style="list-style-type: none"> • Accounting – clients not subject to audits 		
<ul style="list-style-type: none"> • Tax 		
<ul style="list-style-type: none"> • Forensic 		
<ul style="list-style-type: none"> • Advisory 		
<ul style="list-style-type: none"> • Payroll 		
<ul style="list-style-type: none"> • Secretarial 		

Impact of the change

How did the amendment to the Companies Act influence on your practice's income?

Increase	
Decrease	
No change	

Indicate the extent of the above change (if applicable)

<10%	10% – 25%	25% – 50%	50% - 75%	>75%

ANNEXURE B

SEMI-STRUCTURED INTERVIEW QUESTIONS

NEED

1. What is your view on the need for an audit?
2. What is your view on audit relief for companies as specified in the Companies Act sec 30?

CHANGE IN PRACTICE - ORGANISATIONAL ARRANGEMENTS

3. How did your practice's **goals** change as a result of the relief from mandatory audits as stipulated in the Companies Act of 2008?
4. What was the impact of this change on your practice's **strategies**?
- 4a. What was the impact of the change on your practice's client profile and size of your client base?
- 4b. What was the impact of the change on the type of services that your practice provides?
5. After implementation of the Companies Act with regards to the relief from mandatory audits, how did this impact your practice's organisational **structure**?
- 5a. What was the impact of the change on your practice's human resources? (staff/qualifications/levels)
6. Has your practice experienced any **administrative** changes due to the relief from mandatory audit in terms of the Companies Act?
- 6a. How did your practice's **systems, policies and procedures** for the development of trainee accountants (in-house development and training programmes - specifically with regards to audits) change?
7. Explain the current **organisational** challenges that your practice experiences as a training office?
8. Have there been any changes in the **ownership** of your practice (e.g. merger) as a result of the relief from mandatory audits as stipulated in the Companies Act of 2008?

CHANGE IN PRACTICE – SOCIAL FACTORS

9. After the implementation of the Companies Act with regards to the relief from mandatory audits, how did this impact your practice's **management style**?
10. How did you manage the impact of the relief from mandatory audits on your staff's morale?
11. How does the current audit environment influence your staff's morale?

CHANGE IN PRACTICE – TECHNOLOGY

12. What was the impact of the change on your practice's **technology** (equipment/information technology)?

CHANGE IN PRACTICE – PHYSICAL SETTING

13. Has the change had any impact on your practice's **physical setting** (office space/design)?

CHANGE IN ORGANISATIONAL PERFORMANCE

14. What was the impact of the change on your practice's income streams?
15. What was the impact of the change on your practice's expenditure?
16. How is your practice going to ensure to maintain sustainability?

FUTURE

17. How do you see that the role and responsibilities of auditors will change in future?

OTHER

18. Do you have any other comments?

ANNEXURE C



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA

FACULTY OF ECONOMIC AND
MANAGEMENT SCIENCES

RESEARCH ETHICS COMMITTEE

Tel: +27 12 420 3395

E-mail: ronel.rensburg@up.ac.za

6 March 2015

Strictly confidential

Prof K Barac
Department of Auditing

Dear Professor Barac

Project: The impact of mandatory audit relief on the audit practice
Researcher: C Coetzee
Student No: 23210452
Promoter: Prof K Barac
Co-promoter: Ms J Seligmann
Department: Auditing

Thank you for the application you submitted to the Committee for Research Ethics, Faculty of Economic and Management Sciences.

I have pleasure in informing you that the Committee formally approved the above study on 25 February 2015. The approval is subject to the candidate abiding by the principles and parameters set out in the application and research proposal in the actual execution of the research.

The approval does not imply that the researcher, student or lecturer is relieved of any accountability in terms of the Codes of Research Ethics of the University of Pretoria if action is taken beyond the approved proposal.

The Committee requests that you convey this approval to the researcher.

We wish you success with the project.

Sincerely

PROF RS RENSBURG
CHAIR: COMMITTEE FOR RESEARCH ETHICS

cc: Ms J Seligmann
Student Administration

Members: Prof RS Rensburg (Chair); Prof R van Eyden(Deputy Chair); Dr WM Badenhorst ; Prof HE Brand; Prof DJ Fourie;
Prof JF Kirsten; Prof BA Lubbe; Prof MC Matthee; Prof SG Nienaber; Ms K Plant; Dr M Reyers; Prof R van Eyden;
Prof C van Heerden; Prof JJ van Vuuren; Prof M Wiese
Administrative officer: Mr M Deyssel

ANNEXURE D



UNIVERSITEIT VAN PRETORIA
UNIVERSITY OF PRETORIA
YUNIBESITHI YA PRETORIA
Faculty of Economic and
Management Sciences

Combined Letter of Introduction and Informed Consent

Dept. of Auditing

The impact of mandatory audit relief on the audit practice

Research conducted by:

Miss C Coetzee (23210452)

Cell: 082 323 6818

Dear Participant

You are invited to participate in an academic research study conducted by Carla Coetzee, Masters student from the Department Auditing at the University of Pretoria.

The purpose of the study is to investigate the impact of the mandatory audit relief on small and medium-sized audit practices in South Africa.

Please note the following:

- This is an anonymous study survey as your name will not appear on the questionnaire. The answers you give will be treated as strictly confidential as you cannot be identified in person based on the answers you give.
- Your participation in this study is very important to us. You may, however, choose not to participate and you may also stop participating at any time without any negative consequences.
- Please answer the questions in the interview as completely and honestly as possible. This should not take more than 1 hour of your time.
- The results of the study will be used for academic purposes only and may be published in an academic journal. We will provide you with a summary of our findings on request.
- Please contact my study leader, Prof K Barac (karin.barac@up.ac.za), if you have any questions or comments regarding the study.

Please sign the form to indicate that:

- You have read and understand the information provided above.
- You give your consent to participate in the study on a voluntary basis.

Participant's signature

Date

Jan 2014

APPLICATION FORM
Ethics Clearance