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THE IMPLEMENTATION OF MANDATORY AUDIT FIRM ROTATION AS TOOL TO ENHANCE AUDIT REFORM IN SOUTH AFRICA: A CASE OF KWAZULU-NATAL

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Abstract:
Using a quantitative research method, this article examined the perceptions of audit experts concerning the influence of mandatory audit firm rotation on audit reform (A.R.) in the province of KwaZulu-Natal. Data was gathered from 102 audit experts knowledgeable in accounting and auditing from Tier 2 audit firms and two public institutions and used for data analysis. The empirical results of this study were two-fold. Firstly, the descriptive statistics provided a general overview of the respondents' opinions. The majority of respondents agreed that MAFR implementation would strengthen audit reform, thereby validating the initial position of the Independent Regulatory Board of Auditors. In addition, most participants agreed that the ramification of the imposition of additional costs could be addressed. Moreover, using SPSS on ordinal logistic regression also found that the probability of a decrease in the progress of audit reforms is significantly higher when mandatory audit firm rotation is in place, and a non-significant positive predictor of mandatory audit firm rotation would increase audit independence. This article contributes to existing knowledge and the continuous discourse on mandatory audit firm rotation rule in South Africa. Conclusively, the study, therefore, recommends that since the research was limited to Kwazulu-Natal, future studies should broadly include registered auditors and academics from institutions and firms in different South African provinces to obtain diverse views about pre-and post-implementation of the rule in 2023 to compare the effects of the policy on audit independence.

Keywords: Independent Regulatory Board of Auditors, Mandatory Audit Firm Rotation, Audit Reform, and Audit Quality

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INTRODUCTION

Global crisis and a sharp increase in accounting scandals such as Sunbeam, Global Crossing, Enron and WorldCom, and most recently Steinhoff has shocked the public and caused policymakers and regulators to significantly reconsider the need for MAFR, which aims to enhance audit reform (A.R.), audit Quality and audit Independence (Harris & Whisenant, 2012; Porter et al., 2008; Rossouw & Styan, 2021). The urgency to adopt MAFR has also been magnified by the perceived failure of traditional audits to alert entities' stakeholders to financial and economic crimes fully and raised serious doubts regarding the credibility of audited financial statements (Rossouw & Styan, 2021).

Leisure-net, Randgold, and Regal Bank are examples of companies in South Africa, the auditors of which have been accused of improper conduct (Marques & Cerbone, 2018). Although MAFR was hotly debated among policymakers, regulators, auditing professionals, and academics,

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South African policymakers still needed to implement it. The discourse about MAFR has recently resurfaced because of corporate governance failures in the country, which have drawn attention to the role of auditors. Revelations by the Zondo Commission of Inquiry into Allegations of State Capture highlighted the role of audit firms (Sekise, 2021). This coincided with the unsettled debate about the impact of MAFR on A.R., with studies providing conflicting results in support of or against the policy. Policymakers, regulators, and the audit profession face pros and cons regarding adopting and implementing MAFR (Harber & Hart, 2018). Proponents of MAFR, such as Azzali, Mazza, Reichelt, and Wang (2021), soundly argue that the requirements enhance auditor independence through fresh eyes and reduce the probability of familiarity threats.

Meanwhile, opponents of MAFR, such as Ramaswami Narayanaswamy and Kannan Raghunandan (2019), argue that MAFR, after a certain period produces an inefficient audit simply because of the high start-up costs of an initial audit. Horton, Livne, and Pettinicchio (2021) concur that understanding the client's business and industry takes time, a key factor for risk-based audits. SAICA (2016a) argues that the policy will protect investors and contribute to transformation by creating opportunities for previously disadvantaged firms.

One of the reasons IRBA formulated the MAFR policy was to decrease audit market concentration due to the dominance of the Big 4. Bleibtreu and Stefani's (2018) research results support the IRBA's decision by indicating that MAFR would decrease audit market concentration and increase A.R. Moreover, other studies found that it would introduce a fresh mindset into the market whereby auditors would serve the public interest rather than satisfying their clients (Rong, 2017; Sulistyo et al., 2019).

Some studies disagree with the IRBA's decision. For example, R Narayanaswamy and Kannan Raghunandan (2019) argue that owing to capacity issues and a lack of capital, it will be tough for tier 2 audit firms to compete with the Big 4, and MAFR will further create more concentration in the end. Choi, Lim, and Mali (2017) maintain that adopting MAFR could potentially lead to losing client-specific knowledge, which will be adverse. Interestingly, in response to corporate scandals and auditor misconduct, there has been an increase in the call for audit reform (A.R.) and stringent regulations concerning A.I. and A.Q. Consistent with the argument made by MAFR proponents, therefore this paper test whether or not MAFR can enhance A.R. in KwaZulu-Natal, South Africa. Our paper will provide significant input to countries considering MAFR adoption and implementation or that have already adopted MAFR. This article contributes to existing knowledge and the continuous discourse on MAFR rule in South Africa. The study will grant more understanding to interested parties in the auditing profession regarding the dynamics of the audit industry concerning the logical connections between MAFR and A.R.

The remainder of the article is organized as follows: The next section presents empirical literature. The third describes the research methodology; the fourth section presents the study's empirical results and discussion. The final section offers the study's conclusions and contribution to the science, limitations, and suggestions for future research.

METHODS

The article adopted a descriptive research design strategy, the positivism paradigm philosophy. This paradigm leads to study outcomes through the statistical analysis and interpretation of numerical data (Watson, 2015). The population was audit experts from accounting and auditing firms in KwaZulu-Natal and academics whose perceptions of the implementation of MAFR and its relationship with A.R. might lead to valuable insights into the phenomenon (Teoh & Lim, 1996). The study described in this dissertation was inspired by the questionnaire survey of K. Said and H. Khasharmeh (2014), who investigated the perceptions of auditors regarding MAFR,

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and that of Gwala and Nomlala (2021), who examined students' perspectives. The sample size of 133 out of 169 firms and institutions was determined through the method recommended by (Israel, 1992; Yamane, 1967). It was adequate for the desired level of precision and confidence. The purposive non-probability sampling method led to the selection of audit experts with in-depth knowledge of MAFR, AR, and the variables of interest based on the researcher's judgment (Cresswell & Plano Clark, 2011; Etikan et al., 2016). The researcher also used quota sampling to select participants based on their belonging to two sub-groups: tier 2 auditors and academics from two tertiary institutions accredited by SAICA in KZN who were chartered accountants (Sekaran & Bougie, 2016). The researcher distributed 168 anonymous online questionnaires approved by UKZN HSSREC to chartered accountants (CAs), registered auditors, audit partners, audit managers, and academics.

One hundred two questionnaires were returned out of 168, despite the researcher's efforts to persuade the remaining participants to complete the survey. However, the response rate of 60.7% was acceptable and indicated that the researcher would be able to draw conclusions based on the findings because, as pointed out by Fincham (2008), for research to reach its goal, a survey should receive a response rate not less than 60%. Robustness analysis was performed using Scientific Package for Social Sciences (SPSS) version 27, which analyzed the data to produce descriptive and inferential statistics. Chi-square analysis determined whether the variables were associated or independent. Cronbach's alpha was calculated for 20 questionnaire items was .796 to measure its internal consistency and was found to be acceptable and reliable (Goforth, 2015).

RESULT AND DISCUSSION

Table 1. Age and Gender Classification of Respondents

Age variable	Frequency(F)	Valid percentage (V.P.)	Gender variable	F	V.P.
25 – 30	8	7.8	Male	66	64.7
31 – 40	46	45.1	Female	35	34.3
40+ years	48	47.1	**Total**	**101**	**100**

Source: Authors' compilation.

Table 2. Race Classification of Respondents

Race variable	F	V.P.
African	26	25.5
Indian	50	49.0
Colored	6	5.9
White	20	19.6
Total	102	100.0

Source: Authors' compilation.

Table 3. Respondents' Highest Academic And Professional Qualifications

Academic qualification variable	F	V.P.	Professional qualification variable	F	V.P.
Bachelor's degree		1.0	CA – SA	101	99.0
Honor's degree	6	76.0	CA – Others	1	1.0
Master's and doctoral degree	23	23.0	Total	102	100.0
	100	100.0			

Source: Authors' compilation.

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Table 4. Positions Held by Respondents and Their Work Experience

Position variable	F	V.P.	Work experience variable	F	V.P.
Audit partner	91	89.2	Less than five years	11	11
Lecturer – Auditing	9	8.8	5 – 10 years	36	36
Lecturer – Others	2	2.0	11 – 20 years	36	36
			Greater than 20 years	17	17
Total	**102**	**100**	**Total**	**100**	**100**

Source: Authors' compilation.

Table 5. Number of Employees in Tier 2 Audit Firms and Institutions As Well As Employment Status

Number of employees' variable	F	V.P.	Employment status variable	F	V.P.
Tier 2 audit firm employees in KZN	91	89.2	Full time	90	91.8
Institution 1 employees	8	7.8	Part-time	8	8.2
Institution 2 employees	3	2.9	Total	98	100.0
Total	**102**	**100.0**			

Source: Authors' compilation.

Table 6. Responses About the Implementation of Mandatory Audit Firm Rotation on 2023

Participants' entity variable	Yes	No	Uncertain	Total	Yes-VP	No - VP	Uncertain-VP
Tier 2 firms	79	2	10	91	77.45	1.96	9.80
Institutions 1 & 2	11	-	-	11	10.78	-	-
Total audit experts	**90**	**2**	**10**	**102**	**88.23**	**1.96**	**9.80**

Source: Authors' compilation.

The data analysis revealed that 65.3% of the respondents (66) were male, while 34.7% (35) were female. Age distribution showed that 47.1% (48) of the respondents were 40 years older and above, whereas 45.1% (46) were between the ages of 31 and 40 years old, and 7.8% (8) were between 25 and 30 years.

As shown in Table 1 above, data analysis results further revealed that 49.0% of the participants were Indians, 25.5% were Africans, 19.6% were Whites, and 5.9% were Coloureds.

The results of the data analysis further showed that most respondents reported having an honors degree (76.0%), 23.0% had a master's or doctoral, and 1.0% had a bachelor's degree. The results revealed that 99.0% of the respondents were C.A.s affiliated with SAICA, and 1.0% were C.A.s affiliated with other professional accounting bodies.

As shown in Table 1 above, the data analysis showed that 89.2% of the respondents (91) were audit partners and R.A.s affiliated with IRBA, while 8.8% were auditing lecturers from two SAICA institutions in KZN, and 2.0% were professional auditing participants. However, they were lecturers in different accounting disciplines, as shown in Table 1 above. Furthermore, 36% of the respondents had worked between 11 and 20 years, 36% had worked between 5 and 10 years, 17% had worked for over 20 years, and 11% had worked for less than five years.

As illustrated in Table 1 above, employees from tier 2 audit firms were 89.2% of total respondents, while 7.8% and 2.9% were from Institutions 1 and 2, respectively. The data analysis revealed that 91.8% of the respondents (90) were full-time employees, while eight worked part-time.

Finally, the results of the data analysis revealed that 88.2% of the respondents (90), who were R.A.s and academics, indicated that the firms that employed them supported the implementation of

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MAFR. However, 2.0% (2), who were also R.A.s and academics, indicated that their firms did not support it, and 10 (9.8%), who were R.A. and academics, were uncertain.

Of the audit experts from tier 2 firms, 79 (86.8%) said that their firms supported the implementation of MAFR, whereas 2 (2.2%) indicated that their firms did not support it, and 10 (11%) were uncertain. All 11 respondents who were academics from institutions 1 & 2 in KZN agreed that their institutions supported the implementation of MAFR. Respondents were allowed to give their opinion on the implementation of MAFR being applied to firms that audit public companies. The results of the data analysis indicated that 88.2% (90) agreed, whereas 1.96% (2) disagreed, and 9.8% (10) were uncertain. The study further enquired whether, as audit experts or professionals, respondents had ever experienced some rotation during their working years. The data analysis revealed that 56.9% (58) of the respondents indicated no, 37.3% (38) indicated yes, and 4.9% (5) were uncertain.

Perceptions of key audit experts on whether or not mandatory audit firm rotation affects audit Reforms. Most respondents agreed that although many internal and external factors influence the implementation of MAFR, it intends to ensure audit reform by encouraging A.I. and A.Q., which might be hindered when firms have too long a tenure. Moreover, most respondents agreed that MAFR would contribute to audit reform by decreasing market concentration because Big 4 firms will no longer be a dominant force in the market, thereby allowing tier 2 firms to compete with them. These results differ from those of Harber and Marx (2019b), who argue that MAFR could increase the domination of larger audit firms that enjoy long tenures.

Respondents mostly neither agreed nor disagreed that MAFR would contribute to audit reform by ensuring a decrease in the market concentration of Big 4 firms who will no longer be a dominant force in the market, thereby allowing tier 2 firms to compete. This result agrees with that of Bleibtreu (2018), who mentions that MAFR weakens the audit market dominance of the Big 4. However, R Narayanaswamy and Kannan Raghunandan's (2019) study concluded that MAFR increases the concentration of big audit firms in the industry and therefore is not a determinant of audit quality.

Indyk (2019) suggests that Big Four audit firms gain in many different ways from MAFR because of their ability to maximize their strong bargaining power. However, SAICA (2016a) argues that MAFR addresses the problem of audit market concentration and advances transformation by creating opportunities for tier 2 firms to penetrate previously unwelcoming markets.

Respondents agreed that MAFR would lead to A.R. by increasing investor trust in the audit profession because of increased A.I. and A.Q. However, Pouwels (2017) found that A.Q. is influenced by the rotation of firms in countries with strong investor protection but negatively influenced in those with weak investor protection (Pouwels, 2017).

Most respondents agreed that tier 2 audit firms might now have to engage in partnership agreements with large firms to serve clients as one entity since they may need more human resources and expertise to audit big companies when MAFR is implemented. The above response is consistent with the arguments of Franzl (2004) as well as R Narayanaswamy and Kannan Raghunandan (2019), who maintain that owing to capacity and capital limitations, tier 2 audit firms may not be able to compete with the Big 4, which would lead to continuing market concentration.

Respondents mostly agreed that some academics and researchers in the auditing profession maintain that implementing the MAFR rule can be very disruptive to organization planning and can also increase start-up costs, which tier 2 audit firms may need help to afford. This result supported the arguments of (Gomber et al., 2018; K. et al. Khasharmeh 2014), and Tertius et al. (2017.

Many respondents agreed that MAFR would promote opportunities for tier 2 audit firms to enter the market if they have the capacity and competency. This was one of the IRBA's aims in formulating the policy. Moreover, this research result was consistent with a survey of audit firms in India, which concluded that varying the audit market structure significantly provided opportunities to firms that only had them after (Thornton, 2016). Table 2 below depicts questions addressing the main aim of this research and the results of the analysis of the responses.

Table 7. Perceptions of key audit experts on whether or not mandatory audit firm rotation affects audit Reforms

Question No	Statement	Mean	Std	N
Q26	Although many internal and external factors influence the implementation of MAFR, it intends to ensure that public accounting firms remain objectively independent and professional, which will lead to quality audits.	3.95	0.495	102
Q27	MAFR will contribute to higher market concentration because large companies always choose Big Four auditors when switching their audit firms, thereby impeding transformation.	3.76	0.892	102
Q28	MAFR will decrease market concentration because Big 4 firms will no longer dominate the market, allowing Tier 2 firms to compete.	3.24	1.351	102
Q29	The implementation of MAFR would lead to an increase in investor trust in the audit profession because of increased auditor independence and audit quality.	4.26	0.562	102
Q30	Tier 2 audit firms might have to partner with large firms to serve clients as one entity since they may need more human resources and expertise to audit big companies when MAFR is implemented.	3.91	0.902	102
Q31	Some academics and researchers in the auditing profession maintain that implementing MAFR might be very disruptive to organization planning and increase start-up costs, which tier 2 audit firms may need help to afford.	3.99	0.995	101
Q32	MAFR will promote the creation of opportunities for tier 2 audit firms to enter the market if they have the capacity and competency.	4.18	0.505	99

Source: Designed by the researcher using output from SPSS version 27.

With an SD of 0.495 and a mean of 3.95, which is approximately 4, 102 respondents agreed that although many internal and external factors influence the implementation of MAFR, it intends to ensure that public accounting firms remain objectively independent and professional, which will lead to quality audits. In addition, with an SD of 0.892 and a mean of 3.76, which is approximately 4, 102 respondents agreed that MAFR will contribute to higher market concentration because large companies always choose Big Four auditors when switching their audit firms, thereby impeding transformation.

With an SD of 1.351 and a mean of 3.24, which is approximately 3, 102 respondents neither agreed nor disagreed that MAFR would contribute to a decrease in market concentration because Big 4 firms will no longer be a dominant force in the market, thereby allowing tier 2 firms to compete with them. In addition, with an SD of 0.562 and a mean of 4.26, equivalent to 4, 102 respondents agreed that implementing MAFR will increase investor trust in the A.P. because of increased A.I. and A.Q.

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With an SD of 0.902 and a mean of 3.91, which is approximately 4, 102 respondents agreed that tier 2 audit firms might have to engage in partnership agreements with large firms to serve clients as one entity since they may not have enough human resources and expertise to audit big companies when MAFR is implemented. In addition, with an SD of 0.995 and a mean of 3.99, which is approximately 4, 102 respondents agreed that some academics and researchers in the A.P. maintain that the implementation of MAFR might be very disruptive to organization planning and also increase start-up costs, which tier 2 audit firms may not be able to afford.

With an SD of 0.505 and a mean of 4.18, approximately 4 99 respondents agreed that MAFR would promote creating opportunities for tier 2 audit firms to enter the market if they have the capacity and competency.

Parameter Estimates. Table 7 above indicates that AR (the main objective of the research) was a statistically significant predictor of audit experts' perceptions of the influence of MAFR on A.R. This means that for every unit increase (negative coefficient of 2.092) in audit experts' perceptions of the influence of MAFR on A.R., there was a predicted decrease of 0.370 in the log odds of A.R. being at a higher level. In other words, the result suggests that MAFR will not positively impact A.R., contrary to (SAICA, 2016a). However, it is consistent with the findings of GAO (2003) (Harber & Marx, 2019b), (R Narayanaswamy & Kannan Raghunandan, 2019), as well as the current study, which revealed that respondents agreed that MAFR would increase market concentration, thereby impeding A.R. Table 3 below presents the parameter estimates.

Table 8. The parameter estimates

		Estimate	Std. Error	Wald	Df	Sig.	95% Confidence Interval	
							Lower Bound	Upper Bound
Threshold	[MAFR = 1.00]	1.014	4.139	.060	1	.807	-7.099	9.126
	[MAFR = 2.00]	3.033	4.168	.530	1	.467	-5.136	11.203
	AR	-2.092	.878	5.668	1	.017	-3.813	-.370

Link function: Logit – Output from SPSS, 2021.

Most respondents agreed that although many internal and external factors influence the implementation of MAFR, it intends to ensure audit reform by encouraging A.I. and A.Q., which might be hindered when firms have too long a tenure. Moreover, most respondents agreed that MAFR would contribute to audit reform by decreasing market concentration because Big 4 firms will no longer be a dominant force in the market, thereby allowing tier 2 firms to compete with them. These results differ from those of Harber and Marx (2019b), who argue that MAFR could increase the domination of larger audit firms that enjoy long tenures.

Respondents mostly neither agreed nor disagreed that MAFR would contribute to audit reform by ensuring a decrease in the market concentration of Big 4 firms who will no longer be a dominant force in the market, thereby allowing tier 2 firms to compete. This result agrees with that of Bleibtreu (2018), who mentions that MAFR weakens the audit market dominance of the Big 4. However, R Narayanaswamy and Kannan Raghunandan's (2019) study concluded that MAFR increases the concentration of big audit firms in the industry and therefore is not a determinant of audit quality.

Indyk (2019) suggests that Big Four audit firms gain in many different ways from MAFR because of their ability to maximize their strong bargaining power. However, SAICA (2016a) argues

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that MAFR addresses the problem of audit market concentration and advances transformation by creating opportunities for tier 2 firms to penetrate previously unwelcoming markets.

Respondents agreed that MAFR would lead to A.R. by increasing investor trust in the audit profession because of increased A.I. and A.Q. However, Pouwels (2017) found that A.Q. is influenced by the rotation of firms in countries with strong investor protection but negatively influenced in those with weak investor protection (Pouwels, 2017).

Most respondents agreed that tier 2 audit firms might now have to engage in partnership agreements with large firms to serve clients as one entity since they may need more human resources and expertise to audit big companies when MAFR is implemented. The above response is consistent with the arguments of Franzl (2004) as well as R Narayanaswamy and Kannan Raghunandan (2019), who maintain that owing to capacity and capital limitations, tier 2 audit firms may not be able to compete with the Big 4, which would lead to continuing market concentration.

Respondents mostly agreed that some academics and researchers in the auditing profession maintain that implementing the MAFR rule can disrupt organization planning and increase start-up costs, which tier 2 audit firms may need help to afford. This result supported the arguments of (Gomber et al. 2018; K. M. Said & H. A. Khasharmeh, 2014) and Tertius et al. (2017.

Many respondents agreed that MAFR would promote opportunities for tier 2 audit firms to enter the market if they have the capacity and competency. This was one of the IRBA's aims in formulating the policy. Moreover, this research result was consistent with a survey of audit firms in India, which concluded that varying the audit market structure significantly provided opportunities to firms that only had them after (Thornton, 2016).

CONCLUSION

Participants' perceptions were gathered through Q26 – Q32 of the survey questionnaire to address the research objective. The analysis of the responses to those questions found an average mean of 3.9. In addition, the data analysis revealed that most respondents agreed or strongly agreed that MAFR would improve A.R. by increasing competition amongst audit firms, and the best firm would be employed. However, tier 2 firms might lack the resources and expertise of Big 4 firms.

Although the position of the IRBA is based on the strengthening of A.R., thereby enhancing investor confidence, the study showed that despite MAFR, Big 4 firms might still dominate the market because of their client-specific knowledge, which ironically might go hand in hand with the familiarity threat, a lack of A.R. Moreover, these firms might need more resources to fill the gap left by the Big 4 firms and provide services to large companies.

This article contributes to existing knowledge and the continuous discourse on MAFR rule in South Africa. The study will grant more understanding to interested parties in the auditing profession regarding the dynamics of the audit industry concerning the logical connections between MAFR and A.R. Our paper will provide significant input to countries considering MAFR adoption and implementation or that have already adopted MAFR. Additionally, the need for tier 2 audit firms to also enjoy similar opportunities just as those of the Big 4 were highlighted in the study. The results of this study may play a part in government policy direction not too distant future by the IRBA and other role players in addressing some unequal market discrepancies in the audit industry (Roos, 2021).

The study only explored the MAFR in the context of KZN, South Africa; the chance of bias cannot be ignored. In addition, the results cannot be applied to jurisdictions outside the country because of differences in levels of development, culture, prevailing market conditions, and the business environment. The present research was centered on the perceptions of audit experts (registered auditors and academics) in KZN. Therefore, the researcher recommends that future

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studies should consider role players in the auditing profession, Registered Auditors (RAs), and academics from firms and institutions in different provinces to obtain diverse views about pre and post-implementation of MAFR in 2023 and its impact on A.R. These could inform or contribute to policy directions concerning audit reforms since the debate on MAFR continues to resurface with evidence of conflicting research results about the link between the rule on A.R. This study has also provided a very robust plan for future researchers since the perceptions of other role players, such as those who prepare companies' financial statements, were not considered in the study.

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