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Auditor independence

- A field study in Pietermaritzburg, South Africa from auditors' perspective

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Preface

Special thanks to the invaluable contact persons in field, Prof. Philip Stegen and Prof. Darma Mahadea at University of KwaZulu Natal, Pietermaritzburg, South Africa. Not only have they helped by assisting in the gathering of empirical data and with logistic solution, but also worked as supervisors who offered guidance. Thanks also to Arne Fagerström, supervisor of the study, who has contributed with valuable ideas and new thinking. A special thanks to Maria Fregidou-Malama for assisting to make contact with University of KwaZulu Natal and her engagement during the study. Finally a big thanks to SIDA for giving eager students the opportunity to realize field studies in developing countries.

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ABSTRACT

Title: Auditor Independence – A field study in Pietermaritzburg, South Africa from auditors' perspective.

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Aim: The empiric material in this study was gathered in Pietermaritzburg, South Africa. The auditor's independence has been a hot topic because of the huge audit scandals worldwide. The quality of auditing is high in South Africa and the aim of this study was to discuss how auditors in South Africa secure their independence and their opinion about the different threats they come across in work.

Method: This is a qualitative study with a descriptive approach. The empirical data was collected by semi-structured interviews with eight South African auditors active in Pietermaritzburg.

Result and Conclusions: The results of this study suggest the auditors in South Africa are well aware of the independence issue and use the regulatory framework as well as basic ethics and moral values. The current legislation, CPC, is seen as a good guideline and used frequently. It seems to be accepted by both the profession and the public.

Suggestions for future research: The focus of this study is from the auditor's point of view. A proposal for further research would be to see the issue from other angles such as different stakeholders.

Another suggestion is to perform a similar study in another country and compare it with the result from this study.

Contribution of the thesis: Hopefully this study will contribute by giving auditors different individual views and perspective on the independence issue and thereby the colleagues can learn from each other.

Key words: Auditor, independence, safeguard, Code of Professional Conduct, South Africa, Qualitative method.

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List of abbreviations and terms used in the study

- CPC - The code of professional conduct
- GAAP - General accepted accounting principles
- IFRS - International financial reporting standards
- ISQC 1 - International standard on quality control
- SAICA – South African institute of chartered accountants
- “Big four” – The four biggest auditing firms. Deloitte, Ernst & Young, KPMG, PWC

1. Introduction

This introductory chapter presents the background to why the auditor's independence has become a topical subject. It gives a brief history of audit scandals behind the tougher laws and heightened ethical demands placed on companies and auditors. The background is followed by a problem discussion that ultimately results in the study's issue, aim and limitations.

1.1 Background

South Africa is a country on the rise and one of the fastest growing economies in Africa. The country is therefore attractive to foreign investors, as well as the domestic investors, who need trustworthy and reliable information in the financial reports. (www.treasury.gov.za)

Even if South Africa is considered a developing country it is well developed and has for example hosted the football world cup in 2010 and also hosts several international conferences. Regulations and laws on accounting and auditing are on a high international standard and South Africa is world leading according to recent reports. (www3.weforum.org)

The importance of reliable and trustworthy information in the financial reports is a key variable for South Africa to keep developing and attract foreign capital to the country. Since the financial reports need to be trustworthy the role of the auditor as an independent agent becomes central, especially when the stakes are so high and both domestic and international investors depends on their independence.

The purpose of a financial report is to provide different stakeholders with relevant and reliable information for making economic decision. There are different stakeholders, who for various reasons make use of the financial statements. The different types of stakeholder are for example investors and creditors, and they need trustworthy information of the company to make the right decisions. For example whether it's worth buying shares in the company or whether the company is sufficiently safe to lend money to. (Kam, 1990)

There are other stakeholders, internal as well as external that also need reliable information about the company. Often the different stakeholders need different information, but they all depend on the information they receive is reliable and correct and that is where the auditor's role becomes crucial (Deegan et al. 2011). As a result, the stakeholders have to trust that the auditors perform good reviews that help the companies provide accurate figures. Since the auditor reviews the reports on behalf of the stakeholders it should be done without impartially and without bias. The auditor should in other words be independent. (Wines, 2011)

Often it is difficult for an auditor to act independently. If a threat to the independence occurs, the auditor must identify that threat and eliminate/ reduce it to an acceptable level before he or she can continue with or accept the assignment. If the auditor cannot reduce the threats using safeguards he or she must resign from the engagement or choose to reject it. (Gordon, 2003)

The importance of the auditor's independence and impartiality has been controversial in recent years when several auditing scandals were revealed. This resulted in stricter guidelines on how the financial statements should be prepared, for example the Sarbanes-Oxley Act which was a result of the Enron's collapse. (Healy et al. 2003)

1.2 Problem discussion

Up until the 1980s, the professional status of auditors was good and the public had confidence in the profession. The independence concept wasn't unknown, but it was not an issue that was particularly controversial.

After several corporate scandals, including Enron and Worldcom in the US, the auditors were blamed for not informing stakeholders. These huge scandals hurt the auditor's reputation and their reliability. To restore the credibility of the auditing profession, new regulations were made. The Sarbanes-Oxley Act was the result in US, the analysis model in Europe and the Code of Professional Conduct (CPC) in South Africa. All of these emphasize the importance of auditors' independence. (Healy et al. 2003)

CPC is very detailed and covers the ethic conduct for auditors active in South Africa. A more in dept presentation of the code can be found in section 3.2.4.

The independent issue can be seen from different perspective and from different users of the financial reports. For example, the opinion of the current legislation considering the auditors independence can differ between auditors and other users of the reports. In this study the focus will be from auditors' perspective and what they think of the current legislation and how they use it in work.

With this perspective in mind, the following issues are of interest for this study:

- In what way does auditor's consider independence to be affected?
- What are the auditor's opinions about their independence?
- What are the auditor's opinions about the current ethics regulation/ legislation considering independence?

This study aims to examine how auditors in South Africa ensure their independence and how they safeguard against the threats to their independence. South Africa is a developing country and is constantly growing so the auditor's independence, and thus the requirement for audit quality, is constantly under scrutiny and evaluation. (www.treasury.gov.za/)

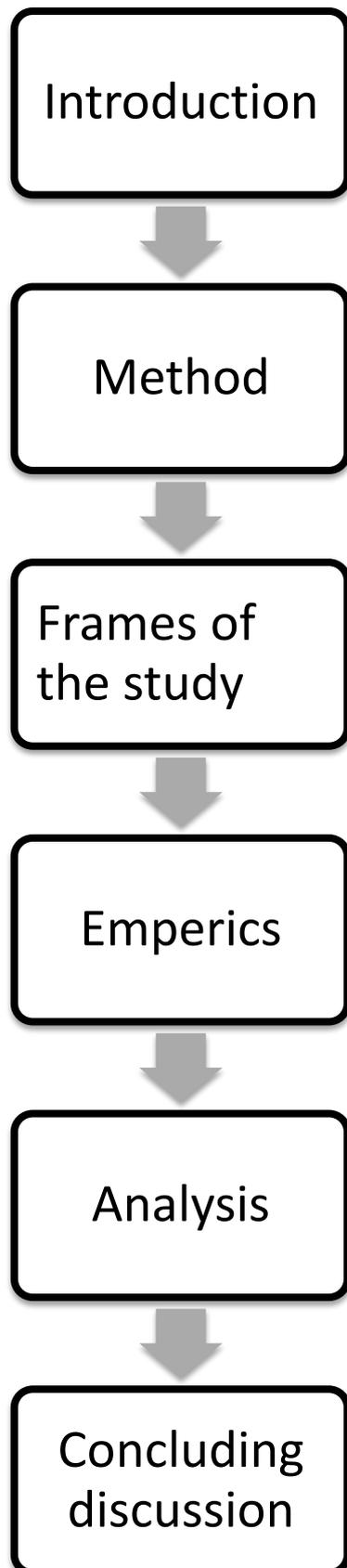
The audit should consequently be reliable and the stakeholders must feel confident that the audited information provided by the client is objective and reliable. This study will hopefully contribute to the South African audit profession by giving an understanding of how colleagues perceive various threats to independence and how they act to safeguard against them and thereby reduce the threats to an acceptable level.

1.3 Limitations

The study's geographic boundaries are limited to auditors operating in Pietermaritzburg, South Africa. The reason for this is a larger study, where auditors from different parts of the country would have been involved, would have been too time consuming and also too expensive. This is however not seen as a concern when the same laws and practices are followed and applied throughout the country. Furthermore, the study focuses on examining auditors' views on independence considering with the guidance of the CPC

and how they work to prevent ending up in situations where they become dependent. The study is thus restricted to auditors' views on independence. It is also limited to the auditor's opinion at the time of the interview and the respondents gender won't be a factor that is evaluated. The term auditor in this study refers to the external auditor, which is another limitation.

1.4 Outline of the study



This chapter intends to give the reader an introduction to the chosen topic. The background description follows by a problem discussion which ends up with to study's issue and aim.

The method chapter aims to explain the choice of matter. It also describes the studies orientation, how data was collected and discuss the reliability and validity of the study. The chapter ends with a source criticism discussion.

The frame of the study is divided into three major areas. The first deals generally on auditors' independence and issues of it. The second presents the legislation in South Africa whit a brief historical preview. The third one presents the selected theories and a motivation of the choice.

The chapter presents the empiric data collected for the study. First a brief presentation of the respondents is given, followed by the result which is presented in the same order as questioned.

In this chapter the empiric data is analyzed. Different issues and behaviors are discussed and explained with help of the framework.

The last chapter consists of a discussion of the empirical data and the analyze of it. It can be seen as a summary of the conclusions of the study.

2. Method

This chapter presents and motivates the method choices for this study. It also gives a presentation of the pre-understanding of the topic and describes how the material used in the study was collected. Finally it presents the actual implementation of the study and how the results, using the concepts of validity and reliability, can be considered trustworthy.

2.1 Scientific approach

Since accounting and auditing is created and used by humans it belongs to social science. The conditions in a social science study will change over time and therefore the results or conclusions will be hard to repeat in the future. (Ashton et al. 1995) A deductive approach has been used in this study since the theories and the pre-understanding were the base when the interview template was constructed. The gathered empiric material has been compared to previous studies and researches. Hermeneutic is applied in social science researches. Hermeneutic sees the overall picture of the scientific issue and the scientist's role as open minded, subjective and dedicated. The scientists pre-understanding is therefore important to be able to interpret the scientific object and for that reason should this study be interpreted with a hermeneutic approach and a deductive view. (Ashton et al. 1995)

2.2 Methodical approach

Depending on the conclusions a study aims to demonstrate the use of different approaches can various. Examples of different methodological approaches are exploratory, descriptive, explanatory and predictive. (Denzin and Lincoln, 2003) This study aims to demonstrate the registered auditor's views on the independence issue and the conclusion provide a descriptive picture of how they reason about their independence and how they work to manage it. The descriptive approach aims to explain the facts and circumstances in a descriptive way, why the choice of this approach came naturally.

The choice to do a qualitative study using a descriptive approach requires a close proximity to the object of research and the possibility of a direct relation with the respondent. (Denzin and Lincoln, 2003)

In a qualitative study it is individuals and / or groups of individuals that are studied and the aim is to describe, analyze and understand the behavior of respondents. (Denzin and Lincoln, 2003)

With a qualitative method it is appropriate to use interviews and interpretive analyzes. The qualitative method is also used to give the authors of the study, a deep understanding of the chosen problem area. (Denzin and Lincoln, 2003)

The qualitative method approach is flexible and therefore comes with the possibility to adapt and adjust as you work for the best results. This flexibility can be beneficial for the study's authors, especially when interviews are conducted. (Denzin and Lincoln, 2003)

As the study includes different interview times and different respondents, it might be necessary to change the structure of the questions to be asked and also add follow-up questions for optimal data collection. A study therefore doesn't need to use exactly the same structure when different respondents are interviewed (Denzin and Lincoln, 2003). This is something that was of great importance in this study. A discussion of the various issues was central and the opportunity to ask supplementary questions were needed to further interpret and analyze the response from respondents.

2.3 Procedures

After the go-ahead was given for the minor field study on auditor independence in Pietermaritzburg, South Africa the first step was to investigate whether there been any similar research in the area. Around the current issue no similar research with the same approach was found. There were a lot of previous researches and studies on auditor independence, both at an international level and at a national level in South Africa. Based on previous researches and studies the next step was to separate and collect relevant data.

2.4 Data Collection

Primary data is so called first-hand information and is such the authors themselves have collected. Secondary data is second-hand information, which means data and/or other information collected by others. (Denzin and Lincoln, 2003) In the implementation of a study, usually both primary and secondary data is used. This study is based on both primary and secondary data. The primary data is collected through interviews with eight auditors in Pietermaritzburg, while the secondary data is extracted from already published sources such as books, articles and dissertations.

2.4.1 Empirical data collection

The primary data were collected through interviews with auditors active in Pietermaritzburg, South Africa. The first contact with the auditors was done by contact persons in field, except for two of the interviews where contacts were made by e-mail in advance. The interviews were mainly done in facilities of the University of Kwazulu Natal but two interviews were also made at various audit firms in Pietermaritzburg.

Each interview took about 30-40 minutes to complete. Three of them were recorded while five weren't, due to personal preferences of the auditors concerned. During all of the interviews accurate notes were taken to ensure that no information was missed. Immediately after each interview the notes were analysed and compiled while the interview still was fresh in mind. Even though the interviews haven't been transcribed, the result is reliable since the answers were confirmed with counter questions and discussions.

2.4.2 Choice of interview method

Primary data in this study consists of interviews, all of which have been conducted with the respondent personally. The choice to meet all respondents personally felt naturally mainly because it reduces the risk of misunderstanding compared to a phone interview, but also because it gave a better chance to both record and take notes during the interview. An additional advantage by meeting the respondents personally is that it provides a better opportunity to have a discussion and thus get more detailed and interesting answers.

When interviews are conducted, they can take several forms. Standardization can be either high or low. A high level of standardization means the interviewer asks the same questions to all respondents, often after a pre-made forms, while a low standardization means the questions asked may vary and be in different orders depending on how it fits the particular occasion and the individual respondent. (Saunders et al. 2003)

The questions forming the basis for the empirical material in this study may be considered to have a relatively low form of standardization, since discussion has been a key and the ability to place follow-up questions depending on the respondents answer has been necessary. Hence, no interview was exactly like the others but all of them contained the same main questions.

An interview differs if it's structured or unstructured. A structured interview gives the respondent little room to answer the questions while an unstructured interview gives the respondent great opportunity to respond to the questions. (Saunders et al. 2003)

An interview with a high degree of standardization is always structured, while an interview with a low degree of standardization can be both unstructured and structured. (Denzin and Lincoln, 2003) This study was made with semi-structured interviews. This means the interviewer is not based on a strict response form, but instead gives the respondent space for discussion. (Saunders et al. 2003)

The questions asked can be seen more as a manual which includes the various areas to be discussed. By having a manual the interviewer is able to keep an overall eye throughout the interview and steer the dialogue if necessary. The manual don't need to be strictly followed, but weight can be added to the issues that cause most discussion. However, it is important the whole manual is covered during the interview. (Saunders et al. 2003)

2.4.3 Interview execution

Before arriving in Pietermaritzburg 15 audit firms were contacted by e-mail and informed of the study's purpose. In these e-mail's the firms were asked to participate and also made aware the study would be totally anonymous and the interviews only would take around 30 minutes. Once in Pietermaritzburg contact were made with the supervisors in field to get additional help with contacting respondents. Out of the 15 e-mails sent in advance, only five had answered, three of them with negative response and

two answered they could participate. It early showed the supervisors would be a valuable resource and with their help six additional interviews were set up. No questions were sent to respondents in advance, partly because the auditor's independence is a controversial topic but also to avoid giving the respondents the opportunity to prepare answers. As previous mentioned the interviews mainly took place in the University of KwaZulu Natal's facilities, except for two cases where they were done in the facilities of the audit firms. Each interview took about 30-40 minutes to complete.

2.4.4 Selection

The choice of interviewing auditors in Pietermaritzburg was mainly due to a previous cooperation between the Universities in Gävle and Pietermaritzburg. As it showed, the extra guidance and help to set up interviews, provided by the contact persons in field, was invaluable. The fact the interviews were done in, with South African measurements, a small city is not seen as an issue when auditors all over the country follow the same regulations and standards. An auditor in a smaller city has to secure his independence as much as one in a large city and sometimes perhaps even more when smaller city's tend to be more familiarity. (Hussey, 1999) The choice to do eight interviews was desired since both larger and smaller audit firms could be included in the study. By including both big and small firms the response team widens and also provides the study with firms that both offers audit and consultation services. According to previous studies, a related service such as consultation often becomes a threat to the auditor's independence. (Ashbaugh et al. 2003) By including auditors with various experiences, differing between one and over 40 years, the study also got a wider perspective.

2.5 Validity and reliability

To increase the credibility of data presented in a scientific study there are some criteria that must be met. These criteria apply to both qualitative and quantitative data. The data presented must be credible and generalizing to be transferable to similar studies and give the same result. Validity is a measure of the credibility and reliability is a measure of how general the results can be considered. (Armour et al. 2009) Reliability thus means the degree of objectivity in the results and that the measurement can be remade with the same results generated.

Validity is usually divided into an external and an internal part. The internal part is a measure of how the results of the study itself can be seen as credible and explains a causal relationship. The external part of the validity describes how the results can be considered valid in a broader context, outside the own study. (Robert, 2009)

Since all the interviewed auditors follow the same legislation, a similar study with other respondents would probably give the same result, which means that the external validity can be considered high. The reliability was strengthened by close, steady notes and also recordings during the interview sessions. During the analysis every recorded interview were listened through several times in order to increase the reliability further. Unfortunately the summaries of the interviews haven't been confirmed by the respondent due to time limits in field. To handle this issue the respondents were offered to double check the notes taken after each interview. Also counter questions were asked to confirm the answers were correctly interpreted.

The choice of respondents with great experience was important as well as auditors with less experience. Since persons with a low experience of auditing and persons with great experience participated the study got a wider perspective. These active selections of respondents have increased the internal validity of the study.

The study's reliability was improved by giving all respondents total anonymity. By doing that, the answers and discussions hopefully became more honest, since the respondents didn't have to consider the consequences of their answers.

2.6 Source criticism

Some secondary data in this study can be seen as old and not relevant anymore. For that reason the oldest literature and articles have been double-checked to make sure the content still is correct. Another source criticism is the credibility and the sincerity of the respondents. Since there were some sensitive questions the answers could be so called politically correct. That means the respondents answer the way they think is the correct according to the regulations for example. This issue was reduced by give the respondent's total anonymity.

In total, the empiric material of this study consist eight interviews with eight different auditors working in Pietermaritzburg. Only eight respondents cannot be seen as a generalized opinion, but the answers can be an indicate of it. The respondents are of different sex, different ages and with different experience and because of that the risk of getting a one-side opinion is reduced. The respondents thereby represent a wide selection of the population. A big issue when interview in another language is the comprehension of the answers and the ability to express correctly when asking the questions. This issue is even bigger in semi-structured interviews since such interviews often end up in discussions and supplementary questions. Hard studying of regular vocabulary and the current legislation were done to reduce the risk of misunderstanding.

3. Frames of the study

The frame of the study is divided into three major areas to assist the reader. The first area deals generally about auditors' independence and issues of it. The second presents the legislation in South Africa and gives a brief historical preview of the outcome of it. The third one presents the selected theories and a motivation of the choice.

3.1 Auditors independence

The term “independence” can briefly be explained as an expression of professional integrity of the individual. Independence requires avoidance of situations which would tend to impair objectivity or permit personal bias to influence delicate judgment. (Hemraj, 2003)

International Standard on Quality Control (ISQC 1) is applied in South Africa and deals with the audit firm's responsibilities to establish and maintain its system of quality control for audit engagements. ISQC 1 sets out the responsibilities of the firm for establishing policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence. (ISQC 1 §§ 20-25)

In the case of audit engagements, it is in the public interest and therefore required by the CPC that members of audit teams, firms and network firms are independent from audit clients. (SAICA, 2010)

According to the South African Institute of Chartered Accountants (SAICA) independence is explained in two major areas, independence of mind and independence in appearance. Independence of mind implies the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, exercise objectivity and professional skepticism. (SAICA, 2010) Independence in appearance means the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, considering all specific facts and circumstances, that a firm, or a member of the audit assurance team's, integrity, objectivity or professional skepticism has been compromised. (SAICA, 2010)

Previous research in the context of auditor independence categorizes independence from three angles. First, it argues the concept of independence includes honesty, integrity, objectivity and responsibility. It also states that in order to be independent, the auditor should avoid all relationships, even unconscious ones, which can affect their objectivity and independence. Thirdly, for independence an auditor should avoid relations outsiders might be seen as conflicts of interest, which means even apparent independence plays an important role whether the auditor will be presumed to be totally independent. (Vanasco et al, 1997)

3.1.1 Issues of auditors independence

Richard (2006) splits the term independence into two main types of independence: the visible independence and the actual independence. The visible independence means the auditor must be independent in the eyes of others and the actual independence is explained as the auditor considers himself or herself as independent. The problems that arise from conceptual categorization is, even though the auditor considers himself or herself independent, i.e. the auditor is in fact independent, an auditor still has to prove to the public that he or she is independent to become visibly independent. (Richard, 2006)

Regarding the relation auditors have with their clients Vanasco (1997) stresses the distinction between the relation to the audited company and the relation to the audited company's stakeholders. The relation the auditor has with stakeholders is to be regarded as virtually non-existent. In contrast, an auditor with a commitment of an audit engagement already has created a relationship with the company in question. The reason the auditor's relationship with stakeholders can be seen as non-existent is because they rarely or never have contact with stakeholders such as suppliers, customers, creditors, etc. (Vanasco, 1997)

A study by Richards (2006) investigated both the management and owners' attitude to the company's auditor. By interviewing both parties comparisons are made between their views. Interestingly, neither the owners nor the management perceived a problem in a very close relation with the auditor and that this would affect the auditor's independence was not even mentioned in the first place. Company management believes a close relation with the auditor is important and the auditor should make time for the company and satisfy their needs. The owners emphasize a good relation with the auditor

is important and an auditor who works mechanically is not desirable. Instead, they stress the importance of a good and open relation going forward and good communication is seen as a key to an effective cooperation.

The auditor's relation to the company should be divided into a professional and a private role. If both parties are professional their relation should also be professional. Richard (2006) points out that professional cooperation between the parties does not stop a private relation from arising. Since the parties have close cooperation, which often lasts for several years, there is a risk that a relation of a more private character will arise. When the auditor has largely been responsible for building trust, a private relationship is however seen as a threat to independence. (Richard, 2006)

3.2 Legislation in South Africa

A brief historical description of the accounting legislation in South Africa is given in the following episode which empties into a more in depth presentation of CPC, where the focus of this study will be. CPC covers the ethic codes for accountants and auditors active in South Africa.

3.2.1 The Corporate Laws Amendment Act

The Corporate Laws Amendment Act was released in December 2007, amending the old Companies Act of 1973 and contained a number of new provisions for auditors in South Africa. Some of these provisions was expected and welcomed but some other was more controversial. (www.info.gov.za) One of these new provisions was related to the status and the independence of the external auditor which, more or less, forced companies to aligning to the Auditing Professions Act. The act also contained different regulations about the rotation of the external auditors and the prohibition of combining non-audit services with the actual audit. (www.info.gov.za) One of the most important provisions, regarding auditor independence was the detailed regulation on how the interaction between the auditor and the audit committee of widely held companies would operate and the fact that it had to follow international reporting standards such as IFRS (International Financial Reporting Standards) and GAAP (Generally Accepted Accounting Principles). (www.info.gov.za)

3.2.2 The King Reports on corporate governance

The first King Report was released in 1994 and was a proposal all companies should adopt a Code of Ethics as well as greater corporate accountability and disclosure of non-financial matters. (www.mervynking.co.za)

After approximately 8 years, in 2002, the second report was released and that edition had greater focus on the position of the auditor, the audit committee and the regulation of the non-audit services. The reports were, from the beginning self-regulatory documents but many of their recommendations have become statutory. (www.saica.co.za)

In 2009 the third edition was released and that report places great emphasis on leadership, sustainability and corporate citizenship. It also contains sections on how the audit committee and the auditor should act to meet the requirements of independence and objectivity. (www.pwc.co.za)

3.2.3 Auditing Profession Act 25 of 2005

The final product of a long-standing review of the Public Accountants and Auditors Act was the Auditing Professions Act, which was promulgated in 12 January 2006. This act replaced the Public Accountants and Auditors Act and now solely regulates the auditing profession in South Africa. One major difference between these two acts is the focus on protection. The Public Accountants and the Auditors Act, had a focus of protecting the auditor while the later one, the Auditing Professions Act, has a focus of protecting the public. This oscillation is an example of the international trend of making the public the main stakeholder in need of protection. The Auditing Professional Act also deals with some issues relating to the auditor's independent. (www.moneyweb.co.za)

3.2.4 Code of Professional Conduct

There are high educational demands to become an auditor in South Africa. The education is comprehensive and after four years in university a three year long trainee period is waiting to become a chartered accountant. (www.saica.co.za) After that title is received the person needs to work for an audit firm for 18 months and then pass the prescribed examinations. (www.irba.co.za)

The latest edition of CPC was released on 1 January 2011 by the International Ethics Standard Board for Accountants and contains three parts (SAICA, 2010):

Part A- establishes the fundamental principles of professional ethics for chartered accountants and auditors with a framework to use to for:

- Identify threats against the independence of the auditor/ chartered accountant
- Evaluate the significance of the identified threats
- Apply safeguards to eliminate or reduce the threats

Part B- describes how the conceptual framework applies to chartered accountants and auditors in practise.

Part C- looks at chartered accountants and auditors in business.

The focus in this study is on the different threats an auditor could face in the profession. The Code of Professional Conduct places these threats into five different categories (SAICA, 2010):

1. **Self-interest threat**- financial or other interest an auditor may have in a company and thus may lead to the auditor not acting impartially and objectively.

Examples of Self- interest threats:

- A member of the auditing team having a significant close business relationship with the audited client.
- A member of the auditing team having a direct financial interest in the audited client, stocks for example.

2. **Self-review threat**- the threat that an auditor will not appropriately evaluate the results of a previous judgment made or service performed by the auditor, or by another individual within the same audit firm, on which the auditor will rely when forming a judgment as part of providing a current service.

Examples of self-review threats:

- The auditing firm issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
 - The auditing firm prepared the original data used to generate records that are the subject matter of the assurance engagement.
3. **Advocacy threat**- the threat that an auditor will promote a client's position to the point that the auditor's objectivity is compromised.

Examples of advocacy threats:

- The firm promoting shares in the audited client unduly.
 - An auditor acting as an advocate on behalf of an audit client in litigation or disputes with third parties.
4. **Familiarity threat**- The threat that due to a long or close relationship with an audited client, an auditor will be too sympathetic to their interest or too accepting of their work.

Examples of familiarity threats:

- A member of the auditing team having a close or immediate family member who is a director or officer of the audited client.
- A member of the auditing team having a close or immediate family member who is an employee of the audited client who is in a position to exert significant influence over the subject matter of the audit engagement.

5. **Intimidation threat**- The threat that an auditor will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the auditor.

Examples of intimidation threats:

- An auditing firm being threatened with dismissal by an audit client.
 - An auditing firm being threatened with litigation by the audit client.
- When the threats are identified and their significance is evaluated safeguards will be applied.

Safeguards are actions or other measure that may eliminate/reduce threats. The safeguards fall into two main categories:

- a) **Safeguard created by the profession, legislation or regulation.** This category includes educational and experience requirements for entry into the profession but also professional standards, legislation and regulations. (SAICA, 2010)
- b) **Safeguards in the work environment.** This category includes demands of the leadership of an accounting firm will focus on fundamental principles of ethics and quality in work processes. (SAICA, 2010)

3.3 Theories applied

The theoretical choices for this study consist of three different theories considered relevant to the study. The starting point in the study's theoretical chapter is agency theory which helps to explain the need of an auditor and how he acts as an independent agent.

Furthermore, auditing theory and the role of the professional auditor is presented to feature how the auditor should act in his profession in a theoretical way.

Finally, basic principles of institutional theory are covered to help explain different views and if they can be explained by laws, norms, ethic codes etc. in the country.

3.3.1 Agency theory

The principal – agent theory has its origins in the 1970s and its purpose was to form a descriptive theory. Unlike normative theories which intend to explain how something is, a descriptive theory aims to describe reality (Arnold and Lange, 2004). The principal – agent theory focuses on relationships between actors in the field of accounting, the reporting person and the accounting recipient. The relation among the parties involved become infected if the agents takes advantage of their knowledge for personal gain at the expense of the principals lack of knowledge in the area, which give rise to conflicts. (Arnold and Lange, 2004)

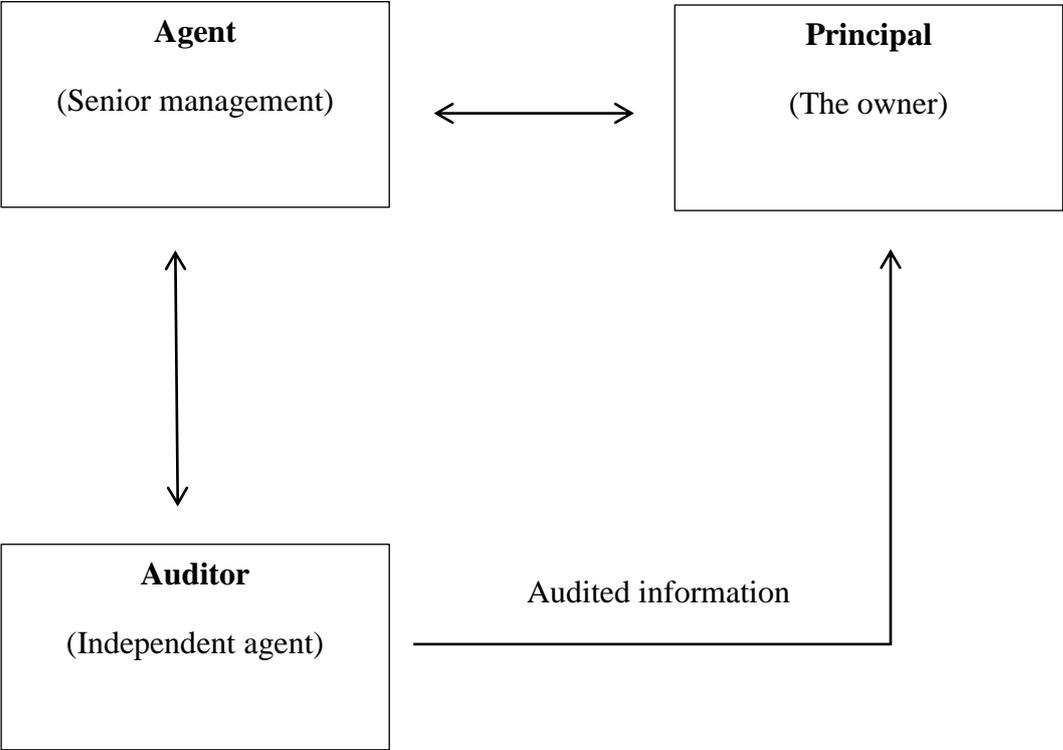


Figure 1. Agency theory and the auditor (Messier, 1997, p.7)

The principals, who in this scenario are the business owners, give the task of managing their wealth in a way that favours their growth to the agent i.e. the senior management. Messier (1997) points out that the main issue is the information asymmetry, reflecting the fact that senior management often have superior information compared with the owners. There is a risk that senior management will exploit this situation for their own personal gain and therefore no longer be loyal to the owners. Since there is a risk that senior management is disloyal to the owners, an auditor is appointed to ensure the senior management fulfils its commitments. The auditor has an important role to play

as an independent agent for the principals and other stakeholders to ensure management's loyalty to the company (Messier, 1997).

Messier (1997) argues that auditors must be considered as objective and autonomous i.e. he or she must be independent in order to meet the requirements of the principals and other stakeholders. The principal - agent theory alone cannot explain the regulation of auditor independence, since also, as a trader in his own business, he or she may have financial and other incentives to act otherwise. Anyone running a business wants to get as much return as possible from it which also applies to the auditor. There is a risk situations may arise when the auditors neglect their loyalty to their clients by taking advantage of such interests which give the best return for the auditors (Arnold and Lange, 2004).

3.3.2 Institutional theory

Institutional theory aims to explain how different institutions arise and leading to rules, regulations and norms for people in the society. Examples of different institutions are laws, ethic codes, contracts between individuals and rules of conduct. These institutions are set up by people to form the collaboration of the society and can explain why people act and think in a certain way. (Scott, 1995)

The institutions guide and influence people in different situations and help them to act in the way the society expects them to act. The key challenge for institutions is to establish a stable structure for interaction between individuals in society. When the society develops, the institutional framework also must develop to achieve better results. Therefore, the framework shows the best institutions for the moment. (Scott,1995)

The change can be said to be influenced by three major forces- the market, the state and society. The market affects behaviour through competition, where individual actors participate for their own gain and consequent generates norms of society. The state affects the laws and regulations that provide standards. The society influence by loyalty among members of social groups and thereby generate norms. (Willmott et al.1992)

The figure below can explain the development of accounting:

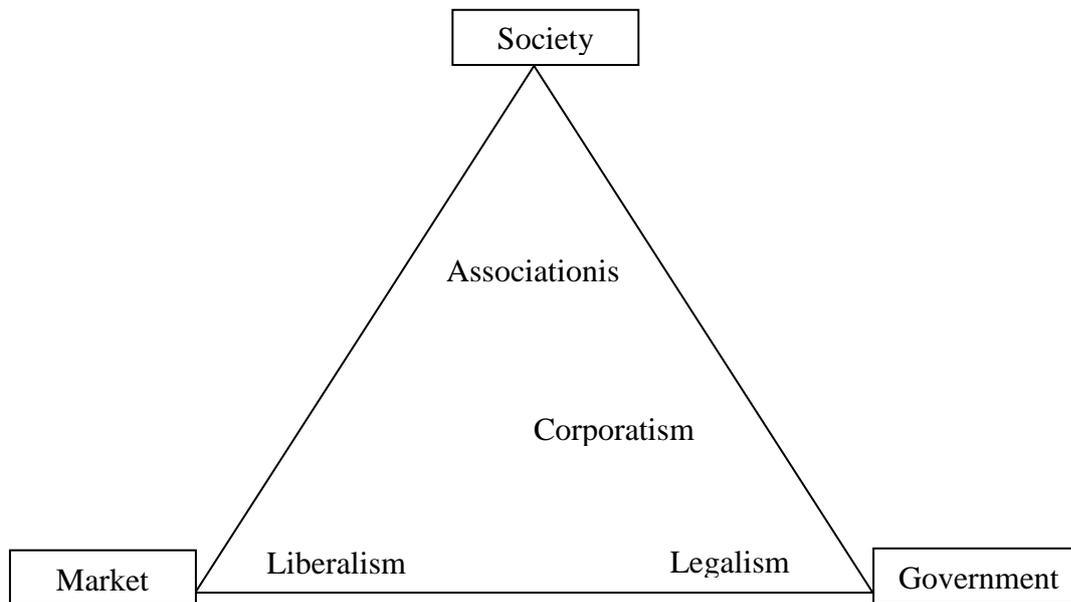


Figure 2. Model how regulations are formed. (Willmott et al. 1992, p. 37)

There are three extreme situations in this model: Liberalism means the development is totally controlled by the market and no regulations exist. Legalism means development is totally controlled by the government, for example, new legislation. The third extreme situation occurs when different individuals, without any impact from the government, come together to form contracts etc. Different associations are examples of such groups. (Willmott et al. 1992)

When it comes to accounting and auditing there are a mix of these three forces. If the government lets different associations set up new regulations it is called corporatism.

The government is just overlooking the standards and makes sure the profession is following them. Associationism means that different interest groups in the community band together to set restrictions and guidelines. (Willmott et al. 1992)

3.3.3 The role of the professional auditor and auditing theory

“Auditing is a systematic process of objectively gathering and evaluating evidence relating to assertions about economic actions and events in which the individual or organisation making the assertions has been engaged, to ascertain the degree of correspondence between those assertions and established criteria, and communicating the results to users of the reports in which the assertions are made” (Porter et al. 2008; p.3)

This quote summarises that auditing is about collecting and evaluating sufficient audit evidence to satisfy themselves that management's presentation of the financial statements fairly presents the reality and therefore can be relied upon by the users of the information. (Porter et al. 2008) The users are all actors who have a financial interest in the company such as banks, employees, shareholders, customers, suppliers, government, etc. Every one of them relies on the professional auditing to detect material irregularities that may give a misleading impression of the company's position and/or its performance. (Porter et al. 2008)

The purpose of auditing is to discover, check, verify and control different evidence in an organization. It is impossible for an auditor to detect all errors in an annual report. To prevent the auditing process being too wide and thereby too expensive for the client, the work that is performed is limited by the materiality and risk concept. These concepts will not be investigated more deeply in this study but mean that small immaterial errors can be accepted by the auditor, as long as these errors do not result in giving the wrong impression of the company. (Munro et al. 2011)

The main assignment for an auditor is to determine whether the financial statements, including the balance sheet, income statement and cash flow statement, of an organisation/company fairly present the operations and the financial position of the organisation/company. (Cosserat and Rodda, 2009) The management of the company is supposed to present the annual report to the auditor and the auditor should then examine the financial statement to ensure that they are fairly presented according to the existing rules. (Munro et al, 2011)

3.4 Previous research

There are many articles and studies about the independence of the auditor. To sum them up, most see two major problems that can affect the independence:

- Where the fee from the client represents a large part of the auditing firm's total revenue, this leads to an increased risk as the auditor is financially dependent on the specific client.

The size of the auditing firm seems to be important, because the revenue from one client may be a larger proportion of the total revenues for a small firm than for a large firm. (Bakar et al. 2005)

- When an auditor and his client develop a friendship that affects the auditor's ability to act independently because of the client's influence on the auditor's review.

(Bakar et al. 2005, Richard, 2006, Vanasco et al. 1997)

Messier (1997) as well as Bakar et al. (2005) points out the difficulty to keep the relation between auditor and client on a professional level. They also emphasize that the client often wants a close relation to his auditor which results in even more tricky situation for the auditor. The last mentioned have to stay professional but to be able to do a satisfying work the relation have to be good and the two parts have to cooperate. Both Messier (1997) and Bakar el al. (2005) also show it is even harder to keep the relation on a professional level in a small town and the familiarity threat is something the auditor has to be aware of.

No previous studies in South Africa, with the same focus, have been found but since South Africa is a former English colony it is relevant to look at other former English colonies with similar regulation structure, Australia and Barbados for example.

Australia

The results of Craswella et al. (2002) study shows that fees don't affect auditor's independence. Non-audit services were also taken into consideration and the results points out that the auditors appear to be willing to offer such services no matter if the client is a large or a small part of the audit firms total revenues.

The results were found by quantitative tests with firms on a local level as well as on a national level in Australia.

Another result of the study emphasizes the difference between being independence in fact and independence in appearance as an auditor. The profession in general thinks the rules and regulation should be based on being independence in fact while the regulators think it should be based on independence in appearance. (Craswell et al. 2002)

Barbados

Another research made in Barbados, also a former English colony, points out the importance of auditors independence. Even though the study has a more widely focus and investigate many different situations when an auditors' independence can be affected it still have the base on the five major threats.

The answers from the respondents, both auditors and users of the financial reports, emphasizes the issue of being independence in appearance and also act independence to be able to present reliable financial reports. The results points out that auditor rotation are important to eliminate/reduce the familiarity threat and thereby improve the independence in appearance for the auditors. (Alleyne et al. 2006)

4 Empirics

This chapter presents the empiric data collected for the study which consists of eight separately interviews with auditors active in Pietermaritzburg, South Africa. A brief presentation of the respondents is given, followed by a summary of the respondents answers. The answers are presented under separate questions from the interview template to assist the reader. The whole interviews are to be found in Appendix 2.

4.1 Respondents

The study's empirical material has been gathered by eight individual interviews that were performed with eight different auditors active in Pietermaritzburg, South Africa. Since several of the auditors had requests to participate anonymously in their personal capacity, all respondents and their firms will remain anonymous. To give the reader some idea of the interviewees a short presentation of each respondent will be given.

The fact that the respondents remain anonymous is unlikely to affect the final outcome of the study but if it does, it makes the respondents more comfortable to speak freely, rather than to answer in a so called political correct way. The respondents are represented by both more and less experienced auditors which give the study greater range. They all works for different audit firms, smaller firms with just a few co-workers but three of the "big four" firms are also represented.

Respondent A

A is working for one of the largest firms in town, aside from the "big four". She is a partner and the firm she represents has a number of registered auditors and most clients are in the close geographic area. She has been a registered auditor for 17 years.

Respondent B

B has worked with auditing for one year and is employed by one of the "big four". She is stationed in both Durban and Pietermaritzburg and her clients in Pietermaritzburg consist of small and medium-sized firms.

Respondent C

C has worked with auditing for 15 years and is very familiar with the legislation and the

issue considering auditors independence. He has mainly worked with medium-sized audit firms.

Respondent D

Has worked with auditing for three years at one of the “big four” firms and is currently stationed in Pietermaritzburg. Nowadays she works more with accounting than with auditing, but still does both.

Respondent E

E has worked with auditing for more than 20 years and is a partner of a smaller audit firm in Pietermaritzburg. E also teaches in the theme of audit and is therefore very familiar with the legislation and the ethic codes of auditing.

Respondent F

F has worked with auditing for 12 years and is currently employed at one of the “big four” firms in Pietermaritzburg. She has worked at both smaller and larger auditing firms.

Respondent G

G has been working with auditing for 12 years for one of the “big four” in Pietermaritzburg. Her focus is on larger public firms where she works as a senior auditor in her team

Respondent H

Works for a small audit firm in Pietermaritzburg. He has over 40 years of experience as an auditor and has also represented larger audit firms. Nowadays he works with small clients in Pietermaritzburg.

4.2 Generally about the auditors independence and threats against it

When does a dependent viewpoint occur, according to you?

The respondent's answers considering when a dependent situation occurs are unanimous. Everyone believe the work with the independence starts as soon as you become an auditor and the work with independence is very important to be able to present reliable reports and to maintain the good reputation of the audit firm.

Which is the most common threat against the independence, according to your experience?

When it comes to the most common threat against their independence as an auditor the answers differ a bit. The most common threat, according to respondent A, B, E, F and G, is the familiarity threat. All of those respondents think it is hard to keep the relation to the clients on a professional level. To do a satisfying work as an auditor you are dependent of a good relation with the client. For that reason it can be hard to find the balance between personal and professional relations with the client. A means the relation to the client must be strict professional but at the same time she also thinks it is necessary to know the persons on a deeper level to be able to communicate and understand them. B and G say it is important to keep the relation with the client on a professional level because of the fact that the audit firm will lose revenues if the auditor becomes dependent. They believe the audit rotation is a good way to handle the familiarity threat issue. E says the familiarity threat is common because the big number of individuals of the audit team and in a small city someone of the team often knows an employee of the client on a personal level. F thinks the professionalism is important for an auditor as well as in any business relationship.

Respondent C and D believe the size of the fees is the most common threats against the auditor's independence. If there are too much competition to get the clients the audit firms might constrain the prices on a level that will affect the quality of the audit in a negative way. If the price of the audit is too high the revenues from that audit assignment will be too important for the firm which might end up in a dependent situation for the auditor. According to Hs' experience the self-review threat is the most common. The reason for this is that H only audits smaller companies where the

guidance often is a large part of the assignment and the line between consulting and guidance is often tricky and thin, according to H.

For how long time do you think it is proper for an auditor to work with the same client?

Respondents A, B, E, F and G believe the current legislation of five years audit rotation for public companies is good and helps the auditor to avoid a too personal relation with the client. Respondent C thinks five years is too long time and says after just three years the auditor's relation to the client often becomes personal and affects the independence. Respondent H doesn't believe a legislated number of years are suitable for all audit assignments. Instead, since every audit assignment is unique the number of years should be determinate separate with professional ethics and common sense. Respondent D doesn't believe there should be any different between public and private companies for large audit firms with many different partners. She believes the intern rotation is enough to secure the independence and avoid the familiarity threat. Respondent A, B, E, F and G believe the stricter legislation for public companies is fair since those companies have many different owners and stakeholders. Respondent C, D and H don't think there should be different rules for public and private companies. The arguments for that are that even private companies often have many different stakeholders which are dependent on a fair and independent auditor and reliable financial reports.

What is your opinion about that audit firms offer both consulting and auditing to the same client?

Respondent A, B, D and G can't see any problem with this issue, as long as it is done by different departments and different partners of the firm. B admits that it can be tricky to see the border between financial guidance and consulting and E, F and G are of the same opinion. Respondent C says it shouldn't exist since it is impossible to prove that the partner controlling the audit doesn't control the consulting and because of that the independence of audit firm can be disputed if it offers consulting and audit to the same client. Respondent F is also questioning this issue and means that small audit firms shouldn't offer both services while larger audit firm probably can handle it but still should try to avoid it. Even though, she thinks it is proper to give the clients some financial guidance as long as it doesn't have a negative impact on the independence and give rise to a self- review threat.

Do you think it is hard to keep the relation with the client on a professional level?

All respondents but D say the relation between the auditor and the client must be strictly professional. D on the other hand means the relation also must be on a personal level to create effectiveness in the audit. Respondents A, B, C and H also says the relation must be good, but still professional, to avoid that the client conceals important material from the auditor. Respondents B, C, E, G and H think it is difficult to determine when different situations are on the edge to become too personal. H exemplifies this issue with playing golf together. If the auditor and the client play golf together once a year it is probably ok, but if it happens every weekend it will be hard to argue that it doesn't have a negative impact on the auditor's independence. But where is the border- two times a year, every second month? G is of a similar opinion and says since Pietermaritzburg is a small city you often could become too personal with your client. All the respondents emphasize the importance of being professional and never jeopardize the independence towards the client. D believes there is more space for personal relations in larger audit firms since there are usually more partners and larger audit teams where intern rotation of the team members can manage the familiarity threat.

Is the current legislation reasonable or is the requirement on auditors to high?

Respondents A, B, E and G believe the current legislation about auditors' independence is strict, but not too strict. B, with least experience of the respondents, thinks it might be too strict for partners but on her level of the audit team she doesn't think so. G says the strict legislation minimizes the risk for loopholes and is good for the reputation of the profession.

C and F also believe the current legislation is good but they emphasize the importance of reconstruct the regulations and rules on a regular basis to avoid it to become archaic. Respondent F says it is important the regulations are up to date since audit has a significant role in society and controls a lot of money. Respondents D and H believe the legislation is a good base but the auditors have to use their experience and ethic codes to be able to translate the legislation to become useful in work. Respondent D exemplifies this issue with the fees. There is regulatory too high fees can't be charged, but it doesn't say the limited amount, what is too high and what is too low?

The sizes of these amounts the audit firms are free to decide them self which result in different fees for different audit firms.

Has a dependent position cast yourself to give up/ reject an assignment?

No one of the respondents has been forced to resign or reject an assignment because of a threat against the independence.

4.3 Code of Professional Conduct and auditors' independence

Do you have the Code of Professional Conduct in mind as you work?

The Code of Professional Conduct is a vital guideline in how an auditor should handle and act in an ethical correct way. All respondents are in agreement that CPC in some way figures in the mind while working. Respondent A goes as far as she believes CPC should be borne in mind at all time, whether you have a client or not. C points out the auditor is the person stakeholder's base their decisions on, which makes it important for the auditor to keep CPC in mind at all time. Respondent B on the other hand doesn't have CPC in mind at all time and highlights that a good education and solid training helps to create what she calls "natural independence thinking". F and H believe CPC is something that exists in the back of their mind rather than something they actively keep in mind and consults on a daily basis. Instead they rely more on their experience. For E, who also teaches in the audit area, it's important to always be up to date regarding news in the CPC and therefore CPC naturally figure in his mind on daily basis. D who personally just has a few years' experience believes CPC is more useful to auditors with less experience than when, for example partner status, is reached. When partner level is reached auditors relay more on their experience and probably also deals with more complex situations which not always is covered in the CPC, according to D.

Do you think the Code of Professional Conduct is enough to secure the independence?

The respondents' opinion if CPC is enough to secure auditors independence differs in various ways. The thing they all agree on is that CPC is a good guideline for auditors and it can be consulted when complex situations occur. Furthermore many respondents stresses that most of the threats to their independence can be eliminated or reduced to an acceptable level by using past experience or consulting a more experienced auditor. According to A, CPC never can guarantee that the auditor's independence is secured,

but if followed it should be enough. A and B has never encountered a situation that not has been covered in the CPC and B thinks CPC is a good tool to use to ensure auditors independence. According to B CPC is a sufficient framework in today's design. F, D and C believe CPC is insufficient to secure the auditors independence and C highlights that no legislation can be complete and never covers all issues. Despite this, both C and D don't think more regulations are the way to secure independence. Using CPC as a guideline, consult your colleges and use your own experience are all equal important ingredients to secure independence. F puts it like this:

"You can only regulate something to a certain amount, after that it all comes down to the person and personality in question"

Respondent E don't believes CPC is enough to secure independence in a theoretical way but by using both his own and colleges experiences to eliminate and/or reduce threats he can stay independent. E has never come across a threat that couldn't be placed under any of the five threats in the CPC. For that reason E believes CPC is a good and effective tool with many examples of threats and safeguards. F and G believe that CPC is enough to secure the independence. They are both in agreement that even if every possible scenario isn't covered in CPC you can always find a similar scenario to use as guidance. In addition to CPC you must also use experience and consult colleges, especially since many threats are reoccurring, says F and G.

Are the five threats equal occurring?

B, E, F and G believe the most common threat is the familiarity threat and it often occurs when an auditor has worked with the same client for a long time. It gets difficult to decide if the relation still is of professional nature. G and E also state the less common threat is the advocacy threat. According to C the most common threat is the self-interest threat and exemplifies with members of the audit team has stocks in the clients company. D says the most common threat is the self-review threat. D believes it's way too common that the same partner does too much, and that they aren't shifted often enough. This specially goes for smaller firms. To quote D:

"There are often different staffs on the bottom doing various things in the audit process and have different assignments and good rotation, but on the top it's often the same partner"

H points out the difference between big public companies from small companies when answering this question. When auditing a small client the self-review threat is most common, especially if the client wants assistance on how to present different accounting figures.

When auditing public companies H says it's often someone in the audit team who have stocks in the client. Respondent A highlights every situation is unique and therefore has its own answer, by using good judgment and always acting in a professional way your reputation as an independent auditor should be ensured.

Do you consult CPC when you encounter a threat?

Respondent A usually uses her experience before consulting CPC. Only in rarely unique situations she consults CPC and sometimes also SAICA support for guidance. B states, since she has short experience, she cannot use experience as much as seniors, but instead of using CPC she rather consults colleges. C believes CPC is useful when encounter new issues and even though the occurred threat isn't mentioned in the handbook, C can look at other similar threats and, thereby manage the situation. D believes CPC is more useful to auditors with less experience and when you become, for example a partner in an audit firm you work more with your experience and with more advanced situations, which the CPC may not cover. F, H and G believes CPC is a good framework that offers guidance to auditors, but as you gain more experience it's natural you use that experience and/or consult your colleges rather than consulting the CPC.

Is the regulatory framework completely, or do you feel it can be developed?

A doesn't mention having come across any loopholes. Rather than commenting on the framework she stresses that by using professional judgment at all time you don't have to worry about being dependent. Respondent B and E believe the regulatory framework is sufficient in design today and can't think of a threat that isn't covered by the CPC:s five threats.

According to C no regulatory frameworks are ever enough to cover everything. Legislation can never be complete and cover all issues. Despite this C doesn't mention ever having come across a loophole. At the same time C don't believe more regulation is the way to go, it's more about getting auditors to always think of the basic ethics of the profession. D doesn't believe the framework itself is enough to secure

independence, however she believe it works as a good guideline. F can't think of any loopholes in the regulation, but at the same time she stresses that just because she can't think of loopholes in the regulation doesn't make the regulation complete. It is rather the opposite and F is sure loopholes exist. Respondent G is of another opinion and believes the regulatory framework covers everything, and if it doesn't, you can always find a similar situation in it that can guide you when a new threat has occurred. H has similar believes and says you can't say there are loopholes in the regulation just because you come across a threat that isn't specified in the handbook.

5. Analysis

In this chapter the empiric data is analyzed. Different issues and behaviors are discussed and explained with help of the framework and the auditors opinions. It is structured in a chronological order of the interview template to give the reader a clear overview.

5.1 Generally about the auditors independence and threat against it

When does a dependent viewpoint occur, according to you?

The high educational demands result in well-educated individuals which also is visible in the answers. All the respondents are well aware of what is expected from them considering the independence issue and the answers points out the knowledge of when a dependent viewpoint occur. They have understood their important role of an independent party to reduce the asymmetric information between the agent and principle (Messier, 1997) and the bad reputation of the profession has resulted in legislation and ethic codes that emphasize the importance of being independent. Many respondents also say a good reputation of the profession is vital to attract new customers and in the end the whole profession is depending on what services the customers are paying for. This is in compliance with earlier research by Healy et al. (2003) emphasizing the importance of being independent as an external auditor.

Which is the most common threat against the independence, according to your experience?

The most common threats, according to the respondents are the familiarity threat and the issue considering fees. These answers is in compliance with the result from an earlier study (Bakar et al. 2005) which points out the great issue of keeping the relation to the client on a professional level and also that big fees can become an independent issue if the revenues from the client represent a large part of the total revenues of the firm. (Bakar et al. 2005)

The relation issue in the article (Bakar et al. 2005) emphasizes the client often wants a close relation to the auditor, while the auditor have to keep it on a professional level but still as a consult, has to make the client satisfied. The results of the article also highlights that this issue is even bigger in a small town. Because of that the empirical

data in this study is even more congruent to the earlier research since Pietermaritzburg can be seen as a small city.

The issue considering the fees can be seen from two different perspectives. The first perspective is when different audit firms are driving the prices down because of a competition situation. One of the respondents says the “big four” firms have been driving the prices down so much that the quality of the audit might be affected in terms of time and resources. This is in compliance with the article of Munro et al. (2011) saying the auditor is not required to find all errors in a financial report. But if the audit team is short of time and resources the auditor might miss errors larger than the materiality.

The other way to look at this issue is from the opposite angle, where the fees are too high. This perspective is also mentioned in the article of Bakar et al. (2005). The authors of the article emphasize that if the revenue from one firm is too high it might affect the independence of the auditor in a negative way since the audit firm is dependent of that revenue to survive. The size of the fees is mentioned and regulated in the South African legislation, but it only says the fees can't be too high or too low. (SAICA, 2010)

This could be a problem, according to respondents of this study, since it is up to every single firm to determine what is too high and too low which can end up in a non-preferable competition situation. One of the respondents says the self-review threat is the most common threat against the auditor's independence since it is hard to avoid to consult and even harder to see the difference between guidance and consulting. One of the respondents says the consulting and audit shouldn't be offered by the same audit firm. Porter et al. (2008) is of the same opinion and mean the audit should be focused on collecting audit evidence justifying the management of the client is acting in a way that is preferable for the different stakeholders of the company and that the financial reports are reflecting the reality for the company.

For how long time do you think it is proper for an auditor to work with the same client?

Five of eight respondents think the current legislation, considering time limit for audit the same client, is good. The other three respondents don't think there should be any difference between public and private companies since most of the two types of companies have stakeholders that are interested and dependent on fair independent financial reports. An argument against the last mentioned is the difference in the ownership structure. In a public company there are many different owners making their investment decisions on the financial reports, while in private companies the owner often is the same individual as the one running the company and thus already knows what happening in the company, i.e. there are no asymmetric information between the owner and the management in a private company and thereby the independence is not as important as in public companies. (Respondent D)

What is your opinion about that audit firms offer both consulting and auditing to the same client?

All respondents can see the issue of offering both consulting and audit to the same client. Even though, some respondents think the threat is eliminated/ reduced by make sure there are different departments controlling the consultation and the auditing. Other respondents says it will be hard to maintain independent no matter if there are different departments controlling, because the independent is not just something you are but also something you have to be able to show you are. This is something written in both SAICA (2010) but also in an article by Richard (2006). The result of the article highlights the importance of being independent in appearance and also the different from being independent in mind. The results of the article points out it is not enough to just be independent in mind if you can't prove it in appearance, because the stakeholders make their decisions from what is seen. (Richard, 2006) Previous studies also emphasize the issue of offer both services to the same client and the result shows it often becomes a threat against the auditor's independence. (Ashbaugh et al. 2003). The respondents in this study also make different between small and large audit firms and believes it is easier for larger firms to offer both services since there are more auditors to rotate with and thereby reduce the self-review threat.

Do you think it is hard to keep the relation with the client on a professional level?

The answers from the respondents were pervading. All of them said it is hard but important to be professional and keep the relation with the client on such level, but it's something they manage. That answer was expected and can be questioned for not being honest. Even if it seems to be important and something the respondents are aware of, a previous study shows this issue is even harder in smaller cities since it is a bigger risk you already have, or develop a personal relation with the client. (Bakar et al. 2005) Another reason to question the respondents' sincerity is that the familiarity threat is the threat mentioned as the most common. If the respondents act professional the familiarity threat wouldn't occur from the beginning. Many of them say it is hard to see the border between a private- and a professional relation and maybe that's the reason why the threat is commonly occurring. When looking at the purpose of auditing (Porter et al. 2008) it is hard to see why this threat is so common. But when looking at other previous studies (Bakar et al. 2005) it explain why this threat is so common since the client often wants a closer relation than is proper for the auditor.

Is the current legislation reasonable or is the requirement on auditors to high?

All the respondents think the current legislation is good. It is enough strict to prevent loopholes and is a useful guidance. Some of the respondents emphasize the role of the professional auditor and says it doesn't matter how strict the regulations are, because in the end it is all about the moral and ethics of the profession. It is impossible to create regulations without loopholes. If an individual wants to circumvent the law he or she will always be able to do that. One of the respondents exemplifies this with the fees. The size of the fees is not regulated in exactly an amount, the legislation only says a audit firm can't to charge a too high or too low amount. The rest is left to every single audit firm to decide. The respondents believe it is necessary with strict regulations and a high quality considering the ethic codes, because the auditor has a lot of power and also the license to directly affect companies and thereby indirect people's situations. Another argument why the auditor needs strict regulation is the fact that the auditor is supposed to reduce the asymmetric information between the management and the stakeholders. If the auditor can't find guidance in the law there's a risk is the financial reports will be unstructured and thereby difficult to interpret. (Porter et al. 2008)

Has a dependent position cast yourself to give up/ reject an assignment?

All of the respondents have come across different threats but no one has rejected an assignment, according to their answers. But if an auditor of a firm is, for example, to close friend to the client he or she will probably send the client to one of his auditor colleagues. The question is if the respondent even thought of that or if they don't see that as a rejection of an assignment. The answers of the question regarding if CPC is a good tool to use was positive. Most of the respondents think it is a good tool and that was the purpose with this question. The previous thoughts about if they understood the question is irrelevant and will therefore not be discussed anymore.

5.2 Code of Professional Conduct and auditors' independence

Do you have the Code of Professional Conduct in mind as you work?

It is clear CPC is a both useful and common tool in the auditors work, since all the respondents are in agreement of its existence in the back of their mind. However it should be noted that the level of use varies depending on the auditor's experience. It is a distinct trend that respondents with less experience consults CPC more frequently and respondents with greater experience relies more on their experience, which also is in compliance with the respondents answers. The exception from this is respondent E who has great experience but still often both use and consults CPC. This can be explained by the fact that E teaches in the subject and has to be up to date of CPC at all time.

CPC is a cornerstone in the ethical behavior for an independent auditor (SAICA, 2010) and the fact respondents see it as a useful guidance implies it is of great importance for auditors to act independent both in appearance and in state of mind as SAICA (2010) intend.

Another explanation to why respondents are greatly aware of the independence issue is the educational demands. They are seen as high according to the respondents and focuses on the importance of both acting and being independent. Institutional theory says the institutions guide and influence people in different situations and helps them to act in the way the society expects them to act. (Scott, 1995) By developing a tool, in terms of CPC, SAICA has succeeded in emerging a regulatory framework that is accepted by both auditors and society and act as a guide how you as an auditor should act in doubtful situations.

Do you think the Code of Professional Conduct is enough to secure the independence?

All respondents are in agreement that CPC works as a good guideline but the opinion if it's complete differs. While some respondents believe it is, some says it's not and goes as far as saying regulations can never be complete or enough. Respondent F puts it like this:

“You can only regulate something to a certain amount, after that it all comes down to the person and personality in question”

At the same time the respondents point out the importance of consulting colleagues, using experience and individuals basic moral and ethical values as necessary complements to CPC. Institutional theory explains the forming of regulation with a triangular model (figure 2). One viewpoint is if the government lets different association set up new regulations which is called corporatism. (Willmott et al. 1992) The government is just overlooking the standards and makes sure the profession is following them. Another viewpoint is associationism, which means different interest groups in the community band together to set restrictions and guidelines. (Willmott et al. 1992)

South African auditors seem to look at the regulatory framework on ethics, CPC, as a guideline they consult when threats to independence can't be reduced/ eliminated by experience or assistance by colleagues. This would place CPC somewhere between corporatism and associationism in the institutional triangular model, figure 2. The framework is developed from different international accepted standards such as GAAP and IFRS. (www.info.gov.za) At the same time experience, consultancy of colleagues and basic ethical/ moral valuations is of great importance, which place CPC as more of a guideline where auditors retrieves guidance.

Are the five threats equal occurring?

Most of the respondents list the familiarity threat as the most common, with the explanation of the non-existing rotation when a private company is audited. Another common explanation according to the respondents is the five year limit a partner is allowed to represent a client when it comes to public companies. Some respondents believe it's wrong to use a specific number of years to determine when an auditor can be considered dependent. According to CPC the familiarity threat is a threat due to a long

or close relationship with an audited client, an auditor will be too sympathetic to their interest or too accepting of their work. (SAICA, 2010)

Even though most respondents agree the occurrence of familiarity threats is depending on how many years an auditor represent the same client, the opinions on what too many years is separates. In other terms the distinction of “too long” is hard to determine. Previous studies shows auditors should avoid relations that can be seen as conflict of interest as well as all relations that can affect their objectivity and independence in order to not risk their independence. (Vanasco et al. 1997)

The respondent’s opinions about relations are very similar and all believe it should be kept on a professional level. Richard (2006) also points out the importance of this by stating, the auditors relation with the company should be divided into a professional and a private role. If both parties are professional their relation should also be professional. The big issue here is how to distinguish when a professional relation passes to a private.

A noteworthy aspect is that some respondents states the rotation isn’t good enough when it comes to partners, since the audit firms only rotate the audit team. Maybe this cause for changes in either the legislation or in the audit firms procedures.

Finally a common opinion respondents have is, if it’s a public company that is audited, the main threat is if someone in the audit team have a personal interest in the company. Usually stocks, which then gives rise to the self- interest threat. This threat however is usually easy to determined and by excluding the affected auditors it’s reduced/ eliminated.

Do you consult CPC when you encounter a threat?

As previous mention the respondents values CPC as a good tool to consult, especially when new and tricky situations occur. However rather than consulting CPC respondents turns to colleagues for guidance and/ or use their own experience. Therefore CPC could be considered more as an educational tool, used when auditors learn their theoretical basis, whether this is its purpose or not. Once out working, CPC figures more in the back of auditors head and experience plays a bigger role than CPC. A possible explanation for this is that many threats are frequently occurring which makes it unnecessary to consult CPC on regular basis. The argument is underlined by several of the respondents and A talks about them as “experience threats”. Since CPC:s five

threats of the auditors independence most often are of this nature, colleagues and experience must be considered equal important tools when facing threats of the independence.

This means the educational level must be of high standard and CPC should be imprinted in auditors mind at an early stage, which it is, according to the respondents. A risk which arises from this behavior is that the safeguards become too much routine and it is of vital importance that auditors keep up to date with CPC.

Is the regulatory framework complete, or do you feel it can be developed?

The fact that none of the respondents can think of a loophole in CPC suggests it's a well-developed tool. The regulatory framework is appreciated by all of the respondents and used to a varying extend. It is probably a step to far to say it is complete, the question is if any legislation ever can be complete. According to the respondents the opinion varies if CPC is enough to secure independence while none believe it is complete. Respondent C puts it like this; no legislation can be complete and cover all issues. Everyone believes CPC is a good tool even if not complete and once again, basic ethics and moral values are considered as important as the legislation. The respondents seem to be in agreement that behaviors cannot be forced by laws.

Institutional theory aims to explain how different institutions arise and leading to rules, regulations and norms for people in the society and to explain why people act and think in a certain way. (Scott, 1995) Earlier in the analysis South Africa was placed between Associationism and Corporatism in the theoretical model which explains how new regulations is formed (figure 2). The respondents do not believe behaviours can be legislated into existence. Laws can control the behaviours of individuals but it is the individual's fundamental ethical and moral values that ultimately matters. CPC probably don't need development even if not complete, it is rather factors as basic moral and ethical that needs review.

6. Conclusions

In this final chapter a concluding discussion will be presented. It also contains our thoughts and reflections as well as suggestions for further research.

6.1 Concluding discussion

According to the answers, South African auditors seems to be well educated and have a great awareness of the expectations from public when it comes to the independence issue.

They point out the importance of always being and acting independent. It seems like earlier auditing scandals, like the fall of Enron and Worldcom (Healy et al. 2003), had a great impact on auditors. These audit scandals have also put the independence issue on the map, which shows in the respondent's answers. The fact auditors nowadays seem to be more aware of the importance of being and acting independent also reflect positively on the reputation of the professional auditor, which was demonized by scandal. The worldwide scandals have resulted in stricter regulations and laws considering auditors independence, which thereby led to greater focus on the independence issue from professional auditors perspective. Hopefully this will improve the reputation of the profession and also the trustworthiness of the financial reports.

The most common threat against auditor's independence, according to the respondents, is the familiarity threat and more specific the relation issue. It seems to be very hard to distinguish when a professional relation becomes a private relation and how to safeguard against it. This is an issue that also is discussed in previous research (Bakar et al. 2005, Rischard, 2006, Vanasco et al. 1997). The only way to avoid it would be to avoid all relations, which of course is impossible for auditors. The challenge is to have a good relation to the client but still keep it on a professional level. Another viewpoint on the issue is that auditors nowadays, in addition to traditional auditing services, also have to attract new clients and thereby act as salespersons. This is something that could be considered to affect independence in a negatively way since it increase the level of personal relationships and also forces the auditor to act in a way that affects the independence.

The issue of fee is also a common answer of the question considering the most common threat. If a competition situation drives the prices down, it might have a negative impact on the quality of the audit. If the fees are too high on the other hand, the audit firm might be too dependent of that revenue and thereby the independence could be questioned.

The respondents answer in this study can be interpreting as a need for an interval considering the amounts of the fees. Another positive side effect of introducing an interval could be that the competition situation becomes fairer and the "big four" gets less space to control the price levels.

When it comes to how long an auditor should represent the same client, it is probably necessary to regulate it, even if it is hard to specify a number of years to distinguish when an auditor becomes dependent. While one auditor might end up in a dependent situation after just one year another auditor could maintain independent for more than five years. It is hard to regulate a behavior if not impossible, so in the end it is all about the basic moral and ethics of the individual. The fact that many auditing firms offer both consulting and audit services is seen as a big issue, according to the respondents. Since consulting is relatively new and escalating, the question is if the legislation is up date and covers all vital issues. It is also important the audit firms can separate the consulting department from the audit department to avoid the self-review threat. Since it is necessary for an auditor to be independent in mind as well as independent in appearance (SAICA, 2010 and Richard, 2006) it could be problematic to offer both services to the same client since society can get the wrong opinion considering the independence of the auditor. The boundary between a private and professional relation is often hard to distinguish. An earlier study points out the same issue (Bakar et al. 2005), but if this is depending on indistinct legislation is hard to determine. This give rise for the familiarity threat and many of the respondents say it is hard to see the border between a private- and a professional relation which might be the reason why the threat is commonly occurring.

The respondents believe the current legislation and regulations are good and help them in the daily work. The importance of legislations and recommendations is highlighted especially since auditors should act as independent agents and ensure the financial reports are reflecting the economic status and the performance of the client. As earlier mentioned, it is impossible to legislate behaviors, so in addition to legislation

it is also important with the auditor's ethics and basic moral. This could be seen as the legislation is enough, because as long as individuals want to circumvent the law they will success and therefor it is even more important the ethics and moral of the audit profession is good.

None of the respondents have rejected or resigned an audit assignment because of an independence issue. This can be interpreted from different perspectives. The first interpretation is that CPC is a great tool to secure the independence since all of the respondents have been able to reduce all the threats they have come across. Another way to look at the answers is that the acceptable levels are too high, i.e. it is easy to reduce the threats to the level which is enough according to the legislation. A third way to interpret the answers is with an institutional viewpoint. The ethics and the moral of the profession might be so good that these threats easily can be reduced or eliminated. Many of the respondents also says the often consult their colleges to find a effective way of reduce the threat. If that is enough the ethics and moral of the profession must be very good.

CPC is a frequently used tool to secure the independence of the South African auditor and seem to figure in the back of auditors head, even if some respondents believe there are details in CPC that need a review. CPC could therefore be seen as a cornerstone but is not enough itself to secure auditors independence. In addition to the CPC the auditors must rely on the basic ethics and moral values, consult their colleagues and use experience in the quest to be and act independent.

Since it earlier has been suggested that behaviors can't be legislated, a reasonable conclusion is that conditions, as independence, neither can be legislated. Therefore it seems naturally CPC needs complements to get auditors to act and be independent.

Since CPC appears to be more frequently used by younger auditors than auditors with more experience, it could be seen as an educational tool. During auditors education it is great focus on CPC and the independence issue, something that seems to reflect many years after the education. From that viewpoint CPC must be considered both vital and useful.

6.2 Suggestions for further research

The focus of this study is from the auditor's point of view and what they think of the independent issue. A proposal on further research is to see this issue from others views. For example, it would be interesting to investigate the client's opinion, their thoughts considering this issue and what they think about the current legislation. Another perspective to tackle this issue from could be from the stockholders viewpoint and if they are confident the financial reports are correct and established under independent state of mind and thereby reliable.

The empirical data was gathered in South Africa. The quality of auditing in South Africa is one of the highest ranked of the world. (www3.weforum.org) For this reason it would be interesting to compare the results from this study with a study where the data is collected in Sweden. The reputation of Sweden, considering auditing, is also very high (www3.weforum.org) and because of that a study comparing this countries could result in solutions both countries could gain from.

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Interview with respondent G, Pietermaritzburg, 2012-04-04

Interview with respondent H, Pietermaritzburg, 2012-04--04

Appendix 1

Interview template

Part 1

Generally about the auditor's independence and threats against it

1. When does a dependent viewpoint occur, according to you?
2. Which is the most common threat against the independence, according to your experience?
3. For how long time do you think it is proper for an auditor to work with the same client?
4. What is your opinion about that audit firms offer both consulting and auditing to the same client?
5. Do you think it is hard to keep the relation with the client on a professional level?
6. Is the current legislation reasonable or is the requirement on auditors too high?
7. Has a dependent position cast yourself to give up/ reject an assignment?

Part 2

Code of Professional Conduct and auditors' independence

1. Do you have the Code of Professional Conduct in mind as you work?
2. Do you think the Code of Professional Conduct is enough to secure the independence?
3. Are the five threats equal occurring?
4. Do you consult CPC when you encounter a threat?
5. Is the regulatory framework complete, or do you feel it can be developed?

Appendix 2

Respondent A

A is working for one of the largest firms in town, aside from the “big four” where she also is a partner. The firm has a number of registered auditors and has most of their clients in the area. She has been a registered auditor for 17 years.

Part 1

According to this respondent the independence issue considered when employees first start at an audit firm and not when you start getting clients. However, respondent A is careful to point out that the preparatory work done before you accept client or accepting an assignment is most important to avoid an independence situation. For respondent A the relationships, which don’t need be direct family relationships, and self-interest in clients companies are primarily associated with a lack of independence. Respondent A argues that small and medium enterprises in the private sector can use the same auditor and the auditing firm for up to 15 years, without having to affect the auditor's independence. Rather than a situation of losing independence, A believes that a too soon rotation of auditor and audit firm leads to the audit becomes too costly. This is for example justified in that system changes and understanding of the internal systems of the company being audited takes time and a too tight rotation of auditors therefore is not preferred.

A, however is careful to point out that different clients require different solutions and that every client is unique and requires its own tailored solution. From personal experience A points out that clients would prefer a long relationship with their auditors and suggests that they would meet the client's requirements by having the engagement partner remain the same but rather replacing the engagement team. Another solution is that if there are multiple partners represented in the audit firm, that they can rotate among the partners but still allow the client to stay with the same firm.

For listed and public companies, A is careful to point out that they by Companies Act may not represent the same client for more than five years, which A also thinks is reasonable. Here, there should be stricter regulation when there is more at stake as A put it. Consulting is according to A necessary both for auditing firms to grow but also to enable businesses to do the same. However, consulting and auditing services should be

kept separate and carried out by different departments in the auditing firm, whether it's a large or small office. Respondent A sees no problem in that the same office is involved in both consulting and auditing, but is careful to point out that the various services should be performed by different departments. It should also indicate in a clear way that there are different departments that perform different services, for independence not to be questioned. In order to perform a good audit A believes that a good understanding and thereby a good relationship with the client is required. The auditor must know which people in the company are key people and therefore which people the auditor should communicate with to get good and valuable information about the company and to create a good understanding. However, it is important that this relationship is kept professional and the auditor must be careful not to enter into a relationship which becomes personal. Auditor independence is a topic that is discussed daily in A's office and with even more focus since scandals like Enron and Worldcom, but also similar scandals but on a smaller scale in South Africa, was brought to light. A suggests that it is good that the independence topic is "hot" and that it leads to more stringent and meticulous auditors. In A's firm, they have internal questionnaire that auditors must use to help secure their independence.

Part 2

Respondent A emphasizes that the CPC should be borne in mind at all times, whether you have a client at that time or not. A is not willing to go so far as to say that CPC is a guarantee to secure the independence of the auditor, but if followed the CPC according to A should be enough to secure auditors independence. The respondent has never encountered a situation that has not been included in the CPC. According to respondent A, the five threats of the auditor to independence that the CPC recognizes are of such a nature that they are generally resolved by the auditor experience, therefore A addresses them for experience threats. However, it may sometimes be necessary to look in the SAICA Handbook and specifically in CPCs for guidance. A also highlights that in some tricky situations that cannot be easily interpreted, they have the opportunity to contact SAICA support for guidance. A point out that this is very unusual, but that it does occur. Situations may arise during an audit that can lead to that the auditor's independence being disturbed, in this case the whole situation needs to be re-assessed and a decision made whether the auditor can continue with the engagement or if the auditor needs to resign. Using your judgment and

separating all situations is vital according to A, and illustrates it by asking the following questions:

Can your independence be questioned if your client gives you a pencil?

Can your independence be questioned if your client gives you a BMW?

A answers these questions by pointing out that probably no one would question your independence if you accept a regular pencil from your client, it might even be seen as an insult. But you still have to use your professional judgment before accepting the pencil. If you on the other hand accept a BMW from your client you can be pretty sure that questions about your independence will arise. In conclusion A highlights that every situation is unique and therefore has its own answer, by using good judgment and always acting in a professional way your reputation as an independent auditor should be ensured.

Respondent B

B has worked with auditing for one year and is employed by one of the “big four” firms, she is stationed in both Durban and Pietermaritzburg.

Part 1

Respondent B says the independence is very important to the whole auditing team and is something that is standard to think of during an auditing assignment. Further B means that the auditor always, on a daily basis has to evaluate situations that might affect the independence direct or indirect towards the client. B exemplifies a direct threat against the independence with the familiarity threat that always is an issue when the auditor has worked with the same client for many years. Even though the professionalism of the profession is good B thinks the current legislation of five year auditor rotation is a good way of handle that issue for public companies, but also the intern rotation in the auditing is an effective way to handle that issue according to B.

B emphasizes the difference between public and non-public companies as the important aspect of the ownership structure and the fact that the independence of the auditor is more important in public companies considering the principle- agent theorem.

A also thinks the time of five years is a moderate period to audit the same client without affect the independence in familiarity way.

Another common threat against the independence, according to B is the fact that most auditor firms offer both consultation as well as auditing to the same client. Sometimes it is hard to not give recommendations to the client without impact on the independence. In those cases it is important to be able to reference to the consultation division of the firm so the auditor doesn't exposes to the self-review threat. B thereby means it is important that there are different persons that consult and audit.

When it comes to the personal relationship with the client B again emphasize the great importance of professionalism. Without professionalism the firm will lose the client and thereby reducing the total revenues for the auditing firm. B says that it many times can be difficult to determining whether a situation might affect the independence or not and in the end the auditor must use its experience to evaluate every unique situation.

Even though the professionalism is very importance the auditor and the client have to work a lot together and because of that it is also important that there is some kind of friendship to facilitate the efficiency in work of both according to B.

B says the independence is an important part of the audit and that is tested and secured both before as well as after an audit assignment. The new rules and legislations, as a result of the large audit scandals worldwide are not too strict or hard according to B, at least not on B's level of the audit team. This far B has not resigned or rejected an assignment because of an independence issue.

Part 2

CPC is nothing B thinks of in the daily work, but is something that comes naturally. B believes a good education and solid trained is important to create a natural independent thinking and to provide the work environment space to regularly evaluate the independence toward the client. Opinions and observations related to independence are often discussed among the colleagues and B believe that is because the large auditing scandals worldwide.

On B:s level there is more focus on the actual audit rather than on the independence, but B thinks the independence part is a greater deal for the partners of the firm.

B think the CPC is a good tool to use to ensure the independence and that the regulatory framework is sufficient in design today. B cannot think of a threat that isn't covered of the CPC:s five threats.

When a threat arises B believes it is easier to consult a more experienced colleague than to find the solution in the SAICA handbook. B further states that common sense and a reliance on past experiences often is enough to eliminate or reduce a threat.

The most common threat, according to B is the familiarity threat which often occurs when an auditor has worked with the same client for a long time. It is often difficult to decide if the relationship has become more than just professional.

Respondent C

C has worked with auditing for 15 years and is very familiar with the legislation and the issue considering auditors independence.

The most common threat against the independence of the auditor occurs because of the fee the client pay for the audit. According to C they are often too large and thereby affect the auditor to act in a way that makes the client satisfied. C also mentions the issue that occurs when an auditor firm offer both consulting and audit to the same client. "That should not exist" C says and points out that one of the "big four" audit firms is selling out the consulting part because of the independence problem consulting results in.

C doesn't think 5 years for public companies is an appropriate time to have the same auditor. C means that after 3 years the independence is affected and the personal relationship to the client will definitively be hard to manage during the fourth and fifth year. Because of that C thinks 3 years would be more appropriate as a limit for audit rotation and that limit should not be applied on just public companies but also on private companies sense even those companies have stakeholders that rely on the auditor's fairness of the review and secured independence.

It's very important that the relation with the client stays strictly professional according to C. Even though, it is important to have an effective and trusted relation with the client to make sure the client doesn't conceals important information from the auditor. This balance can be tricky for the auditor according to C. An auditor don't want to effect the

relation in a negative way by say no to for example a dinner, but the auditor also have to make sure that dinner should be in an professional atmosphere. The auditor must always evaluate different situations and always mindful not to compromise the independence, C says.

C thinks the current legislation is good and is a result of the new issues that occurs on a regular basis. That means that the legislation today is good, but needs to be reconstructed to be effective in the future also. The legislation should be developed in the same pace as new problems arise, according to C.

C has never been forced to resign or not accept an assignment because of an independence threat.

Part 2

Since the auditor deals with confidential information and is the one the stakeholders base their decisions on, it is important for the auditor to always have CPC in mind according to C.

The CPC is not enough to secure the auditor's independence because no legislation can be complete and cover all issues. Despite of that, C doesn't think the current law should be redesigned or more detailed, but always think of the basic ethics of the profession. So, additional to the CPC, the auditor can evaluate threats and counter them with help of colleges and former experience. C also says that every person in the profession is free to contact SAICA support for guidance.

C says the most common is the self interest threat and exemplifies with members of the audit team have stocks in the client. C often looks in the SAICA handbook to counter new kind of issues and even though the occurred threat isn't mentioned in the handbook C can look at other similar threats and, thereby manage the situation.

Respondent D

Has worked with auditing for three years at one of the “big four” firms and is currently stationed in Pietermaritzburg. Nowadays she works more with accounting than with auditing, but still does both.

Part 1

D directly points out that a dependent situation always arises when it comes to the size of the fee for the audit. From D’s experience there is kind of a struggle between the “big four” firms and that this often has an adverse effect on the quality of the audit. So the single biggest threat to the independence of an auditor is also according to D the fees.

When it comes to the problem of both consulting and audit within the same firm D means that it’s ok that a firm has both these divisions but that they should be separated and newer controlled by the same partners. It that’s the case D thinks it’s a big threat to the independence of the whole firm.

Respondent D don’t think there should be any differences for the time an auditor can work with the same client and as long as there is multiple partners within the audit firm D doesn’t see any need for a legally restricted period of time that a audit firm can have the same client. D however is careful to point out that smaller firms, with just one or two partners, only should keep the same client for five years, as restricted by law.

When it comes to the auditors relations towards its clients D believes that there should be some personal relation to higher the quality of the audit. D develops this by saying that you don’t have to go on fishing trips with your client, and off course you shouldn’t do that, but you should be friendly and have a good relationship. Since it’s a gray area D think the relationship also should depend on the size of the audit firm. In bigger firms with multiple partners the auditors have more room for friendly relationships than in smaller firms with just one or two partners. However D don’t think it’s ever appropriate with gifts between the auditor and the clients, and that you should be careful to get too friendly with your client if you are an auditor.

D thinks that scandals like Enron and Worldcom has contributed strongly to making the auditors independence a hot topic, and also points out that it's dangerous to start favor and helping people in your professional environment, which D still believes is far too common.

The legalizations on auditors' independence and ethics are a good basis but that it's necessary for the audit firms to expand them. As an example D goes back to audit fees, there is regulatory that too high and too low fees can't be charged, but it doesn't say what exactly is to high and what is too low. This is therefore often determined by the firms themselves and can vitiate from one firm to another and it's D's opinion that fees and similar things needs to be determined by law and legislated.

D has never personally been forced to give up or reject a assignment, but D's firm has been involved in situations that cast them to both give up and refuse assignments.

Part 2

D thinks that CPC is in the back of auditors head at all times, but not like they walk around all days and thinking about it and making sure everything is done exactly according to CPC, more like it's there because it's such a big part of the ethics auditors must learn. Respondent D don't think CPC itself is enough to make sure that auditor act independent but that it works as a good guideline. D believes that CPC is more useful to auditors with less experience and when you become for example a partner in a audit firm you work more with your experience and with more advanced situations, that the CPC may not cover.

When it comes to the threats in CPC, D thinks that the most common one is the self review threat. D explains this with that it's her believe that it's way too common that the same partner does too much, and that they aren't shifted often enough. This specially goes for smaller firms, but D had also experienced it in the "big four" firms. To quote D:

"There are often different staffs on the bottom that does various things in the audit process and have different assignments and god rotation, but on the top it's often the same partner"

Respondent E

E has worked with auditing for more than 20 years and is a partner of a smaller audit firm in Pietermaritzburg. E also teaches in the theme of audit and is therefore very familiar with the legislation and the ethic codes of auditing.

According to E the work with the independence starts even before an assignment is accepted. E's experience says the familiarity threat is most common because of the auditor team consists of many different individuals that could have a personal relationship with the client's employees. For this reason, all individuals that should be included in the team must be checked to thereby ensure that no threat exists.

E only audit smaller private companies and says there is no problem to have the same client for more than 10 years. The only thing that has to be ensured is that the relationship stays on a professional level during these years and that both sides are pleased with it.

E says that consulting and audit to the same client can be tricky sometimes and self review threats can occur. Advices about taxation are common but those issues can E handle without affect the independence. E emphasize that advices about how the client should run the business etc are not given as long as E audit the client.

The personal relationship with the client must stay on a professional level according to E, but sometimes it hard to see the border between a personal and professional event. In those situations it is important to be critical and don't be afraid to disclose the client about the occurred threat.

E has never resigned or rejected an assignment because of any of the five threats in the CPC, but has reject assignment because of other reasons. For example, E rejected to audit a security firm because it was a high risk mission and the owner had a doubtful background.

Respondent E points out that it can be hard to reject assignments because of the lost revenues that causes. But even if it is hard you have to think in a long run perspective and of the reputation of the audit firm, E adds.

Part 2

E always has the CPC in mind during audit work. E also teach in the audit area and for that reason E always is up to date regarding news in the CPC.

Respondent E don't think the CPC is enough to secure the independence, not in a theoretical way at least, but in practise E also use his own and colleges experience to make eliminate threats and thereby stay independent. E always makes sure that he and his audit team are independent and test it both before as well as after the audit assignment.

E has never come across a threat that does not can be placed under any of the five threats in the CPC. For that reason E thinks the code is a good and effective tool with many examples of threats and safeguards.

The most common of the five threats is the familiarity threat as was written above. On second most common is the self interest threat with its financial dilemma. The self review threat is also quite common because of the mix of consult and audit services. The advocacy threat is the less common threat against auditors' independence according to E.

Respondent F

F has worked with auditing for 12 years and is currently employed at one of the "big four" firms in Pietermaritzburg. She has worked at both smaller and larger auditing firms.

Part 1

The auditor has to start consider independence as soon as he or she becomes an auditor. The independence is always under review and regardless if the auditor is about to accept an assignment, is currently working with an assignment or after finished an assignment there is a risk of ending up in a dependent situation. F:s experience is that the familiarity threat is the most frequently occurring and also the threat she has to look out for. However she has never been forced to reject or resign from an assignment.

F thinks that the regulation provides good guidelines for how long an auditor can represent the same client. She, as well as the regulation, points out that there is a

difference between public and private companies. When it comes to public companies with lots of different stakeholders she believes that the 5 year limit is fair. A longer time would probably end up with that the auditor's independence starts to be questioned by different stakeholders. In smaller private companies there is not the same problem according to F and she don't see a problem with an auditor representing the same client for up till 10 years without having the independence questioned. She explains this with that there is less incitement for the auditor to act dependent when the economic factors is limited and therefore don't motivate the auditor to act in someone else's interest.

It is F:s opinion that larger auditing firms should be careful with offering both auditing and consultation. She explains this with that even if the consultation and the auditing is done at separate divisions with separate partners according to the audit firm you can never control that this really is the case. Therefore it is not preferred that this to services is performed by the same audit firm. For smaller firms F believes that they shouldn't offer consultation at all. F however is careful to stress the difference between consultation and guidance, some basic financial guidance can be offered by both larger and smaller firms without having to affect the independence. It is when it comes to active consultation the problem arises.

F can see how the relationship between the auditor and the client can be a threat to the independence. However she has not experienced this as a problem personally. According to F it's not much different to any professional relationship, you need to respect each other, give and take some and watch out so you don't get to personal. Remember to always keep it at a professional level to avoid any questions about your independence.

F believes that the main reason for that auditors independence is constantly discussed is because the auditor can make such a big different. The indirectly has control over very large amount of money, this off course mainly goes for larger public firms. F means that the big firms and big audit scandals has put the light on al auditors and auditing firms, regardless of size.

Part 2

F says that CPC probably lays latent in her mind as she work, but she doesn't actively think about it while working. She consults CPC sometimes when it comes to complex situations, but nowadays she relays more on her experience. Therefore F believes that CPC is a good framework that offers guidance to auditors, but as you gain more experience it's natural that you use that experience and more rarely consult the CPC.

F also stresses that CPC never can be enough to secure the auditors independence. She puts it like this:

“You can only regulate something to a certain amount, after that it all comes down to the person and personality in question”

When it come to loopholes in the regulation she can't think of any, but she also stresses that just because she can't think of loopholes in the regulation doesn't make the regulation complete. It's her opinion that regulations never can be complete, and that there most certain exists loopholes in it. Out of the five main threats against auditors independence that CPC handles the most frequently occurring is the self interest threat according to F. She thinks both CPC and her company has good safeguards and procedures to handle/reduce any problems caused by the familiarity threat.

Respondent G

G has been working with auditing for 12 years for one of the “big four” in Pietermaritzburg.

Part 1

The independence is very important according to G and she always have to think of it in work. The most common threat against the independence is the familiarity threat. Another threat G mention is the issue with the fees.

When it comes to Gs' opinion considering audit firms offer both consulting and audit she can't see that as a problem at her employer. “We have different departments for auditing and consulting” G says and means that one person never consult and audit the same client. G thinks the legislation of 10 year auditor rotation for public companies is

proper and she says that the number of years is good to manage the familiarity threat. The personal relationship can be hard to maintain on an acceptable level, according to G. She says sense Pietermaritzburg is a rather small city people know each other quite well and therefore many times it can be hard to keep the relationship on a professional level.

Her solution of this issue is to always think twice before she acts or say thinks that's not belong directly to the work she is doing for the client.

The new auditing legislations worldwide are of course results of the huge scandals, according to G. G also thinks the new regulations and are good for the reputation of the profession and she don't thinks they are to strict. She says auditing is an important part of the society and all different stakeholders must be confident that the reports are a correct reflection of the reality. G has never resigned or rejected an assignment because she couldn't reduce a threat against the independence.

Part 2

G always has the CPC in mind in work. She says it is an important part of the final product that she and her team are independent. The CPC is enough to secure the independence, according to G. She says you can find guidance for most of the threats she has came across during her years in the profession. Of course, all different situations are not mentioned in the handbook, but it is easy to find a similar and use that example as guidance when reducing or eliminating a threat. Even if G often looks in the handbook for guidance she says many threats are recurring and therefore she can use her experience instead. She also often asks her colleges for guidance when new threats occur.

G doesn't think anything is missing in the CPC. According to her, there are no loopholes even if every possible threat isn't mentioned. G means that it usually is obvious when a new situation is a threat and when it's not and she has never came across a situation when she couldn't solve it with help of CPC. G says the familiarity threat is the most common threat in her work. Advocacy and intimidation threat are the least common.

Respondent H

Part 1

H thinks the most common threat against the auditor independence is the consulting-audit issue. It's often hard for the auditor to avoid the self-review threat, especially for smaller audit firms according to H. When it comes to the current legislation of the five years audit rotation H don't think such a long period is proper. He means it's impossible to put up a number of years and say that is the correct number. Instead H means you have to look at every specific assignment since all of them have different conditions from the beginning. Sometimes it is hard to maintain independence after just one year but sometimes it's no problem even after 10 years. H thinks the legislation should be the same for public and private companies H is not satisfied with the current legislation and he think many auditors with less experience than him might look too much in the regulations and rules and don't rely to their own professional judgment. H means the legislation is not enough to secure the independence. The rules and regulations have to be combined with the ethic codes of the profession because it is impossible to create rules that covers all possible issues that occurs. The consulting- audit issue can be a problem according to H, but as long as the consulting and the audit is made by different persons it is possible to maintain independent and avoid the self-review threat. Again, it is all about ethics and common sense of the auditor.

When it comes to the question about the auditor's personal relationship to the client H again point at the ethic codes. You, as an auditor, must rely on your professional judgment and common sense. H means it sometimes can be hard to reject gifts and invites to events with the client and the line between what is proper or not is often very diffuse. H says the auditor must act professional in such situation, even though the client doesn't see the difficulty of the situation. H says this many times can be hard for the auditor to explain for the client. Both the client and the auditor need an effective and reliable relationship, but from the auditors perspective the relationship cannot be more than on a professional level. As an example H says it might be ok to play golf together once a year, but if it happens every weekend the relationship is probably on a non acceptable level from the auditor's point of view.

H thinks the current laws and regulations are good as guidance but can never be complete. In the end it is about the law, ethics of the profession and the common sense and experience of the auditor combined. These factors needs to be aggregated in order to solve new issues and threats against the independence according to H. H also says it is important that the education level of the profession is up to date and they make sure they are upgraded when, for example, new derivatives starts to be used. H means the worldwide audit scandals aren't a result of insufficient laws. It is a result of deficient ethic and poor educated profession, according to H. H has never rejected or resigned an assignment because of an independence issue.

Part 2

The CPC is very important to H and even if he doesn't think of it every day he always has it in mind to when new situations and questions occur. H think the five threat cover all different threats that can occur, but again, if you can't find exactly the same threat exemplified in the SAICA handbook, you must act professional and use your experience and common sense to reduce the treat to an acceptable level. You can't say there are loopholes in the law just because the threat you have came across isn't written in the handbook, according to H.

Of the five threats listed in the CPC, H thinks the self-review and the self-interest are the most common. The self-review because when you audit small clients you often get questions about how to present different accounting entries to affect the result in a certain direction. In those cases, as an auditor, you have to make sure you just present alternatives for the client and don't suggest a particular solution, H says. The self-interest threat is common when you audit public companies, according to H. He says someone in the audit team rather often have stocks in the client. H doesn't very often look in the SAICA handbook. Instead he uses his long experience in the profession to reduce or eliminate threats.