



**A qualitative analysis of auditors' responsibility in South African
corporate scandals**

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Abstract

For time immemorial, the audit profession has faced backlash from the users of the annual financial statements (AFS) for not doing enough. The calls for the auditor to do more come at times when the entities being audited go into liquidation, business rescue or become corporate failures and these entities were audited with no issues being detected and reported to the users in the audit report. This resulted in financial losses to the users of the AFS who made economic decisions based on the AFS that were audited. The response by auditors is often that it is not their job to prevent corporate scandals or to detect fraud. The role of the auditor in contributing to the corporate scandals not being detected and reported was explored in this study. This study employed a qualitative document analysis approach to analyse the contents of documents relating to the performance of the audit on corporate scandals that occurred in South Africa since 2000 and for which information on the performance of the audit was publicly available. A total of three corporate scandals were explored to determine the contribution of the auditor to the corporate scandal not being detected and reported. A self-developed index was used to categorise the findings into the standard of audit work performed to answer the research questions and achieve the research objectives. It was found that in all three corporate scandals that were analysed, an inappropriate audit opinion was issued and therefore, an audit failure existed. Further, it was found that the audit partner was not independent and detected the material misstatements in the AFS but failed to report the misstatements in the audit report in all three instances. This study sought to provide an understanding of the contribution of the auditor to the corporate scandal. This study provided insight to the role of the auditor in not detecting and preventing corporate scandals and specifically where the problem lies. To the best of the author's knowledge, this study was the first study that explored the contribution of the auditor to corporate scandals not being detected and reported. Future research could explore the role of auditors in more corporate scandals as more information becomes available as well as exploring the role of auditors in corporate scandals in other countries.

Keywords: Corporate scandal, corporate failure, audit failure, financial reporting fraud, accounting fraud and accounting irregularity

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List of acronyms and abbreviations

| | |
|------------|---|
| ACFE | Association of Forensic Examiners |
| AFS | Annual Financial Statements |
| AG | Auditor-General |
| CA | Chartered Accountant |
| CFO | Chief Financial Officer |
| EQCR | Engagement Quality Control Reviewer |
| GOA | General Accounting Office |
| IRBA | Independent Regulatory Board for Auditors |
| IESBA | International Ethics Standard Board for Accountants |
| ISA | International Standards on Auditing |
| JSE | Johannesburg Stock Exchange |
| KPI | Key Performance Indicator |
| KPMG | KPMG South Africa Incorporated (KPMG) |
| MAFR | Mandatory Audit Firm Rotation |
| Nkonki | Nkonki Incorporated |
| PIE | Public Interest Entities |
| PFMA | Public Finance Management Act |
| PWC | Price Waterhouse Cooper |
| SAA | South African Airways |
| SARB | South African Reserve Bank |
| SARS | South African Revenue Service |
| SAICA | South African Institute of Chartered Accountants |
| The AP Act | The Auditing Profession Act No 26 of 2005 |

Chapter 1: Introduction

1.1 Introduction and Background to the study

The audit profession in South Africa has been barraged by allegations of negligence and stakeholders questioning the relevance of the profession. (Majola,2021) The allegations were because of alleged or actual fraud and misconduct in companies that were audited but the material misstatements were either not detected and reported or were detected and not reported on. Such companies were audited by external audit firms ranging from the “Big 4” (Deloitte, Price Waterhouse Coopers, KPMG, and Ernest and Young) to mid-tier firms such as Ngubane & Co. and Nkonki Inc. (Accountancy SA,2020) Companies such as VBS Mutual Bank, Steinhoff International, South African Airways and Tongaat Hulett engaged in financial reporting fraud in preparing their AFS. (News 24,2020) These fraudulent AFS, which had been audited, were then used by investors in their investment decisions as well as by financial institutions in granting finance to these companies. These companies incurred large litigation claims for loss of shareholder value and misrepresenting their financial position to financiers. The price of Steinhoff International Holdings NV shares fell from R8,80 on 5 January 2018 to R1,07 on 4 June 2018 representing an 88% decrease in share price. The company is also battling with large debt levels and is technically insolvent. (Kruger,2022) Similarly, Tongaat Hulett Limited shares fell from R53,17 at the beginning of 2019 to R16,50 on 15 July 2019 representing a loss of 69% of shareholder value. (Callidus,2019) Tongaat Hulett was also not financially stable and was battling with high levels of debt to a value of R20 billion that the company cannot pay-off. (Arde',2022)

These corporate scandals are believed to have been gone undetected due to audit failures and as a result South Africa's audit profession ranking slipped from first in the world for the period 2010-2014 to 49 by 2019 (World Economic Forum,2014) (World Economic Forum,2019). After a financial statement fraud is exposed, a common question from the public is “Where were the auditors?” (Deloitte,2012:15)

Apart from the allegations of fraud and misconduct, there is a perception by the Independent Regulatory Board for Auditors (IRBA)-which regulates external audits in South Africa-that the quality of audits is decreasing (Logie and Maroun,2021). The

IRBA performs inspections annually on audits performed by South African audit firms and reports on the quality of the audits. The outcomes of these inspections are classified as Satisfactory, Unsatisfactory or Investigation. An unsatisfactory outcome is one in which significant improvement is needed as the audit opinion may or may not be appropriate. A referral to investigation outcome is where there is a fundamental failure in the audit. Unsatisfactory and Referral to Investigation outcome implies that the audit report issued may not have been appropriate. (IRBA,2021a)

The outcomes of audit inspection findings over the years as published by the IRBA are summarised below:

Table 1: Outcomes of IRBA inspections in South Africa (Source: student's own work)

| Outcome/Year | 2016¹ | 2017² | 2018³ | 2019⁴ | 2020⁵ | 2021⁶ |
|---------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Investigation | 14% | 6% | 14% | 21% | 24% | 20% |
| Unsatisfactory | 47% | 45% | 32% | 41% | 39% | 34% |
| Satisfactory | 39% | 49% | 54% | 38% | 37% | 46% |
| Total | 100% | 100% | 100% | 100% | 100% | 100% |

As seen above, the number of engagements referred for investigation has increased considerably from 2017. The results contained in the table reflects the concern pertaining to the audit profession in South Africa as not even half of engagement file inspections pass satisfactorily, one fifth of all audits are referred to investigation and more than half of the audit files inspected may have issued inappropriate audit opinions.

Corporate scandals

A corporate scandal refers to a situation of actual or alleged wrongdoing that becomes publicly scrutinized (Concise Encyclopaedia of Business Ethics,2023). For the

¹ IRBA,2018

² IRBA,2018

³ IRBA,2018

⁴ IRBA,2021b

⁵ IRBA,2021b

⁶ IRBA,2021b

purposes of this study, the term corporate scandals specifically refers to alleged or actual fraudulent financial reporting.

A corporate scandal may have an audit failure as a contributor. For example, when the AFS are fraudulently misstated and the audit does not detect and report the material misstatements due to negligence of the auditor, an audit failure would have contributed to a corporate scandal not being detected and reported. An audit failure results from poor audit quality.

Fraudulent financial reporting

The Association of Forensic Examiners (ACFE) (2023) defines fraud as an intentional misrepresentation or concealment of a fact to influence the actions of another to not act against their own best interest. The International Standards on Auditing (ISAs) (2004) that govern the performance of financial statement audits similarly define fraudulent financial reporting as an intentional misrepresentation to obtain an unfair advantage.

The fraud triangle theory was introduced to highlight the conditions that are usually present when financial statement fraud is perpetrated (Cressey,1953). Reasons for financial statement fraud being perpetrated can be classified into these conditions (perpetrating the fraud due to an incentive or perceived pressure, a perceived opportunity to commit the fraud and rationalisation for perpetrating the fraud).ISA 240: The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (2004) paragraph A1 includes these fraud risk indicators as factors that the auditor should be aware of when identifying and assessing the risk of fraud. Corporate scandals such as Tongaat Hulett and Steinhoff were perpetrated by company management who concealed misstatements in the AFS and was undetected and/or not reported by auditors who issued an unmodified opinion. Financial statement fraud is difficult to detect as it is intentional and therefore the perpetrator can conceal the fraudulent misstatement. The auditor may not detect the fraud even when the audit is performed to the highest standard. Therefore, not detecting a financial statement fraud on its own does not mean that the auditor was negligent or that an audit failure occurred. (ISA 240,2004)

There are also instances whereby fraud is perpetrated by the auditor.

Auditor Fraud

Auditors have also been found guilty of fraud. In such instances, fraud was perpetrated by audit partners who detected the material misstatements contained in the AFS but did not report these material misstatements to users of the AFS as the audit partners signed unmodified audit opinions. This act of detecting the material misstatement but not reporting it in the audit report meets the definition of fraud as the act of not reporting the material misstatements is an intentional act by the auditor to conceal the nature and amount of the material misstatement. One such instance of this was the audit engagement partner on the VBS Mutual Bank audit who knew that the cash balances were materially misstated yet signed the unqualified audit opinion. (Motau,2018) The audit partner also had loans granted to him at favorable terms that impaired or is perceived to have impaired his independence. (Motau,2018).

This study aimed to determine the contribution of the auditor to corporate scandals not being detected and reported. The findings of the study as it relates to auditor fraud is that the auditor was guilty of fraud in all three case studies analysed per the AFCE definition of fraud.

Corporate scandals and audit failures are neither new to the auditing industry nor to South Africa. The next paragraph will highlight the history of audit failures and corporate scandals in South Africa.

History repeating itself

An article by accounting magazine, Accountancy SA (1993), titled "Profession in crisis?" questioned whether the audit satisfied the needs of the users of the AFS as users had lost confidence in the service being provided. The regulatory body of auditing in South Africa agreed in 2020 that the audit still needs to meet investors' needs. (IRBA,2020) Since 1993, the volume and losses incurred per corporate scandal has increased significantly. As will be seen in the following sections, not much has changed in the past thirty years.

In 1994, the South African Institute of Chartered Accountants (SAICA) performed an investigation into the existence of the audit expectation gap between the public's

expectations and the work performed by auditors in the South African audit industry. SAICA thereafter strategized to reduce the expectation gap. This strategy was contained in a discussion paper termed DP 12. The audit expectation gap is explained in the following chapter. However, there was no criteria provided to inform the reader of how opinions of interested parties were selected for inclusion in the paper. The consultation process included mainly seven of the big audit firms and was therefore not representative of the population. References made to published and other material was also inadequate, amongst other deficiencies as noted. (Gloeck and De Jager, 1994)

1.2 Problem statement

The entities that became corporate scandals were audited by external auditors prior to the scandal. The external auditor did not detect and/or report the material misstatements in the AFS and therefore issued an inappropriate opinion. Consequently, the users of the AFS relied on this opinion and made economic decisions which resulted in financial loss.

At the heart of the problem lie the reasons for the auditors' failure to detect and report the material misstatements that resulted in the corporate scandals.

1.3 Research Aim

To the knowledge of the author, the role that external auditors played in the corporate scandals has not been examined before by means of evaluating the auditor's performance. As noted in the literature review, the users of the AFS believe that the auditors should have detected and reported the material misstatements contained in the AFS prior to the entity becoming a corporate scandal.

Therefore, the aim of this study was to establish whether there was deficient performance (by not detecting and/or reporting material misstatements in the AFS therefore resulting in an audit failure) on the part of the auditor during the audits of entities that subsequently became corporate scandals in South Africa since 2000.

1.4 Objectives of the study

The objective of this study was to explore the role played by external auditors in corporate scandals in South Africa.

This was determined by:

1. Evaluating whether an audit failure existed by assessing the appropriateness of the audit opinion issued to the entity; and
2. Assessing whether the audit failure contributed to the corporate scandal not being detected or prevented.

1.5 Research questions

1. How did the auditor contribute to the entity becoming a corporate scandal?

To answer the main research question, the following sub-research questions were explored:

2. What was the nature of the material misstatements contained in the financial statements of entities that became corporate scandals?
3. What was the cause of the material misstatements in the financial statements not being detected and reported in the audit opinion?
4. What could the auditor have done to detect and report the material misstatements in the annual financial statements?
5. What was the appropriateness of the audit opinion issued?
6. What were the findings against the auditor by regulators, the investigative journalists and forensic experts?

1.6 Significance of the study

As highlighted in the literature review, a study of this nature has not, to the knowledge of the author, been performed before either locally or internationally. Therefore, the study provided new insight into the auditor's contribution to corporate scandals being undetected and unreported in South Africa by evaluating the performance of the auditors.

This study contributed to the discussion surrounding the role that auditors' failures played in corporate scandals not being detected and reported in South Africa as well as the reasons for the deficient performance of auditors.

1.7 Scope of the study

This study explored the contribution of the external auditors to the corporate scandals that occurred in South Africa since 2000. Of the eight corporate scandals that occurred in South Africa since 2000, only three corporate scandals had sufficient publicly available information pertaining to the performance of the audit and therefore all three scandals were included in the study. The publicly available sources of data were used

employing a document analysis to qualitatively and inductively explore the contribution of external auditors to the corporate scandals not being detected and reported.

1.8 Organisation of the study

This dissertation comprises of five chapters which are structured as follows:

Chapter 1 contains an introduction to the study, its background, scope and significance as well as objectives and research questions.

Chapter 2 contains a detailed literature review bringing to light the key concepts and theoretical concepts of the study.

Chapter 3 contains the research methodology including the research design, population and sample, data collection method, data validity and reliability and data analysis.

Chapter 4 contains the research results and a discussion thereof.

Chapter 5 presents the conclusions of the study and summarises the results and findings. Possible areas of future research are also included.

1.9 Chapter summary

This chapter provided an overview of the study. An introduction to the problem, the research objectives, questions, significance, and scope were also discussed. The next chapter contains the literature review highlighting the key theoretical frameworks underpinning the research.

Chapter 2: Literature review

2.1 Introduction of the audit expectation gap

The audit profession was created out of the demand for external assurance of financial statements prepared by management because of agency theory. (Chow, 1982) This theory notes that there is a conflict of interest between shareholders (who own the equity of the business but are not involved in the day-to-day decision-making), managers and those charged with governance (who are involved in the day-to-day decision-making of the financial resources provided by the shareholders and issuers of debt) and the issuers of debt. (Ross,1973) This conflict is due to shareholders wanting long-term value creation which is a result of sustainable, cash-generating operations, share price appreciation as well as dividends. Those who operate the daily activities of the firm (management and those charged with governance) want maximum personal remuneration in the short-term such as bonuses, promotions and increases which are earned based primarily on the financial results reflected in the AFS.(Cuevas-Rodriguez, Gomez-Meija and Wiseman,2012) Management and those charged with governance are therefore incentivised to present financial statements that achieve their personal objectives even though they are false or misleading to the shareholders.(Chow, 1982) There is an information asymmetry as management and those charged with governance have access to the true financial results where as the shareholders and issuers of debt only have access to the financial statements prepared by management. (Healy and Palepu, 2001)

The term “audit expectation gap” was defined by Liggio (1974) as the difference between the work performed by the auditor and what the users of the AFS want done. The Cohen Commission (1978) on auditors amended the definition to consider the fact that the users of the AFS may want work done that the auditor cannot realistically do. This was supported by Porter (1993) who dissected the audit expectation gap into the performance gap and the reasonableness gap. The reasonableness gap refers to the part of the audit expectation gap arising from users of the AFS having expectations that the auditor cannot practically meet-such as auditing every transaction. The performance gap relates to difference between the actual performance and what is required to be performed by the auditors. Porter (1993) further broke down the performance gap to recognise that auditors may not meet the expectations of users

as they are not required to (deficient standards) or because they did not perform the audit as required per the standards that govern audits (deficient performance). This was illustrated by Porter (1993) using the diagram below:

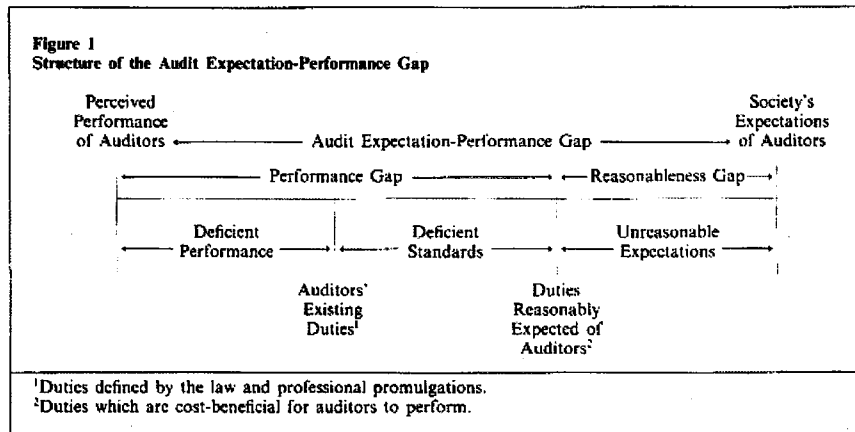


Figure 1: Structure of the Audit Expectation-Performance Gap (Porter, 1993:50)

In corporate scandals, the auditors of the entity often point to the reasonableness gap (that they could not possibly be expected to detect every fraud or prevent the corporate scandal) or the standards gap (the ISAs do not require the auditor to detect fraud which resulted in the corporate scandal not being prevented or detected). It may therefore be concluded that the auditors believe that they have performed the audits in accordance with the ISAs and that they are not required to identify fraud. The purpose of this study was to determine whether the auditors of the corporate scandals did not detect and report the material misstatements because they did not perform the audits in accordance with the ISAs.

The audit expectation gap has been confirmed in many countries as summarised in the table below. In South Africa, however, there appeared to be only one study confirming the expectation gap. This study was done by Gloeck and De Jager (1993), who concluded that the audit expectation gap existed. Those surveyed expressed concern regarding the perceived lack of independence of auditors as well as uncertainty surrounding the responsibility of the auditor for fraud and going concern issues. The requirements of the auditor pertaining to fraud and going concern has since been clarified in ISA 240: The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (2004) and ISA 570 (Revised): Going

Concern (2015) respectively for audits of year ends on or after 15 December 2009. Maseko, Yasseen, Paidia and Brahmhatt (2015) confirmed that not much research had taken place on the audit expectation gap in South Africa. None of these studies analysed the performance of the auditors. The table below summarises the research performed relating to the audit expectation gap:

Table 2: A summary of the studies performed internationally regarding the Audit Expectation Gap. (Source: student's own work)

| Title | Year | Country | Research method | Data collection method | Finding in relation to expectation gap | Aspect of audit expectation gap investigated |
|--|------|--------------------------|-----------------|------------------------|--|--|
| Are we closing the expectation gap? ⁷ | 1977 | United States of America | Quantitative | Survey | Audit expectation gap confirmed between Auditors and users of the financial statements | Standards gap relating to the responsibilities of the auditor regarding the disclosure of irregularities |
| The audit expectations gap in Britain: An empirical investigation ⁸ | 1993 | Great Britain | Quantitative | Surveys | Audit expectation gap confirmed | Performance gap of auditors |
| An empirical study of the audit expectation gap ⁹ | 1993 | New Zealand | Quantitative | Survey | Audit expectation gap confirmed | Performance gap of auditors |
| Investor views of audit assurance ¹⁰ | 1994 | United States of America | Quantitative | Survey | Audit expectation gap confirmed between Auditors and Investors | Reasonableness gap related to the level of assurance to be provided by auditors |
| The Focus Point of the | 1994 | Republic of South Africa | Quantitative | Surveys | Audit expectation | Audit expectation |

⁷ Baron, Johnson, Searfoss and Smith,1977

⁸ Humphrey, Moizer and Turley,1993

⁹ Porter,1993

¹⁰ Epstein and Geiger,1994

| Title | Year | Country | Research method | Data collection method | Finding in relation to expectation gap | Aspect of audit expectation gap investigated |
|--|--------------------------|----------------------------|-----------------|------------------------|---|---|
| Audit Expectation Gap in the Republic of South Africa ¹¹ | | | | | gap confirmed | gap regarding the responsibilities and independence of the external auditor |
| Auditors and investors perceptions of the expectations gap ¹² | 2001 (Submitted in 2000) | United States of America | Quantitative | Survey | Audit expectation gap confirmed between Auditors and investors | Reasonableness expectation gap relating to the duties of the auditor |
| An empirical investigation of the audit expectation gap: Australian evidence ¹³ | 2001 | Australia | Quantitative | Mail questionnaire | Audit expectation gap exists | The audit expectation gap created by the wording of the audit report regarding the nature of an audit and the duties of management and the auditor respectively |
| An empirical study of the audit expectation gap ¹⁴ | 2004 | People's Republic of China | Quantitative | Surveys | Audit expectation gap confirmed between auditors and users of the financial statement | Audit expectation gap relating to the responsibility for fraud detection |

¹¹ Gloeck and de Jager, 1994

¹² McEnroe and Martens, 2001

¹³ Munroe and Woodliff, 1994

¹⁴ Lin and Chen, 2004

| Title | Year | Country | Research method | Data collection method | Finding in relation to expectation gap | Aspect of audit expectation gap investigated |
|--|------|------------------------------------|------------------------------|--|---|--|
| An exploratory ¹⁵ study into the auditor's responsibility for fraud | 2005 | Barbados | Quantitative | Survey of auditors and users (management and | Expectation gap exists and is wide | Audit expectation gap relating to the unrealistic expectations - the responsibility for fraud |
| Locating audit expectations gap within a cultural context: The case of Saudi Arabia ¹⁶ | 2007 | Saudi Arabia | Qualitative and quantitative | Surveys and Interviews | Audit expectation gap confirmed between auditors and users of the financial statement with deficient standards and deficient performance being the key perceived causes | Performance gap relating to auditors' duties as well as a reasonable expectations gap relating to the auditor's responsibility for fraud detection |
| Audit Expectation-Performance Gap Revisited: Evidence from New Zealand and the United Kingdom | 2012 | New Zealand and the United Kingdom | Quantitative | Surveys | Audit expectation gap confirmed | Performance gap, reasonable expectations gap and standards gap |

¹⁵ Alleyne and Howard, 2005

¹⁶ Haniffa and Hudaib, 2007

| Title | Year | Country | Research method | Data collection method | Finding in relation to expectation gap | Aspect of audit expectation gap investigated |
|---|------|-------------|-----------------|------------------------|--|---|
| Part 1 and 2: Changes in the Gap in New Zealand 1989–2008 and in the United Kingdom 1999–2008 ¹⁷ | | | | | | |
| Audit Expectation Gap between Auditors and Users of Financial Statements ¹⁸ | 2014 | Pakistan | Quantitative | Survey | Audit gap exists relating to the usefulness and reliability of financial statements | Reasonableness gap |
| Addressing Information Needs to Reduce the Audit Expectation Gap: Evidence from Dutch Bankers, Audited Companies and Auditors ¹⁹ | 2015 | Netherlands | Quantitative | Survey | Information regarding on-going errors and reported errors may reduce Bankers' audit expectation gap while changes to the audit report format did not | Reasonable gap relating to |
| Audit Expectation Gap in The Public Sector in Romania ²⁰ | 2015 | Romania | Quantitative | Survey | Audit expectation gap confirmed between | Reasonable gap regarding the audit profession and the audit |

¹⁷ Porter, hÓgartaigh and Baskerville,2012

¹⁸ Devi and Devi,2014

¹⁹ Litjens, van Buuren and Vergoosen,2015

²⁰ Dhana,2011

| Title | Year | Country | Research method | Data collection method | Finding in relation to expectation gap | Aspect of audit expectation gap investigated |
|--|------|-------------|-----------------|------------------------|--|--|
| | | | | | Student's unreasonable expectation of Auditors' Profession | expectation gap regarding fraud detection by the auditor |
| The Audit Expectations Gap in Turkey ²¹ | 2015 | Turkey | Quantitative | Survey | Audit expectation gap confirmed | Audit expectation gap relating to the performance gap and the reasonableness gap |
| Fraud: auditor's responsibility or organisational culture ²² | 2017 | Middle-East | Quantitative | Survey | Audit expectation gap confirmed between Auditors and users of the financial statements | Audit expectation gap relating to the responsibility for Fraud |
| The Existence of Expectation Gap Between Financial Statement Users and Auditors from Various Aspects in Surabaya ²³ | 2018 | Indonesia | Quantitative | Survey | Audit expectation gap confirmed between Auditors and users of the financial statements | Expectation gap regarding the auditor's role and the audit process |
| A Partial Least-Squares Structural Equation Modelling Approach to Investigate the | 2019 | Bangladesh | Quantitative | Surveys | Audit expectation gap confirmed | Reasonable gap and performance gap |

²¹ Kose and Erdoğan,2015

²² Jizi, Nehme and ELHout,2017

²³ Ajeng,2018

| Title | Year | Country | Research method | Data collection method | Finding in relation to expectation gap | Aspect of audit expectation gap investigated |
|--|------|---------|-----------------|------------------------|--|--|
| Audit Expectation Gap and Its Impact on Investor Confidence: Perspectives from a Developing Country ²⁴ | | | | | | |
| The relationship between audit components and audit expectation gap in listed companies on the Tehran stock exchange ²⁵ | 2019 | Iran | Quantitative | Surveys | Audit expectation gap confirmed | Performance gap and reasonableness gap |

Numerous studies performed have confirmed that there is an audit-expectation gap relating to the auditor's responsibility for fraud and the auditor's perceived lack of independence. Baron, Johnson, Searfoss and Smith (1977) noted that auditors and the users of the financial statements required that the auditing standards should be updated to require the auditor to report material irregularities detected during the audit. It is noted that the study has acknowledged the updated standards that addressed the identified standards gap. Baron, Johnson and Turley (1993) found that in Britain, there was an expectation gap relating to the auditor's responsibility for fraud, the perceived performance of auditors and the nature of the audit function.

Gloeck and de Jager (1994) conducted a study which found that there was an audit expectation gap regarding the role and independence of the auditor. The study found

²⁴ Fengju and Akther, 2019

²⁵ Salehi, Jahanbin and Adiban, 2019

that 53.7% of individuals that are not auditors surveyed believed auditors are influenced by management (Gloek and de Jager,1994:23) and 49% of auditors surveyed agreed with that statement reflecting that the concerns of the public are valid. (Gloek and de Jager,1994:24) The study also found that 29.1% of individuals that are not auditors expected the auditor to actively search for fraud where as only 14% of auditors thought that it was their responsibility to search for fraud. (Gloek and de Jager,1994:27) Kose and Erdoğan (2015) likewise found that the users of financial statements believe that auditors tend to serve the audited company's management and that an audit will prevent management of a company from perpetrating financial fraud. McEnroe and Martens (2001) came to a similar conclusion when they surveyed investors who indicated that the auditor should confirm that the financial statements are free from management fraud before signing an unqualified audit opinion. Epstein and Geiger (1994) found that almost half of the investors surveyed expected the auditor to provide absolute assurance and over 70% of investors expected the auditor to detect material misstatements due to fraud which was contrasted by the auditor of which only 26.36% responded that they believed that the auditor should detect material misstatements due to fraud. (Epstein and Geiger,1994:62) This was further corroborated by Haniffa and Hudaib (2007) who confirmed that the auditor and financial directors differ from other users of the financial statements in relation to the responsibility of the auditor in relation to fraud detection and the reporting of suspected fraud to regulatory bodies. This is consistent with the findings of Lin and Chen (2004) who performed a similar study in China with the users of the financial statements and auditors. Porter (1993) confirmed the existence of a performance gap in New Zealand as ten out of eighteen duties of the auditor that the users of the financial statements expected the auditor to perform, were already duties of the auditor as included in the auditing standards. Porter, hÓgartaigh and Baskerville (2012) performed a follow-up study comparing the change in the audit expectation gap between 1989 and 2008 in New Zealand and 1999-2008 in the United Kingdom respectively. The authors noted that the audit expectation gap has improved, specifically in the United Kingdom, in part due to the scrutiny faced by the auditors. Auditors were also found to have evolved as the needs of users increased.

Despite the consistent belief of auditors that it is not their responsibility to detect fraud, Jizi, Nehme and ElHout (2017) found that auditors in the Middle East actively search

for illegal acts committed by their clients to protect the reputation of the audit firms. This is in contrast with the study conducted by Haniffa and Hudaib (2007). However, in the firmer study, the authors attribute this to the corporate scandals that occurred since 2007.

Munroe and Woodliff (1994) found that changing the wording in the audit report significantly reduced the audit expectation gap regarding the some of the responsibilities of the auditors and management such as the responsibility for maintaining records, but also created new expectation gaps regarding responsibilities such as the auditor's responsibility to detect fraud and the prospects of the company as this was not clearly addressed in the new wording of the audit report.

Alleyne and Howard (2005) found that in Barbados, the auditors believed it is management's responsibility to detect fraud but management and the users of financial statements believed it is the auditor's responsibility to detect fraud. Similarly, Dhana (2011) found that there was a significant difference in the expectations of students regarding the auditor's independence, responsibilities for fraud and credibility of the audit report based on their level of work experience. Students ranged from distance-learning with more work experience to students enrolled in Masters programmes and students with little or no work experience.

Litjens, van Buuren and Vergoosen (2015) conducted a study in which the informational needs of bankers as the users of the financial statements were surveyed and found that bankers are more impacted by the disclosure of additional information being disclosed in the financial statements such as covenants and covenants breached, audit procedures performed to assess the continuity of the business than auditors or managers and that the needs of bankers will not be met by strengthening the legitimacy of audits.

Although numerous studies were conducted, most studies performed were of a quantitative nature using surveys and did not obtain a deep understanding of the heart of the problem relating to the audit expectation gap. The use of surveys provided participant's opinion on the topic, however, none of the studies obtained an in-depth understanding of the validity of the opinions of the participants. None of the studies performed obtained objective evidence on the validity of the auditor's opinion that fraud

is not their responsibility. The validity of the auditor's opinion may be questioned if it was found that the auditor did not perform audits to the standard required in the audits of entities that became corporate scandals and that the auditor could have detected the fraud had the auditing standards been applied correctly.

In South Africa, Ramsarghey and Hardman (2020) explored the role of the auditor in South African corporate scandals. Although the study also adopted a qualitative document analysis, the study did not evaluate the performance of the auditors in audits of entities that subsequently became corporate scandals but rather evaluated peer-reviewed articles on the findings against the auditor. The study found that an audit firm's large clients may exert pressure on the auditor to act in contravention to the Code of Professional Conduct.

Erasmus (2022) considered the role of the auditor in driving accountability in the South African public sector and found that that auditors should be enablers of accountability. The study however, did not analyse the performance of the auditors on audits of entities that became corporate scandals.

Ferreira (2020) also considered the role that auditors played in the corporate scandals in the United States of America by evaluating other studies performed on the topic rather than evaluating evidence of the auditor's performance during the audit. The study found that a lack of auditor independence, poor quality and conflicts of interest contributed to corporate failures not being detected and reported. However, the study did not evaluate the performance of the auditors on audits of entities that became corporate scandals.

Hurley, Mayhew and Obermire (2019) conducted a quantitative study in the United States of America whereby they evaluated the effect of changing the economic bond between auditors and management as well as making auditors psychologically accountable to investors in an experimental audit market. The study found that changing the auditor's financial relationship with management to one of psychological accountability to investors significantly increased audit quality. However, this study did not evaluate the contribution of auditors to corporate scandals not being detected or reported by analysing the auditor's performance.

Alabede (2012), based on a survey of the clients of audit firms, concluded that there are auditors who are discarding their professional ethics in the pursuit of monetary gains. This study did not analyse the performance of the auditor on the audits of entities that became corporate scandals

Peecher, Solomon and Trotman (2013) conducted a study in which they used a two-dimensional framework to determine what could regulators use to motivate auditors to improve quality and to evaluate how well auditors executed their duties. Four potential changes came out of this study, namely implementing a rule for inspectors to use in evaluating the judgements made by auditors, the use of a concurrent element in inspections, auditors questioning the judgements made by themselves and rewarding auditors that detect fraud. However, this study did not evaluate the contribution of auditors to corporate scandals not being detected or reported by analysing the auditor's performance.

McLaughlin, Armstrong, Moustafa and Elamer (2021) conducted a study in which a quantitative investigation was performed on the association between characteristics of an audit committee and the occurrence of a corporate scandal in the United Kingdom. However, this study did not evaluate the contribution of auditors to corporate scandals not being detected or reported by analysing the auditor's performance.

2.2 Audit Quality and Audit Failures

DeAngelo (1981) defined quality of an audit as a measurement of the likelihood that:

- (a) if there is a contravention of a statutory, regulatory or financial reporting principle, that the auditor will detect it; and
- (b) report the contravention to the appropriate parties.

DeAngelo's definition has two parts and emphasises an important point which is that the audit must detect the contravention as well as report it for the audit to be of a high quality. In the VBS Mutual Bank corporate scandal, it was found that the audit partner detected the material misstatement, however neither reported it to the users of the AFS, the IRBA as prescribed in terms of the Auditing Profession Act of 2005, nor was the matter reported to the South African Reserve Bank (SARB) that governs the banks in South Africa (Motau,2018).

Audit quality is determined by the appropriateness of the audit opinion and compliance with audit and accounting standards. (ISQC 1,2004) Therefore an audit failure exists when an inappropriate audit opinion is issued, specifically when the AFS contain material misstatements due to fraud or error and an unmodified audit opinion is issued stating that the AFS are free from material misstatement due to fraud or error. Consequently, an audit failure occurs because the auditor performs a poor quality audit in that he/she failed to comply with the relevant standards. This results in the auditor not detecting fraud or errors in the AFS which may result in an inappropriate audit opinion being issued.

To determine what the auditors should do, the standards on auditing was reviewed. The next section therefore examines the question of “What are auditors required to do?” by outlining the requirements contained in the auditing standards and relevant legislation.

2.3 International Standards on Auditing

The ISAs govern the performance of audits in South Africa and many countries internationally. Any differences between the performance of an audit and the requirements of the ISAs would represent a performance gap and any difference between what the ISAs require and what the auditor could reasonably be expected to perform would represent a standards gap.

2.3.1 ISQC 1: System of Quality Control

ISQC 1: System of Quality Control (2004) was applicable during the period when the perceived audit failures occurred and required the firm to obtain assurance that it and its staff complied with all applicable requirements and that appropriate reports are issued. Therefore, auditors are required to issue audit reports that are appropriate in the circumstances.

An audit failure because of the auditor’s negligence is therefore in contravention of the level of performance expected of the auditor. This constitutes deficient performance on the part of the auditor.

2.3.2 ISA 220: Quality Control for An Audit of Financial Statements

Paragraph 9 of ISA 220: Quality Control for An Audit of Financial Statements (2020) mandates the auditor to comply with the prescribed ethical requirements which includes independence. Paragraph A4 (explaining paragraph 9) notes the relevant ethical requirements as independence and objectivity amongst others. The auditor is to be independent in mind (actually independent) as well as independent in appearance (an outsider looking in should also view the auditor to be independent). The paragraph also refers to compliance with the International Ethics Standard Board for Accountants (IESBA) Code of Conduct. Part 3 of the Code details the requirements of auditors. (IESBA,2022) Section 340 of the Code requires the auditor to not accept any inducement offered with the intent to improperly influence the behaviour of the auditor. The section further states that the inducement was considered to be improperly influencing the actions of the auditor if it results in the auditor acting in an unethical manner. One of the safeguards recommended to reduce the threat arising from an inducement is to report the inducement to senior management of the firm.

Part 2 of the Code relating to conflicts of interest further requires that the auditor disclose any conflict of interest in a client.

2.3.3 ISA 240: Auditors responsibility for fraud

The standard requires the auditor to obtain reasonable assurance that the AFS taken as a whole, are free from material misstatement, whether due to fraud or error (ISA 240,2004).

The standard notes that there is an inherent risk that there may be material misstatements contained in the AFS even though the audit is performed in line with the ISAs (ISA 240,2004) This is consistent with the Supreme Court of Appeal of China and the Auditing Profession Act which finds the auditor liable for not detecting fraud only if there was gross negligence. (Lin and Chen,2004), (Auditing Profession Act 26, 2005).

The Treadway Commission concluded that at least one third of the corporate failures were a result of auditors' failure to identify the risk arising from fraud-related risk factors that would have been noted had the auditors performed the audits with the required diligence. (Chong,2013).

To assess the risk of fraud, the auditor is required to maintain professional scepticism which is defined as maintaining a questioning mind. (ISA 240,2004) The auditor is required to maintain a level of professional scepticism and the findings of Chong (2013), indicating that auditors lack professional scepticism, therefore point to the audit failures being caused by deficient performance and not deficient standards.

2.3.4 ISA 570: Going concern

The International Standards on Auditing requires the auditor to assess the going concern assumption of management. The standard states that the auditor is to obtain sufficient and appropriate evidence that the going concern assumption was applied appropriately. (ISA 570,2015)

The going concern assumption states that the AFS are prepared on the basis that the entity will continue to operate as usual for at least twelve months from the year end and will not liquidate or cease trading in that time. (IASB,2018). Therefore, when a corporate scandal occurs because of the entity not being able to settle their obligations as they fall due and an unmodified audit opinion was issued in the previous twelve months, an audit failure may have occurred as a result of deficient performance of the auditor. This will be examined in the case studies in the following chapters.

2.4 Other legislation

2.4.1 Companies Act 71 of 2007

Section 29 of the Companies Act (2008) requires all companies to prepare AFS that present the company's state of affairs fairly and must not be false or misleading and section 76 of the Companies Act requires directors to not knowingly cause harm to the company.

The Johannesburg Stock Exchange (JSE) recently banned the Chief Financial Officer (CFO) of Steinhoff International Holdings from being a director of a listed entity for 10 years as well as fined him twice for R1 million each after it found that he did not perform his duties as required and for the preparation of AFS that did not comply with International Financial Reporting Standards. (Smit,2022)

2.4.2 Auditing Profession Act No 6 of 2005

The Auditing Profession Act (2005) (The AP Act) prescribes the duties of Registered Auditors while performing audits. Section 45 of The AP Act, is specifically relevant as

it requires the auditor to report any suspected or actual reportable irregularity that has taken place or is taking place to the IRBA “without delay”. (The AP Act 2005:31)

Within the definition of a reportable irregularity is financial reporting fraud/ corporate scandals as it is an unlawful act by a person in management which is likely to cause material financial loss to shareholders and financiers, is fraudulent, or is a material breach of fiduciary duty of those charged with governance. Therefore, each corporate scandal that is detected by the auditor, is required to be reported.

2.4.3 Mandatory audit firm rotation

In response to the recent corporate scandals and perceived audit failures, the IRBA had planned to implement Mandatory Audit Firm Rotation (MAFR) in the audits of South African companies listed on the JSE as well as Public Interest Entities (PIEs). The IRBA’s view is that auditors that are not independent, and consequently lack professional scepticism, are part of the cause of the corporate scandals not being detected and reported. Harber and Marx (2020) found that Audit partners, CFOs and Audit Committee Chairpersons:

- disagreed with IRBA’s opinion regarding the lack of professional scepticism and independence in audits and that this results in misstatements not being picked up;
- agreed that independence and professional scepticism of the auditor is sufficiently legislated in the literature; and
- agreed that the newly appointed audit firm has a lower probability of picking up misstatements than the predecessor auditor.

However, it must be noted that the findings of Harber, Marx and De Jager (2020) that audit firms will have to incur significant costs as well as endure lost revenue from clients also indicated a possible reason for audit firms to be against MAFR. The auditor is conflicted in responding to MAFR as the auditor, a profit maximising business, would be forced under the MAFR to lose clients every 10 years where as audit revenue was previously all but guaranteed, recurring revenue. The auditor would also have to incur significant costs in upskilling and training staff for each new client (which they would lose in 10 years). The study also provided possible explanations for the audit committee chairpersons and CFOs not being in favour of MAFR. This is because the audit committee chairs would have to invest significantly more time in obtaining and assessing auditor tender submissions for each rotation as well as the CFO and senior

finance staff re-training new auditors after each rotation. Therefore, the CFO and audit committee chair is also conflicted in providing feedback on MAFR.

The General Office of the Accountant (GOA) performed a study on auditor rotation in the United States of America and had findings consistent with Harber and Marx. (GOA,2003).

Azadinamin (2012) found that the independence of the auditor, although refuted by those in Harber and Marx's study, is critical to the quality of the audit and the appropriateness of the audit opinion. He found that, in some of the major audit failures that occurred and have been studied thus far, the auditor's independence was found to have been impaired. In the Lehman Brothers audit failure, Azadinamin further noted that Ernest and Young intentionally turned a blind eye to the manipulations in the AFS. Arthur Anderson, auditor of Enron, was perceived not to be independent due to the extensive non-audit fees earned. (Lindberg and Beck,2004). It may therefore be concluded that the external auditor, as the audit firm is still private business, is conflicted in providing an opinion on this topic.

MAFR was implemented to increase audit quality by decreasing the familiarity threat and tenure between auditors and management of audit clients. This is due to the perception that if an audit firm's tenure is limited and a new auditor will be appointed after ten years, the auditor will act independently as the audit firm is not dependent on the revenue continuing beyond year 10. Based on the findings of this study, MAFR may be an appropriate response to prevent the profit-seeking nature of audit firms from over-shadowing their professional responsibility, independence and audit quality.

It is lastly noted that the Supreme Court of Appeal has set aside the MAFR on 1 June 2023 thereby negating the legal requirement to rotate auditors. (IRBA,2023a) This set-aside has created a greater need for a study of this nature. The findings of this study will contribute to the argument in favour of or against the implementation of the MAFR.

2.4.4 Zondo Report

The Zondo Commission was instituted in South Africa to commission an enquiry into allegations of State Capture. The enquiry noted that Price Waterhouse Cooper and Nkonki did not perform their duties as a watchdog institution in their audit of South African Airways (SAA) and that proper performance of their role would have resulted in the issues being picked up earlier. (Zondo,2022) Deputy Chief Justice Raymond

Zondo's opinion is important as it reflects the views of the users and relevant stakeholders who have expectations of the auditor. Whether these views or expectations form part of the reasonableness gap, performance gap or standards gap will be determined in the study by determining the auditors' contribution to the corporate scandal not being detected and reported.

2.5 Auditors' perceived responsibility for fraud

Precedent was set in the Supreme Court of China in 1996 when auditors were found to be answerable to the users who placed reliance on inappropriate audit reports. (Lin and Chen,2004). The AP Act similarly notes that the auditor is liable if it is proven that the auditor issued that audit opinion negligently (Auditing Profession Act, 2005). This method seems to strike a balance between the difficult nature of detecting fraudulently concealed material misstatements and the auditors using that justification as a get out of jail free card

In South Africa, the onus to prevent and detect fraud lies with management. (Accountancy SA,2021). However, the courts did not stop at holding management responsible when KPMG was sued for R863,6 million by the curator of the VBS Bank for the role played by KPMG in signing an unmodified audit report even though there were material misstatements as well as the audit partner being conflicted yet still being the audit partner on the engagement. (Buthelezi,2021)

Deloitte settled to pay up to R1.3 billion to claimants who were suing their audit client, Steinhoff International, for losses incurred. (Cronje,2021). These cases all point to the fact that if an inappropriate audit report was issued, the users and the Courts will hold the auditors liable.

The debate about the role of the auditor relating to fraud and the expectation gap has been extensively researched in the international context. In Turkey, the most common response from auditors is that it is not their responsibility to detect fraudulent financial reporting during the audit. (Kose and Erdoğan,2015) In Barbados, it was the perception of the auditor that the detection of fraud was within management's mandate meanwhile users of AFS disagreed (Alleyne and Howard,2005). In South Africa, there was a clear difference between the users' expectation of the auditor relating to fraud and the auditor's perceptions. (Maseko, Yasseen, Paidia and Brahmhatt,2015)

Haniffa and Hudaib (2007), Lin and Chen (2004) and McEnroe and Martnes (2001) note that auditors are not responsible to detect fraud in Saudi Arabia, China and United States of America respectively. Kassem and Higson (2016) concluded that the auditor was responsible for detecting misstatements arising from corruption which includes fraud as the result may be material misstatements in the financial statements.

The research performed on auditors penalised in China therefore reveal that it is the regulator's opinion that the detection of fraud is the responsibility of the auditor unless it was concealed in such a manner that made it almost impossible. (Firth, Mo and Wong,2005)

2.6 South African regulators' opinion

2.6.1 Independent Regulatory Board of Auditors

The former acting CEO of IRBA noted that IRBA's view is that there should be more duties placed on the auditor to satisfy the requirements of users. (IRBA,2021b) The IRBA also issued Staff Practice Note 4 in May 2022 which confirmed the duties of the auditor in line with ISA 240: The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements. (IRBA,2022a) The guide further noted that the Public Inspections Report found numerous significant reported findings concerning a potential lack of professional scepticism. This was consistent with the findings of the Chong (2013) and points to deficient performance rather than deficient standards. The audit regulator investigated Registered Auditors who audited the entities at which corporate scandals occurred to determine if the audits have complied with the regulator's code of conduct or professional standards. The IRBA's views are reflected in its actions of stripping Jacques Wessels, former audit partner of the Gupta-owned Linkway Trading of his title as registered auditor after finding him guilty of not performing audits in accordance with the requirements. The consequence of this is that he may no longer perform external audits (IRBA,2019).

2.6.2 SAICA

Likewise, SAICA has taken disciplinary action against Chartered Accountants (CA)s who are Registered Auditors and were found to breached The Code by stripping them of their designation. (SAICA, 2019)

2.7 Is the debate over the responsibility of the auditor for fraud relevant?

The debate of the auditor's duties regarding fraud may be futile as essentially, the corporate scandals were caused by misstatements not being picked up and an

inappropriate audit report being issued. Whether the cause of the misstatement was intentional (indicating fraud) or not intentional (indicating that it was an error), may not be relevant. This is in line with Chapple and Mui (2015) who noted that an audit failure is affected in two stages, the first being that the AFS contained material misstatements and the second stage being that the auditor did not detect the error during the audit.

Based on the information contained in the literature review, it can be concluded that much debate has occurred on the topic of the auditor's responsibility to detect fraud. The question that arises is that if annual financial statements contain material misstatements (whether due to fraud or error), is the external audit providing value to the intended recipients?

However, before the relevance of the profession is questioned, this study aimed to determine whether material misstatements due to fraud or error are possible to be detected and reported to user of the financial statements. Chapter 4 provides the detailed findings which indicate that it is possible for auditors to detect and report material misstatements due to fraud.

2.8 Literature Gap

There is a dearth of knowledge in South Africa relating to this topic and more so as it relates to the component of the gap that has led to audit failures.

Du Toit (2012) confirmed that while much research has been conducted on accounting irregularities, most of the literature is done from the perspective of the United States of America and that there is little research done in a South African context. Du Toit further noted that the articles published on the topic were published in business magazines and not in accredited journals. The lack of research done in South Africa on accounting irregularities was confirmed in 2015. (Maseko, Yasseen, Paidia and Brahmbhatt,2015)

Ramsarghey and Hardman (2020) explored the role of the auditor in South African corporate scandals, however, the study did not obtain a deep understanding of why the material misstatements contained in the financial statements were not detected and reported by the auditor. Similarly, Ferreira (2020) also considered the role that auditors played in the corporate scandals in the United States of America by evaluating other studies performed on the topic and did not evaluate the reasons for auditors not

detecting and/or reporting the material misstatements. Hurley, Mayhew and Obermire (2019) and Alabede (2012) conducted a quantitative study in the United States of America whereby they evaluated the effects of the financial remuneration on the auditor, however, the studies were not targeted at the auditors of entities that became corporate scandals to obtain a deep understanding of the auditor's contribution.

Erasmus (2022) considered the role of the auditor in driving accountability in the South African public sector and found that that auditors should be enablers of accountability. The study however, did not analyse the performance of the auditors on audits of entities that became corporate scandals and this study was focused on the public sector and not the private sector.

Peecher, Solomon and Trotman (2013) conducted a study in which they used a two-dimensional framework to determine what could regulators use to motivate auditors to improve quality and to evaluate how well auditors executed their duties. However, this study did not qualitatively evaluate the contribution of auditors to corporate scandals not being detected or reported by analysing the auditor's performance to obtain a deep understanding.

Based on the analysis, the following literature gaps have been identified that forms the basis of the research:

1. Qualitative objective research to ascertain whether financial reporting fraud was not detected due to deficient performance of auditors.
2. Research on the existence and extent of the audit expectation gap in South Africa since 1994.
3. Research on the implications of the MAFR being set aside.

2.9 Chapter summary

This chapter dealt with the concepts of the audit-expectation gap, audit quality and audit failures. The extant literature from the auditing standards and other legislation was also considered to determine what auditors are required to perform during audits. The research performed highlighted apparent gaps in the literature. The first gap is research on the existence of the audit expectation gap in South Africa since 1994. The second gap identified is that the studies thus far have only sought to confirm the

existence of the audit expectation gap but none sought to determine the contribution of the auditor to corporate scandals not being detected and reported by evaluating the auditor's performance. The last gap identified is the effect of the MAFR being set aside on audit quality. Suggested areas for future research are detailed in Chapter 5. This study contributes to the body of knowledge by highlighting the auditors' contribution to corporate scandals not being detected and reported.

Chapter 3: Research method

3.1 Introduction

Chapter 2 provided an overview of the extant literature and theoretical frameworks that are the foundation of this study and discussed the existing literature on topics such as the audit-expectation gap, audit quality, audit failures, corporate scandals, fraud, the ISAs and the relevant legislation. The literature review also highlighted gaps in research for future areas of study.

Chapter 3 outlines the research methodology adopted in performing this study. This chapter will detail the research methodology, research design, data collection and analysis, sample selection and sources of data.

3.2 Research methodology

The objective of this study was to obtain deep insight and understanding of the auditor's contribution to the corporate scandals not being detected and reported. The research methodology adopted was specifically chosen to achieve the objective of the study.

Research methodology is defined as the techniques and processes used to generate new knowledge or better understanding from the data which includes designing the study to ensure that valid reliable results are obtained to address the research aim and objective. (University of Newcastle a) Research methodology can take the form of qualitative or quantitative research. (Taguchi,2018)

Qualitative research

Qualitative research can be defined as the study of a phenomena. (Sharan, Merriam, Grenier,2019). In this study, the phenomena being studied was the auditor's contribution to the corporate scandal not being detected and reported. Qualitative

research is used to inductively obtain an in-depth understanding and knowledge of the phenomena. (Johnson,2015) Qualitative research therefore provides a lens for learning about non-quantifiable data such as the contribution of the auditor in corporate scandals not being detected and/or reported through investigative techniques. While it is used more in the social sciences, it is also employed more in other fields of research. (Bhangu, Provost and Caduff, 2023). Qualitative research can also be described as any type of research that produces insights that were not generated by applying a mathematical method of interpretation and is more appropriate based on the nature of the problem being investigated such as the exploration of a topic where there is much to learn due to little pre-existing knowledge. (Strauss and Corbin, 1998).

Qualitative research was therefore appropriate for this study to obtain a deep understanding of the cause of corporate scandals not being detected and reported by auditors. Qualitative research also results in more discovery-orientated information and is suitable when little research has been performed. (Stake, 2010) A discovery-orientated research methodology was suitable to this study due to there being little or no extant literature on this topic from the perspective of the auditor's performance as noted in the literature review. This research methodology therefore enabled the study to discover the knowledge and uncover themes underpinning the phenomena of auditors not detecting and reporting corporate scandals.

On the other hand, quantitative research uses numerically measured variables to test hypothesis based on theories and is more deductive in nature (De Vos, Strydom, Fouche and Delpont,2020). A quantitative study was not appropriate due to the lack of extant literature. Further, the use of numerically measured variables was not appropriate to obtain inductive knowledge of the auditor's contribution to corporate scandals not being detected and reported. The use of numerically measured variables would only have provided deductive knowledge which was not appropriate to achieve the objective of this study.

Interpretive approach of qualitative research

A qualitative research study requires an interpretivist approach to guide the inquiry process of which there are four main approaches. Phenomenology relates to the lived

experiences of individuals and data is generally obtained through interviews, Grounded theory focuses on an action and generates a theory, Ethnography is the description and interpretation of the beliefs and behaviour of a group sharing the same culture and Case study is the analysis of a circumstance that can be used to understand a specific issue. The case study method provides in-depth insight into a problem by analysing textual documents to identify thematic findings of the case or cases as well as the overall findings. (Courtis and Keeler, 2022) The interpretive paradigm is deemed to be the essence of qualitative research in that the researcher obtains insight into a phenomenon and uses an instrument to inductively interpret meaning from the data to understand the phenomenon. (Merriam, 2002) This study therefore employed the case study interpretivist approach using the case studies identified in the sample selection section. The case studies used were the performance of the auditor in specific audits to understand the contribution of the auditor to the corporate scandals in South Africa not being detected and reported.

Content analysis as a method of case study analysis

Qualitative interpretive case study research has many approaches with the content analysis approach being the most appropriate for this study. (Morgan,2021). Content analysis is a set of techniques for systematic analysis of data in the form of text or other media to interpret the meaning. (Seddighi, Yousefzadeh & López, 2021) Content analysis relates to the categorisation of information based on the research questions and thematic analysis is the method of recognising patterns in the data with the identified themes becoming the categories for analysis. (Bowen,2009)

Document analysis as a method of content analysis

Document analysis is used to generate the data that is then organised in to themes using content analysis. (Labuschachne, 2003)

This approach was the best source of objective evidence of the performance of auditors to assess whether the auditor contributed to the corporate scandal not being detected and reported. Document analysis is also appropriate where interviews with the participants may not be possible. As was the case with this study, the audit partners and audit firms of the corporate scandals were unlikely to answer questions truthfully that may legally implicate them and therefore interviews would not have been

a reliable source of data. Qualitative document analysis can take two forms. In one, the researcher is involved in creating the data (for example during interviews) and in the other, the researcher uses pre-existing data and therefore does not influence the data. (Rapley,2018) The analysis of documents is also a more credible source of data, and therefore used in this study, as it was verifiable and not able to be influenced unlike the case of an interview whereby the researcher can ask or refrain from asking certain questions to guide the interview. (Morgan,2021) Framework analysis is a method of document analysis and is popular due to its systematic approach and contains five steps. The five steps include obtaining the data, familiarisation with the data, coding, developing an analytical framework and applying the framework. (Gale, Heath, Cameron, Rashid and Redwood, 2013). Once the document was analysed, the data was codified which was done by repeatedly reading the data. (Morgan,1993) Codes were then categorised based on its interpretation and relevance and based on purpose of the study, relationships were identified between the categories and sub-categories based on their consequence. (Morse and Field,1995) In this study, the documents analysed were the findings from forensic investigators, regulators and investigative journalists who analysed the performance of the audit.

3.3 Credibility, validity and reducing bias

One disadvantage of qualitative interpretive research was the researcher's ability to alter findings by interpreting the data with their own bias. This would have brought into question the research finding's credibility and validity. While this would have usually been mitigated by triangulation, in this study triangulation was not needed. This was because the document analysis method was applied to pre-existing data that is publicly available restricted the ability of the researcher to influence the analysis of the data. (Flick,2018)

In addition, a means of enhancing credibility of a document analysis was to analyse the documents for authenticity, credibility, representativeness and meaning:

- Authenticity refers to the extent to which a document is genuine;
- Credibility refers to the extent to which a document is free from errors;
- Representativeness is determined by the collection of many sources of information rather than just one source; and
- Meaning is the significance of the document's contents. (Flick,2018)

This was employed in the study to ensure that credibility was enhanced. In this study, before the document was analysed, it was assessed for authenticity by ensuring that it was obtained from an appropriate source, it was assessed for credibility by assessing the use of the document and it was assessed for representativeness and meaning by assessing the process that was followed to finalise the report as well as who the report was present to.

3.4 Research design

3.4.1 Data collection and analysis

Data collection methods can be classified as primary and secondary. In the secondary data collection method, data is collected by someone other than the original user such as published books, journals and online media (Kabir,2016) As the research aim was to assess the auditors' contribution to the corporate scandals not being detected and reported, the secondary data collection method was used as it was the only method that that will provide objective evidence.

As noted earlier, the framework analysis method was appropriate for this study. This method required the researcher to gather data and then categorise the data into key themes. (Armstrong,2021) The data on auditors' performance was read multiple times, identifying a thematic framework, indexing (such as the various deficiencies in the audit), charting and interpretation such as drawing conclusions from the data that was mapped to ultimately answer the research aim of how did the auditors contribute to the corporate scandals not being detected and reported. (Fereday and Muir-Cochrane,2006). The data from these documents was codified into categories to answer the research questions and ultimately, achieve the research objective as set out below:

Table 3: Codification used to analyse the data from the document review (Source: student's own work)

| Failure/Auditee | Corporate Scandal |
|-------------------------------------|--------------------------|
| Type of fraud | |
| -Misappropriation of assets | |
| -Financial reporting | |
| | |
| Findings against the Auditor | |
| -Lack of independence | |

| | |
|---|--|
| -Lack of ethics | |
| -Insufficient audit evidence | |
| -Inappropriate audit evidence (documents not agreeing to recorded amounts or not factual) | |
| -Material misstatements detected and not reported | |
| -Reportable irregularity not reported | |
| Lack of professional scepticism | |
| Auditor found guilty of not implementing the auditing standards correctly | |
| Auditor not performing their own methodology/policies) | |
| Inappropriate audit report issued | |

3.4.2 Sample selection

Data was collected by searching for keywords such as “corporate scandals, accounting fraud and accounting irregularity” using research engines such as EbscoHost, Research Gate, Google Scholar and Google. The population was all corporate scandals in South Africa since 2000 that were audited. As a result of only a few corporate scandals that occurred in South Africa since 2000 for which sufficient publicly available information was available, all corporate scandals that were in the population were used and therefore no sampling was performed. As the auditing profession is rapidly evolving and changing, only corporate scandals that occurred in this century were used to prevent the insights gained from being skewed by outdated information or information that was addressed by updated auditing standards. A summary of the population and reasons for corporate scandals not being selected is included below:

Table 4: Summary of population (Source: student’s own work)

| Year | Entity | Accounting fraud | Was the entity audited? | Sufficient information available regarding the auditor’s performance? | Is the item included in the population |
|------|--------|------------------|-------------------------|---|--|
| | | | | | |

| | | | | | |
|-----------|----------------------------|-----|-----|-----|-----|
| 2017 | Steinhoff International NV | Yes | Yes | No | No |
| 2018 | Tongaat Hulett | Yes | Yes | No | No |
| 2013-2016 | Linkway Trading | Yes | Yes | Yes | Yes |
| 2014 | Oakbay Resources | No | N/A | N/A | N/A |
| 2017 | VBS Bank | Yes | Yes | Yes | Yes |
| 2008 | Sharemax | Yes | Yes | No | No |
| 2007 | Eskom | N/A | N/A | N/A | N/A |
| 2012-2019 | EOH | No | N/A | N/A | N/A |
| 2012-2016 | South African Airways | Yes | Yes | Yes | Yes |

3.4.3 Sources of data

The sources of data were:

- Forensic investigation report by Advocate Motau (The audit of VBS Mutual Bank)
- Reports of disciplinary investigations by IRBA into the audit work performed and the conduct of its members on the audit of Linkway Trading
- The findings of the Zondo Commission of enquiry into State Capture regarding the audit of South African Airways.

As the IRBA is the audit regulator, the detailed reason for findings was not necessary but the overall findings issued by the regulator sufficed as the regulator was deemed to have the knowledge and experience to analyse the auditor's work appropriately.

3.4.4 Authenticity, credibility, representativeness and meaning

As noted in section 3.4.3, the data for this section was checked for authenticity, credibility, representativeness and meaning before being used.

The Great Bank Heist report

The Great Bank Heist report by Advocate Motau was accessed from the South African Reserve Bank website and is therefore considered to be genuine. As the report was prepared by an Advocate and forensic investigators and is being used in the criminal proceedings as evidence in the Court of Law, the report is considered free from errors and credible. The report has been written after studying and including various sources of information such as documents, data and interviews with individuals and therefore contains representativeness. The findings of the report, particularly regarding the role of the auditors is crucial for the study as it provides details of the auditor's contribution to the material misstatement not being detected and reported and therefore has meaning.

The Zondo Report

The Judicial Commission of Inquiry into State Capture Report by Chief Justice Raymond Zondo (hereafter referred to as The Zondo Report) was accessed from the South African state capture website and is therefore considered to be genuine. As the report was prepared by the Chief Justice and a team of lawyers and forensic investigators and is being used in the criminal proceedings as evidence in the Court of Law, the report is considered free from error and credible. The report has been written after studying and including various sources of information such as documents, data and interviews with individuals involved in the matter and therefore contains representativeness. The findings of the report, particularly regarding the role of the auditors is crucial for the study as it provides details of the auditor's contribution to the material misstatement not being detected and reported and therefore has meaning.

KPMG internal investigation and IRBA report

IRBA findings

The IRBA disciplinary findings and actions instituted was accessed from the IRBA website and is therefore considered to be genuine. As the report was prepared and issued by the IRBA and was used in the disciplinary proceedings against the auditor, the report is considered free from error and credible. The report has been written after studying and including various sources of information such as documents, data and interviews with individuals and therefore contains representativeness. The findings of the report, particularly regarding the role of the auditors is crucial for the study as it provides details of the auditor's contribution to the material misstatement not being detected and reported and therefore has meaning.

KPMG Statements

KPMG International performed internal investigations at KPMG South Africa and issued some of its findings in public statements. These statements were accessed from the KPMG website and can therefore be considered as genuine. As these statements were prepared and issued by KPMG International and was used in the internal proceedings of the company, the report is considered free from error and credible. However, it is noted that KPMG International is conflicted in this report as the entity may omit facts. Nevertheless, the report will be used for the findings noted in the report and the IRBA findings mentioned above will be used for a complete list of deficiencies. The report has been written after studying and including various sources of information such as documents, data and interviews with individuals and therefore contains representativeness. The findings of the report, particularly regarding the role of the auditors is crucial for the study as it provides details of the auditor's contribution to the material misstatement not being detected and reported and therefore has meaning.

This chapter provided the detail of the research methodology and data collection methods. The next chapter will detail the findings of applying the research methodology to the data collected.

3.5 Ethical considerations

Due to the nature of the study only including the analysis of documents and not interviews with participants, ethical clearance was not necessary. Furthermore, ethical clearance exemption was obtained from the university.

3.6 Chapter summary

This chapter contained the details of the research methodology pertaining to the study. The research methodology employed was a qualitative interpretive method to inductively obtain in-depth knowledge of the contribution of the auditor in corporate scandals in South Africa not being detected and reported. Furthermore, a qualitative research methodology was appropriate due to the lack of knowledge relating to the performance of auditors in audits of corporate scandals as identified in the literature gap section of the literature review and due to there being limited data.

A method of qualitative interpretive research known as document analysis was used to analyse the documents produced that evaluated the auditor's performance in the audits of entities that became corporate scandals in South Africa. The Case Study

method was deemed to be the most appropriate form of a qualitative interpretive research method as this method is the analysis of a circumstance that can be used to understand a specific issue. Document analysis was as an appropriate method of content analysis because interviews with the audit firms and management accused of perpetrating fraud is not deemed to be a reliable source of information and the analysis of documented evidence of the auditor's performance would best suit the research objective. A document analysis technique known as framework analysis was employed due to its flexible nature in categorising the data obtained from the documents pertaining to the auditors' performance. Data was obtained based on corporate scandals that occurred in South Africa since 2000 for which information was publicly available regarding the auditor's performance. The data was tested for authenticity, credibility, representation and meaning before being used in the study. Ethical clearance was not necessary as the study did not involve interviewing participants.

Chapter 4: Results presentation and analysis

4.1 Introduction

Chapter 3 provided an overview of the research methodology, design, data collection, sample selection and analysis. The results of the study are presented, interpreted, and discussed in this chapter.

4.2 Findings

4.2.1 VBS Bank

4.2.1.1 Introduction

VBS Mutual Bank (VBS Bank) is a bank that operated in the province of Limpopo in South Africa. Per the bank's website, the bank was placed in liquidation by the North Gauteng High Court on 13 November 2018. (VBS,2020) This occurred because of the liquidity issues experienced by the bank. The curator noted that there were massive losses and therefore a forensic investigator was appointed to identify any wrong doing on the part of the directors, shareholders and staff of VBS bank. (Motau, 2018)

This constituted a corporate scandal and the entity was audited by KPMG South Africa Incorporated (KPMG) for the year ended 31 March 2017 and the AFS signed off on or around 17 July 2017. These AFS were later withdrawn as they could not be relied on. (Motau,2018)

4.2.1.2 The contribution of the auditor to the material misstatements not being detected and reported.

Advocate Motau noted in his report that the bank balance reflected in the 31 March 2017 AFS of R770 866 124 was overstated by approximately R700 million. (Motau,2018) This difference between the amount reflected in the general ledger and the amount that existed in the SAMOS account- used to transfer funds between the bank and the South African Reserve Bank (SARB). Other accounts were also misstated because of suspense accounts being used and fictitious journal entries being recorded in these accounts to conceal the movement of actual cash.

The first-year audit trainee had difficulty in performing an otherwise straight-forward audit procedure of agreeing the cash on hand per the trial balance to the bank statement. The issue was escalated to the second-year audit trainee and then the third-year audit trainee. The third-year audit trainee noted that the amount per the trial balance for one of the bank accounts did not agree to the amount per the supporting

document. The third-year audit trainee then reported this to the audit manager who escalated the matter to the audit partner. The audit partner allegedly indicated that the matter will be resolved by himself. The third-year audit trainee documented the work performed on the audit file as “Specific procedures were performed by the Partner and CEO respectively” (Motau, 2018:84). The audit partner was aware of the difference however, failed to adequately address the issue and issued an unmodified audit opinion despite the large difference in the amount of cash on hand per the bank statement and the trial balance. There was an Engagement Quality Control Reviewer (EQCR) who is normally appointed to review certain high-risk sections of audit files of JSE listed companies and Public Interest Entities if deemed necessary by the firm. The EQCR had not reviewed the bank and cash section and was not aware of the cash difference that existed. (Motau,2018)

An unmodified audit report was issued indicating that the AFS were free from material misstatements when the AFS were materially misstated. This was even though the audit partner was aware of the R700million cash shortfall.

The audit opinion also noted that the AFS was prepared on the going concern basis meaning that the bank will be able to settle liabilities as they become payable for the subsequent 12 months. The AFS were materially misstated due to the cash shortfall and the bank could not continue operating for the next 12 months resulting in the bank being placed in curatorship shortly thereafter.

Analysis

Going concern assumption incorrectly applied

The ISAs require the auditor to assess the going concern assumption of management. The standard states that the auditor is to obtain sufficient and appropriate evidence that the going concern assumption was applied appropriately (ISA 570,2015) The going concern assumption states that the AFS are prepared on the basis that the entity will continue to operate as usual for at least twelve months from the year end (or the audit report date if the AFS are audited) and will not liquidate or cease trading in that time. (IASB,2018). The audit report was signed on or around 17 July 2017 and the bank was placed under curatorship on 11 March 2018. Therefore, the going concern assumption as at the date of the audit report was incorrect as the bank did not have sufficient resources to satisfy its obligations for 12 months from the date of the audit report.

While it may under vastly different circumstances, be argued that the auditor could not have reasonably known or expected to know that the bank had an indication of being a going concern risk, this was not the case in the instance of VBS Bank. The audit partner knew that at least R700 million of the cash that the bank supposedly could not be traced to supporting documents and this should have triggered the audit partner to determine whether an event or condition exists that may cast significant doubt on the entity's ability to continue as a going concern as required by paragraph 10 and 11 of ISA 570 (Revised): Going Concern. (ISA 570,2015)

Given that the entity is a bank, with short-term depositors, identifying a R700 million cash shortfall is likely to be an event that created a material uncertainty on the going concern assumption being appropriate in the AFS. While the VBS report does not include specific evidence of the audit work performed on the use of the going concern assumption, the audit partner and audit manager were aware of the event and failed to adequately address the issue in the audit report. The bank was subsequently placed in curatorship and thereafter liquidation indicating that the going concern assumption was inappropriately used.

Reportable irregularity not reported

The AP Act prescribes the duties of Registered Auditors while performing audits. Section 45 of The AP Act, is specifically relevant as it requires the auditor to report any suspected or actual reportable irregularity that has taken place or is taking place to the IRBA "without delay". (The AP Act 2005:31)

The AP Act defines a reportable irregularity as any unlawful act or omission committed by a person responsible for the management of the entity which has or is likely to cause material financial loss to any member, shareholder, creditor, or investor of the entity or is fraudulent and amounts to theft. (The AP Act,2005)

The overstated cash balance of R700million was fraudulent and amounted to theft and was an unlawful act (misstating AFS) by at least the CFO (an individual charged with responsibility for managing the bank) that was likely to lead to material financial loss to the depositors/investors. The definition of a reportable irregularity was therefore met and should have been reported to the IRBA by the audit partner. The reportable irregularity did not have to be confirmed for it to be reported but rather suspected. (The AP Act,2005) Therefore, when the audit manager and audit partner identified the

issue, it should have been reported to the IRBA. This constituted a contravention of the AP Act. The apparent reasons for this contravention will be discussed in the following sections.

Failure to report the material misstatement

There were many issues in the section above. The first issue was that the entire audit team was aware that the cash on hand did not equal the cash amount per the statements. In an audit of a bank, this is a huge issue. It may be equated to half of the inventory of a retailer not existing. While the audit team was aware of the issue, the question to be answered is why did no one report the issue when the audit report was signed? Is it indicative of a lack of understanding of the audit process, the materiality of misstatements or a culture where staff do not care or are too afraid to raise issues?

While the first-year audit trainee and possibly the second-year audit trainee may be excused from not reporting this issue as a lack of experience, there is no excuse for the third-year audit trainee, the audit manager and inexcusable for the audit partner.

The third-year audit trainee thought that he covered himself from any wrong-doing by amending the wording of his working paper to indicate that the audit partner had performed audit procedures with the audit client. This amendment to the working paper was made after the audit report being signed and just before the audit file was closed-off where after no changes may be made to the file. This indicated that despite knowing that the difference was an issue, he did not escalate the issue through the proper channels but rather attempted to cover up the issue. The third-year audit trainee acted dishonestly by amending the audit documentation and contributed to the material misstatement not being reported. ISA 230: Audit Documentation (2005) paragraph 8 requires the auditor to prepare audit documentation that is sufficient to enable an experienced auditor to reperform the procedures and arrive at the same conclusion as the auditor. The audit documentation did not comply with this standard of reperformance as “specific procedures were performed by the audit partner and CEO” (Motau 2018:96) cannot be reperformed by an auditor to come to the same conclusion as the third-year trainee. This indicated an attitude of complacency whereby the audit partner had the final say.

There is also a perceived pressure of trainees to accept the partner and manager’s word as the trainee’s performance evaluation and any prospect of a promotion and

salary increase is dependent on the feedback provided by the audit partner. If the third-year audit trainee is deemed to be defiant by questioning the audit partner and manager or seen as going over the audit partner and manager by reporting matters to the EQCR and the firm, this may result in his/her performance evaluation being adversely affected. The third-year audit trainee is also at the mercy of the audit manager particularly as the process to qualify as a CA requires the third-year to demonstrate competencies on audit engagements which the audit manager approves. There is a perceived pressure in audit firms that if trainees do not follow the instructions of the audit managers and audit partners, then the trainees will not receive the competencies needed to qualify as a CA or the manager and partner will make it difficult to achieve these competencies. However, the attitude displayed by the third-year audit trainee by amending the working paper seems to indicate that signing unmodified audit opinions while material misstatements were present and not reported was a norm at the time.

The audit manager was aware of the issue and blindly accepted the audit partner's explanation. The lack of follow up on issues did not only happen in one instance. The audit manager had sent a message to the audit partner shortly before signing the audit opinion to confirm whether the audit partner was satisfied with signing the audit report despite not receiving the bank reconciliation and whether he was satisfied that the cash aspect of the AFS was satisfactory. The audit partner replied "happy to go ahead" (Motau 2018:86). The audit manager took this at face value and did not pursue the matter further relying on the audit partner's word. The audit manager also failed to perform her duties by not following through on the cash difference with the partner and not raising the matter to the EQCR.

In preparation for the audit committee meeting near completion of the audit, the audit manager drafted the matters to bring to the audit committee's attention together with the draft audit report. The audit manager raised a point that not all bank reconciliations were provided to the audit team. This point was scratched out by the audit partner who confirmed that it was him who removed that point but could not provide an adequate explanation for removing it- other than that he must have been told that all bank reconciliations were provided. The audit partner subsequently confirmed that at the time of removing the above-mentioned point, that the reconciliations had not been prepared.

There is also a perceived pressure of audit managers to accept the partner's word as their performance evaluation and any prospect of a promotion and salary increase is dependent on the feedback provided by the audit partner. The audit manager was a CA and was also bound by the Code of Professional Conduct. (SAICA Code of Professional Conduct,2022) Section R113.1 requires a CA to act diligently and in accordance with applicable technical and professional standards.

The audit manager correctly identified that there was a problem with the cash amount and brought it to the attention of the audit partner. The audit manager also subsequently followed up with the audit partner when she realised that the audit report was still to be signed despite the issue in the cash section as well as raising the issue on the draft outstanding list for the audit committee. However, she failed to adequately challenge the audit partner's decision to sign the audit report despite the R700million cash difference, she failed to challenge the audit partner on the removal of the unreconciled cash difference from the report to the audit committee which would have alerted the client to the issue and she failed to report the matter to the EQCR that was assigned to the audit. These actions amount to a lack of professional competence and diligence in the performance of her duties and a contravention of the SAICA Code of Conduct.

The EQCR had not reviewed the bank and cash section and- by his own admission-if he had, the problem would have been obvious. (Motau,2018) The EQCR noted that he only reviewed significant judgements and significant risk areas identified by the engagement team. It is hard to understand how the bank and cash section of a bank was not a significant risk area as it faced both risks of fraud (misappropriation of assets as well as financial reporting fraud). This pointed to a lack of understanding of the EQCR on his role. He appeared to have relied solely on the audit team to instruct him to the sections that he should be reviewing and not determining these sections for himself. Therein lies a significant flaw in the role. He should be an independent person of the team ensuring that quality is achieved. How can he ensure that quality is achieved if he blindly accepts the decisions of the team relating to which risks are significant?

Irrespective of the actions of the third year and audit manager, the audit partner accepted ultimate responsibility for the quality of the audit engagement file (ISQC

1,2004) The audit partner was not straight-forward and honest in his dealings with the audit team and the audit client which was required of him by the SAICA Code of Professional Conduct (2022) as well as the Auditor's Professions Act (2005). This was due to him being dishonest regarding the cash shortfall and the appropriateness of the audit opinion issued. The audit partner intentionally ensured that the issue of the cash shortfall was not discovered. This was done by informing the audit team that he would address the issues with the CFO, by informing the audit manager that he was satisfied with the cash balance when signing the AFS, by removing the outstanding bank reconciliations from being brought to the attention of the audit committee, by not informing the EQCR of the issue and by issuing an unmodified opinion. The reasons for the audit partner's actions are detailed below.

4.2.1.3 Lack of independence and objectivity

Soon after the bank was placed in curatorship, it was found that the audit partner had loans and facilities in the amount of R18.8 million in his own capacity and R9.8million together with another KPMG partner from VBS bank at special terms and conditions that were not at arms' length despite confirming to the audit team that he was independent of VBS Bank and had no conflicts of interest (the audit partner was ultimately responsible for repaying the entire R28.8 million and this is the amount that will be referred to going forward). He further admitted that the loans were for his personal benefit and the different applicants were merely a front and that it should have been declared. (Motau, 2018) The audit partner received several vehicle finance facilities, an overdraft facility (R11.5 million) and a mortgage bond for his primary residence (R7.3 million). These loan facilities are allowed but are to be at arm's length terms and conditions that any other customer of the bank would receive.

The audit firm or partner (or their immediate family) is not allowed to have a loan from an assurance client that is a bank even if the terms and conditions are at arm's length if the loan amount is material (IESBA,2022) The loans are material as it was confirmed that the audit partner would not be able to service only the monthly interest on these loans and facilities with the salary earned by KPMG. (Motau,2018)

Analysis

The audit partner had several opportunities to report the material misstatements that were detected. First to the EQCR as the sounding board of all significant judgements, then to the audit committee before he removed that specific point from the outstanding

list, and lastly in the audit report itself. Such determination in preventing the material misstatement from being reported was not by chance or an error in judgement. It was an intentional act preventing the users of the AFS, in some cases the poor community of Limpopo, from understanding the extent of the cash hole in the bank.

The gross dishonesty and omission of facts from the various parties by the audit partner seemed to have been motivated by his financial interests in the bank. The audit partner had received several loans and facilities to the amount of R28.8 million that had very little repayment terms and which his salary could not cover.

The audit partner blatantly disregarded a material misstatement that was brought to his attention and subsequently did not follow up on the status of the issue before signing the audit report. This subsequently resulted in the entity being placed in curatorship and not being a going concern.

This appeared to be the root cause of the corporate scandal not being reported to the users of the AFS- the audit partner's lavish lifestyle including three vehicles, his primary residence mortgage bond and the overdraft facility. Further, it was found that money stolen from the bank was used to make some of the few payments against these accounts. (Motau,2018)

These grossly false misrepresentations made by the audit partner were on loans that were definitely not at arm's length. The audit partner was clearly aware of the loans and that he was making little to no repayments on these loans and that the debit orders on these loans were reversed each time. In a meeting after VBS Bank being placed in curatorship, the audit partner represented to the EQCR and the Chief Risk Officer that the loans were at arm's length. Further it is evident that no other bank would have granted such finance to him and the process followed by VBS Bank was circumvented to allow the audit partner's finance to be granted easily. The audit partner received finance on two of his three vehicles on rates that are only offered to employees, directors and shareholders of the bank.

This financial self-interest, which was not declared by the audit partner to KPMG South Africa as it should have been, represents a breach of the South African Institute of Chartered Accountants Code of Professional Conduct (2022), the AP Act (2005) as well as the IESBA Code of Ethics (2022).

The SAICA Code of Professional Conduct (2022) requires an accountant in public practise to identify threats to the fundamental principles of the Code of Professional Conduct. Section 300.6A1(a) lists one such threat is having a direct financial interest in a client.

Further, section R340.8 of the Code of Professional Conduct specifically prohibits an accountant in public practise from accepting any inducement which the accountant or a reasonably informed third party may conclude was offered with the intent to improperly influence the behaviour of the recipient and that the response should be to inform the senior management or those charged with governance of the client or amending/terminating the agreement with the client. The audit partner's loans and facilities from the bank undoubtedly played a significant role in improperly influencing the audit partner's behaviour from reporting the material misstatement to not reporting it and the audit partner did not terminate the business relationship with the client.

Section R511.5 of the Code of Professional Conduct states that an audit team member shall not accept a loan from an audit client that is a bank unless it is under normal lending procedures, terms and conditions. As noted above, two of the three vehicle finance facilities were granted at rates in accordance with a scheme for employees, directors and shareholders of the bank which is not normal lending practises for a bank. Further, the audit partner made little payments against these loans and his debit orders were consistently reversed while no attempt was made by the bank to recover the funds from him. Lastly, the loans issued by the bank exceeded the amount that the audit partner could afford to pay and this represents non-routine trading practises and a clear breach of the code of professional conduct.

The reason for the audit partner disregarding his obligations to the profession, his firm and audit client may be determined from the way the money supposedly borrowed from the bank was spent. The audit partner used the money made available to him to live well beyond his means. Apart from the assets purchased, it was ironic that R2.2 million of the amount received from VBS Bank was used by the audit partner to pay off a loan from KPMG, a payment that KPMG should have possibly investigated to understand the source of the audit partner's funds given that a big loan was suddenly paid off.

The audit partner used R1.4 million to pay for tuition fees in respect of a Masters of Business Administration at Oxford University whereas local institutions offer the qualification at a fraction of the cost. He also transferred R3 million to his personal bank account that he said “went for university fees again, and I had to pay for air tickets, school fees and things like that” (Motau 2018:109) His explanation of the use of the R3 million does not make sense as he paid R1.4 million to enrol at Oxford and then cites education fees twice as the reason for using the R3million.

However, the money was spent excessively on items that ordinarily would not have been purchased or on items for which cheaper substitutes would have sufficed. This lavishness, greed and excessiveness is seen to be the reason for abandoning his professional ethics and duty.

Section 44(6) of the AP Act (2005) prevents a registered auditor from conducting the audit of AFS of an entity if the auditor has a conflict of interest in the entity. The actions of the audit partner to conduct the audit and issue an opinion on the AFS is a clear breach of the AP Act.

What differentiated the audit partner from the audit trainees and the audit manager was the intention of the actions, the level of experience and the professional obligation. The first-year and second-year trainee may be excused for lack of experience and may be commended for escalating the matter up the ranks. The audit manager, while not a Registered Auditor, was still a CA and should have acted with professional competence and due care by escalating the difference to the EQCR. While there was no confirmation that escalating the matter to the EQCR would have resulted in the matter being reported in the audit report and communicated to the users of the AFS, it is much more likely.

The lack of independence contributed to a lack of professional scepticism. With the reliance on the audit client for a contribution to the partner’s fee earned as well as his financial conflicts with the bank, the audit partner did not have a questioning mind required of him. He failed to enquire further when the cash shortfall arose to understand how such a shortfall can occur and the reason for it.

The audit manager faced a lack of objectivity. She faced undue pressure from the partner to not report the matter in the audit report and to the audit committee. There is also a time pressure that is associated with the audit profession. Given the late nights

and long hours worked on an audit deadline, staff are often busy completing audit procedures and have little to no time to question the information in front of them. When the audit manager identified the cash shortfall, she did not question the cause of it and how a bank can have R700million missing. She also did not question the audit partner when he informed her that he intended to sign the audit report. Neither did she question the audit partner when he instructed her to remove the bank reconciliations from the list of outstanding documents. This lack of professional scepticism is critical to the audit profession and appears to be dependent on independence and objectivity.

The generation of audit fees and executing audits in a profitable manner is the most important objective of auditors. This is particularly true in an environment where the Big 4 audit firms compete to generate the highest revenue globally. This pursuit of fees has overshadowed the audit profession's humble and noble beginnings.

4.2.1.4 Auditor fraud

As noted in the literature review section, the auditor detecting the material misstatement but not reporting it in the audit report meets the definition of fraud as the act of not reporting the material misstatements is an intentional act by the auditor to conceal the nature and amount of the material misstatement. Based on the information in this chapter, it is concluded that the audit partner committed fraud (per the ACFE definition) by intentionally issuing an unqualified audit report to conceal the fact that the AFS were materially misstated.

4.2.1.5 Conclusion

The audit of VBS did not meet the requirements of the ISAs and the ethical requirements of auditors for several reasons.

1. How did the auditor contribute to the entity becoming a corporate scandal?

The audited AFS contained R700million in missing cash and was therefore materially misstated. An unmodified audit report was issued stating that the AFS was free from material misstatements and therefore an audit failure occurred as an inappropriate audit opinion was issued.

The audit partner was aware of the material misstatement and despite this, signed the unmodified audit opinion which constituted fraud. The reason for this appeared to be the financial conflict of interest that the audit partner experienced. While performing the role of auditor of VBS Bank, the audit partner received loans and

facilities to the value of R28 million for which he repaid very little. These loans were not at arm's length as the audit partner's salary could not cover the interest on these loans and in some instances, the loans were given to the audit partner at rates only provided to employees, directors and shareholders of the bank.

The audit partner was grossly dishonest in his dealings with KPMG and the audit team as he was required to disclose these financial interests to KPMG which would have resulted in KPMG not allocating him to be the audit partner of VBS Bank. Further, the audit manager did not report the issue to the EQCR or the KPMG hotline and accepted the audit partner's explanation at face value. The audit manager did not act with professional competence and due care as is required of CAs.

The material misstatement was detected and not reported in the auditor's report because of greed and gross dishonesty. This greed was also apparent from the way the money was spent on three luxury vehicles and an overdraft used to pay off a KPMG loan as well as tuition fees for a Masters qualification at Oxford University.

2. What was the nature of the material misstatements contained in the AFS of entities that became corporate scandals?

The amount of bank cash and cash equivalents was overstated by approximately R700 million in the AFS.

The AFS was prepared on the going concern basis of accounting which was inappropriate as the bank was placed in liquidation within 12 months from the audit report.

3. What was the cause of the material misstatements in the AFS not being detected and reported in the audit opinion?

Ultimately, the audit partner was not independent and objective as required by the standards. He had a material financial conflict of interest in that he was the beneficiary of R28.8million in loans and facilities that he made little payment towards and which were granted on extraordinary terms not available to the ordinary customer. These loans were used to satisfy his greed and finance a lavish lifestyle including his primary residence, three luxury vehicles and funding the enrolment in a Masters qualification amongst others. Blinded by this greed and

lavish lifestyle, he turned a blind eye to a problem that left hundreds of the poorest families of South Africa with no savings. He assisted in further plunging what was deemed one of the most noble professions into darkness.

The audit partner did not act with integrity as he knowingly falsely stated that he had no direct or indirect financial interests in VBS Bank. He further intentionally prevented the material misstatement that was detected from being reported to the users in the AFS, the audit committee as well as the EQCR. There was a lack of professional scepticism by the partner relating to the cause of the missing R700million cash.

The AFS was also prepared on the going concern basis of accounting which assumed that the value of the assets and liabilities will be realised at the carrying amount reflected in the AFS. This was inappropriate as the Bank was not a going concern and the bank was placed into liquidation and the value received for assets is less than the carrying amount.

In addition to this, the EQCR seemingly did not question the audit team's assessment of significant risks. He blindly accepted the team's assessment and performed no work on the most important aspect of the AFS of a bank- cash and cash equivalents. He either did not understand the significant risks applicable to the bank or blindly followed the work performed in the previous year.

The audit manager failed to perform her work with professional competence and due care and accepted explanations from the audit partner at face value. She did not challenge the decisions and actions of the partner.

The third-year audit trainee was dishonest in the performance of the audit work as steps were taken to mitigate any consequences for the trainee instead of performing audit work in accordance with the standard required.

The underlying cause appeared to be a financial conflict of interest based on loans and facilities granted to the partner. The audit partner was reliant on these loans and facilities to live his lavish lifestyle, reliant on the audit fees to meet his Key

Performance Indicators (KPIs) as well as earn his bonus and any salary increase and promotion.

The audit partner prioritised his greed and lavish lifestyle over his professional ethics and duties.

4. What could the auditor have done to detect and report the material misstatements in the annual financial statements?

The audit partner should have acted ethically and curbed his greed by reporting the financial conflict of interest to KPMG and not being the audit partner on the engagement. The audit partner should not have accepted loans and facilities that were not at arm's length and should have lived within his means- which is quite comfortable for an audit partner of a Big 4 audit firm with a net salary of between R120 000 and R130 000 after tax and a profit share of between R1million and R1.5 million after tax (Motau,2018).

The audit partner should have engaged with the EQCR regarding the unreconcilable cash balance to obtain the EQCR's opinion on the matter and further reported the difference to the audit committee.

The audit partner and manager should have assessed the effect of the cash difference on the ability of the entity to continue operating as a going concern and communicated this in the audit report together with issuing a qualified audit report at the least.

The audit manager should have maintained a questioning mind throughout and challenged the audit partner's decision to sign an unmodified audit report even though the reason for the difference in cash was not resolved. The audit manager should have further challenged the audit partner's decision to remove the bank reconciliations from the outstanding list presented to the audit committee and requested the audit partner to disclose the problem to the audit committee. Lastly, the audit manager should have reported the issue to the EQCR and the firm's hotline.

The third- year audit trainee should have alerted the EQCR to the issue in bank and cash as well as report the matter through the firm's hotline.

Lastly, the EQCR should have reassessed the significant risks applicable to a bank and challenged the audit team's assessments of significant risks

5. What was the appropriateness of the audit opinion issued?

The audit report was inappropriate as the AFS contained a material misstatement that was detected but not reported by the audit partner. The AFS included approximately R700million in cash that did not exist and therefore overstated the bank and cash as well as total assets by R700million. This means that the AFS was materially misstated and should have had a qualified or possibly an adverse audit opinion issued at the least. However, an unqualified audit opinion was issued stating that the AFS were fairly presented. Therefore, an audit failure occurred.

6. What were the findings against the auditor by regulators, the investigative journalists and forensic experts?

The findings were that the AFS contained material misstatements to the extent of R700million that was included in the AFS. The findings also included that the audit partner was not independent, lacked professional scepticism and was dishonest in his declaration of financial interests.

4.2.2 South African Airways

4.2.2.1 Introduction

From the entity's website, South African Airways (SAA) is South Africa's national airline that flies both domestically and internationally and is owned by the government of South Africa, specifically by the Department of Public Enterprises. (SAA,2023)

The Zondo Commission was instituted in South Africa to commission an enquiry into allegations of State Capture. The enquiry noted that Price Waterhouse Cooper (PWC) and Nkonki did not perform their duties as a watchdog institution and that proper performance of their role would have resulted in the issues being picked up earlier. (Zondo,2022) The way the audit was performed and the reasons why their duties were not performed is detailed below.

4.2.2.2 The contribution of the auditor to the material misstatements not being detected and reported

Overview

Section 3 of the Public Finance Management Act (1999) (PFMA) states that the Act applies to the AFS of a government entity, such as SAA and requires that the entity apply a fair and equitable procurement system and report on it in its AFS. Section 55 of the Act requires the public entity to disclose in its AFS, amongst other matters, any material loss in the form of fruitless and wasteful expenditure as well as irregular expenditure.

ISA 250: The Auditor's Responsibilities Relating to Laws and Regulations in An Audit of Financial Statements (2016) requires the auditor to identify the material misstatements in the AFS because of non-compliance with laws and regulations applicable to the entity being audited, specifically the laws and regulations that are generally known to have a material effect on the determination of material amounts and disclosures in the AFS. Paragraph 25 of ISA 250: The Auditor's Responsibilities Relating to Laws and Regulations in An Audit of Financial Statements(2016) notes that if the auditor concludes that the non-compliance has a material effect on the AFS, then the auditor must issue a qualified opinion. It is well known that procurement is the most important aspect of any public entity especially an entity as large as SAA with large procurement undertaken each year. Given the amount of attention it receives in the media, it is also well known that fraud within the procurement process is a significant risk to a government entity. PWC and Nkonki should have factored this into the audit. Therefore, any non-compliance with the PFMA that had a material effect on the amounts disclosed in the AFS of SAA (such as the amount of fruitless and wasteful expenditure or irregular expenditure incurred) should have resulted in SAA receiving at least a qualified or disclaimer opinion on the AFS and the risk of fraud should have been identified and addressed during the audit in terms of ISA 240: The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (2004).

Background

PWC together with Nkonki Incorporated (Nkonki) were the joint-auditors of SAA for the financial years of 2011/2012-2015/2016, each year issuing an unqualified audit opinion. Thereafter, the Auditor-General (AG) took over the audit for the 2016/2017 and issued a qualified audit opinion with significant audit findings on the compliance

with laws and regulations. A representative for the AG office testified that when the AG took over the audit, the financial records were in a dismal shape and that the poor audit work performed previously by PWC and Nkonki “enabled state capture, corruption, and irregularities to remain undetected at SAA for many years” (Zondo 2022:346) because of a lack of good governance at SAA.

The 2015/2016 AFS had to be restated in the 2016/2017 financial year as the amounts disclosed for the 2015/2016 year that were audited by PWC and Nkonki were incorrect. In the 2015/2016 financial year, the amount of irregular expenditure disclosed in the AFS that were audited by PWC and Nkonki amounted to R5 million whereas the same amount in the 2016/2017 financial year audited by the AG was R125 million which was an incomplete figure as the lack of documents prevented the AG from confirming whether other transactions were irregular as well. A sample selected by the AG to test the compliance with laws and regulations resulted in 121 out of 140 contracts being irregular (R6.6 billion out of R7.6 billion) during the 2016/2017 financial year audit. SAA had initially only disclosed R40.4 million of fruitless and wasteful expenditure and R125.9 million of irregular expenditure whereas the AG had identified R300.6 million in fruitless and wasteful expenditure and R4.5 billion in irregular expenditure during the 2016/2017 financial year audit. This was in contrast to the R7.3 million fruitless and wasteful expenditure and R5.4 million irregular expenditure disclosed in the AFS audited by PWC and Nkonki. (Zondo,2022) It was noted that as much as PWC and Nkonki were the joint auditors, no input was provided from any individual representing Nkonki.

The reason for the difference in conclusions reached by the AG and the joint audit of PWC and Nkonki is detailed below.

4.2.2.3 Deficient audit work performed

When the AG reviewed the audit file of the 2015/2016 audit conducted by PWC and Nkonki, it was concluded that the work performed by them could not be relied upon by the AG as there was a lack of supporting documentation relating to critical documents that were required to be maintained on the audit files. (Zondo,2022) For example, there was a register of contracts that was maintained from which suppliers were paid, however, SAA did not have the actual contracts on hand for most of the entities on the register that were being paid.

An auditor from the AG confirmed that upon review of the audit file of the prior year (the audit performed by PWC and Nkonki), not much work was done on compliance with laws and regulations specifically relating to procurement. The PWC and Nkonki team conceded verbally in a meeting that the work performed by them in the previous audit on procurement was inadequate. An email from the AG to the previous audit partners confirmed that the work performed by the previous auditors was insufficient and would not be relied upon by the AG. It was further concluded during the Commission that PWC and Nkonki failed to perform the audit to the standard required of it.

It was further noted that the previous auditors (PWC and Nkonki) had identified deficiencies in internal controls and failed to communicate this to those charged with governance as required by ISA 260: Communication with Those Charged with Governance and reported in the audit report and that all issues present were not identified.

Analysis

Insufficient competence to perform the work

ISQC 1 (2004) paragraph 26 requires audit firms to establish policies and procedures for the acceptance and continuance of client relationships to provide the firm with reasonable assurance that it will only undertake or continue relationships and engagements where the firm is competent to perform the engagements.

The audit partner from PWC stated that while his obligation was to consider matters of compliance, that was not the audit team's main concern. The audit team was more focused on the going concern risk. It must be noted that given the nature of this entity, the users of the AFS- in this case the government, the Accounting Officer and the Department of Public Enterprises- are just as interested in the amounts relating to the Fruitless and Wasteful Expenditure and Irregular Expenditure incurred. It may even be argued that given that SAA is a government institution, some users (including the citizens of the country) may be more interested in the Irregular Expenditure and Fruitless and Wasteful Expenditure amounts. The audit partner from PWC also displayed his lack of competence in stating that "he did not view his role as auditing a public entity as materially different to auditing a private entity." (Zondo 2022:370).

This statement could not be further from the truth. In an audit of a public entity, there are three aspects to audit. The first is the AFS like that of a private entity. The second is the compliance audit or the audit of supply chain management which results in the amounts disclosed in the AFS as fruitless and wasteful expenditure and irregular expenditure. The last type of audit is the audit of performance objectives which the entity sets and reports its achievement of. The audit partner's views were evident in the findings of the audit performed by PWC and Nkonki- the audit team clearly lacked an understanding of the entity and its environment. The audit team did not appreciate that this audit would be significantly different to the audit of any of their private sector audit clients. The AG found that PWC and Nkonki had performed inadequate audit procedures on the supply chain management which resulted in the excessive amounts of irregular expenditure and fruitless and wasteful expenditure incurred as well as the dismal state of SAA. The AFS audited by PWC and Nkonki were restated by the AG indicating that the AFS contained material misstatements even though an unmodified audit opinion was issued.

The audit work performed by PWC and Nkonki could not be relied upon by the AG which was a strong statement highlighting the lack of competence in the work performed. Further, the requirements of ISA 240: The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements (2004) to identify and address the risk of fraud should have further prompted the audit team to do more work on the audit of compliance. That is because in the public sector, it is widely appreciated and accepted that the procurement process contains a significant risk of fraud and the AFS include amounts spend on procurement which undergoes the procurement or supply chain process and therefore amounts in the AFS may be fraudulent because of tender fraud or procurement irregularities. Therefore, the PWC audit partner's view is not accepted as the team did not have the skills and knowledge required to undertake this audit. It must be noted that missing tender documents is not just an administrative matter to be reported on in the audit report. It is the very crime that plagues our South African economy.

The reason we experience load shedding, the reason that households go for days and weeks without essential services like water, the reason the police service is understaffed and under-resourced, the reason that public hospitals are in a mess and the

frustration of every tax-paying citizen of South Africa comes down to this-procurement fraud and maladministration.

An audit of an entity of this size and public interest should have required an EQCR to be allocated that would have assessed the audit team's significant judgement and significant risk areas. It is not known whether this was considered nor is it known why an EQCR was not appointed. It is further unclear as to whether an EQCR would have assisted in the first place as the EQCR may not have the competence and experience to ask the pertinent questions to perform the role of an EQCR adequately. If such an EQCR partner existed within PWC, surely that partner would have been tasked with being the engagement audit partner in the first place.

The SAICA Code of Professional Conduct (2022) and the AP Act (2005) require CAs and auditors respectively to perform their duties with professional competence and due care and to only accept engagements that the auditor is competent to perform. The audit partner clearly lacked understanding of the audit of a public entity and did not have the experience necessary to audit any public entity, let alone an entity the size and complexity of SAA. It is evident that the audit partner did not consider this important.

The next section discusses whether this lack of competence was an error or is it more than a coincidence.

4.2.2.3.1 Inappropriate audit report issued

It was found that the auditor had issued an inappropriate audit opinion. This is because an unmodified audit opinion was issued whereas the scope of the audit of compliance was limited. The tender documents requested were not provided to the audit team and therefore an unmodified audit opinion should not have been issued. It was found that the documents were not provided indicating that the opinion should have possibly been a qualified or disclaimer of opinion. The Commissioner noted that PWC was "not in a position to make a determination about SAA's compliance with legislation if it did not even have at its disposal the records that it would have needed to make its assessment." (Zondo 2022:376) The audit partner from PWC agreed that the audit team did not alert the public to the issue at SAA relating to the non-compliance with procurement legislation and this was an "omission of duty." (Zondo

2022:376) The audit partner further agreed that the audit report was inappropriate as it relates to the compliance or rather non-compliance with laws and regulations.

Analysis

While the section above may indicate that the audit partner simply bit off more than he could chew with regards to skills and competence, other facts must be considered.

The shocking evidence presented by the AG indicated that PWC and Nkonki had a lack of supporting documentation. The AG found that the contract register did not have the supporting documents underpinning the register and payments. This amounts to insufficient evidence and it would have been difficult for the auditors to obtain the sufficient and appropriate audit evidence necessary to issue an unmodified audit report. However, an unmodified opinion was issued. The question to be asked is how did the auditors issue an unmodified opinion if the supporting documents which underpin their opinion could not be provided to them?

The audit partner's response was that "for the simple stuff that we had selected we followed that through and where there were challenges and there were deviations, we found them and we raised them with management and the audit committee." (Zondo 2022:376). But this answer attempts to throw a blanket over a huge problem. The audit team was unable to complete their audit procedures and while communicating this with those charged with governance is one of the steps, it certainly is not the last and should not have ended there. The audit partner failed to alert the public to the missing tender documents for which millions if not billions were spent on. An alert that would possibly have come in the form of a disclaimer opinion that would have set the cat to the pigeons and could have possibly saved SAA, if done timeously.

The situation was only made worse by the fact that internal control deviations were identified by the team but not reported to the users of the AFS in the audit report as required. This yet again highlights the audit partner's poor attitude to reporting matters. With a similar attitude to the lack of supporting documentation for tenders, the audit partner explained it as a simple "omission of duty" (Zondo 2022:375). that the team also "did not identify all the issues" (Zondo 2022:375). He consequently ceded that these matters (the missing tender contracts and the internal control deficiencies) should have been reported in the audit report revealing that the audit partner knew right from wrong but chose wrong.) While the audit partner considers it an omission,

these omissions point to a poorly performed audit. As noted in the literature review section, the auditor not reporting the inability to audit the supporting documentation and still issuing an unqualified opinion meets the definition of fraud as the act of not disclosing the lack of supporting documentation is an intentional act by the auditor to conceal the nature and amount of the material misstatements. Based on the information in this chapter, it is concluded that the audit partner committed fraud

What would make an audit partner do this? The section “Lack of independence” highlights the seemingly overarching reason.

4.2.2.3.2 Reportable irregularities not identified and reported

SAA had legally awarded a contract for the catering services at the airport lounges to a company. After some time, the entity decided to cancel the contract and rather award it to another state entity that had submitted a bid but that did not meet the requirements to qualify for consideration to be awarded the tender. (Motau, 2018) The audit partner was aware that a contract with a successful bidder was cancelled and awarded to another entity but did not think that this constituted a reportable irregularity, despite reading the minutes of the board meeting where this decision was taken and despite being aware of the transaction.

Analysis

The definition of a reportable irregularity includes a situation where, amongst others, the directors (in this case, the board):

- perform an unlawful act: the act of cancelling a legally binding offer unilaterally is unlawful);
- which could cause material financial loss: the original awardee of the tender could sue SAA for the contract amount of R85 million (which the party did end up doing); or
- represents a material breach of a fiduciary duty: the decision was not in the best interest of SAA and is a breach of the fiduciary duty placed on directors from section 76 of the Companies Act (2008) to act in the best interest of the company for the following reasons:
 - the actions of the board to cancel the contract with the company that went through the tender process and was awarded the bid to award the

entity that did not meet the requirements to qualify for consideration of the tender

- The company that was subsequently awarded was the current service provider that caused SAA to go out to tender for another service provider due to customers complaints,
- SAA's internal legal team advised the board not to cancel the contract and re-award it but the advice was ignored.

The audit partner noted that the materiality threshold was R250million for the purposes of the audit, however, the term "material financial loss" referred to in the Companies Act is not necessarily the same as materiality for audit purposes. Further, ISA 320: Materiality in Planning and Performing an Audit Engagement (2009) states that a misstatement may be qualitatively material if the users of the AFS would change their economic decision based on the misstatement. Based on the focus on tender fraud in the country, a legal case of R85 million would be qualitatively material to the users. However, it is noted that the requirement to be a reportable irregularity is material financial loss or represents a material breach of duty and therefore even if the amount of the loss is immaterial, the decision to cancel and subsequently award the company that was under-performing was not in the best interest of SAA and the decision by the board was a material breach of fiduciary duty.

This definition is drilled in to auditing students from the undergraduate degree to the completion of their training contract as well as on every audit. While it may be argued that there were several possible reportable irregularities that existed during the audit, at least the one that the audit partner conceded to be aware of should have been evaluated. A quick evaluation, without formally diving into the definition in too much detail, would reveal that the actions of the board to cancel a contract and award it to the service provider that was under-performing would result in SAA being sued. Therefore, it is hard to comprehend the audit partner's actions apart from a clear motivation not to find problems. The section on a lack of independence expands more on this topic.

4.2.2.3.3 Lack of professional scepticism

In the 2016/2017 audit, the AG identified a contract for ground handling that was a significant contract (R1.8billion) that took four years to be awarded from the date of

the tender closing. The transaction was not audited by the PWC and Nkonki audit team as it did not appear in their sample.

When asked why it was not tested, the PWC audit partner responded that the audit team was not provided with the minutes of the relevant board meeting (this should have also been assessed as a scope limitation) and that due to the amount of the contract being too high in value that “obviously the expectation is that it would have gone to the Board after it had gone through the necessary approval processes within South African Airways.” (Zondo 2022:385) This indicates a clear example of the lack of professional scepticism and competence applied by the audit partner. The audit partner’s response indicated that even if the item had been selected as part of the sample, the issue would not have been raised as there was a pre-conceived idea that the tender would have followed the proper channels. The auditing standards do not prescribe a specific sampling methodology but it is general practise to select items that are individually above materiality as well as select a sample from the population that remains. It is therefore difficult to accept that one of the biggest tenders was not selected as part of the sample. It is not known whether the audit partner and staff understand how samples should be selected.

The Commissioner concluded that the frame of mind applied in terms of detecting irregular activity was inappropriate for a public entity.

Ernest and Young, in an interim report, flagged this contract as being on a month-to-month basis and not detected by the auditors. The PWC Partner’s response for not being aware of the contract was that the draft report was not provided to the auditors. This response is not accepted as the media reports and amount of attention it received should have prompted the partner to investigate further.

It was lastly noted that PWC had not done a media coverage review of SAA for the 2016 financial year audit which would have flagged as a high risk the significant contracts that were in non-compliance with laws and regulations. While the media review of audit clients is not a mandatory procedure, it was a practise performed by PWC in their ordinary course of business and was performed for the SAA audit for each year until 2015. PWC therefore was found to not have applied their own methodology which could have resulted in the risks being detected and reported in the audit report.

Analysis

Maintaining professional scepticism requires a questioning mindset. One which does not accept verbal or physical evidence at face value. Maintaining a professionally sceptic mind is difficult in the audit profession as it is due to time pressures – and even more so if one is not or does not appear to be independent. It almost seems as if the audit partner was trying not to report issues that were detected- the opposite of the intended purpose of the audit. A professionally sceptic mind would have realised that the risk of fraud in procurement is a significant risk and must be addressed, it would have realised that missing tender documents is a huge red flag and one that warranted a different audit opinion on compliance than an unmodified opinion, it would have realised that the partner needed more training on the audit of supply chain management in the public sector, it would have realised that media searches on SAA may highlight tenders that require more audit attention and it would have realised that all of this made the perfect storm. The next section details one main reason why the audit partner did not maintain his professional scepticism.

4.2.2.3.4 Lack of independence

PWC was the joint auditor of SAA for the 2011/2012 financial year until the 2015/2016 financial year. The Commission first found that the appointment of PWC and Nkonki for the audit after the 2011/2012 year in itself was irregular because the tender to which PWC applied and the letter of appointment was only for the 2011/2012 financial year yet PWC and Nkonki continued to audit for four subsequent years.

In and around the latter part of 2014 and early 2015, PWC and the audit committee chairwoman's (Ms Kwinana) audit firm submitted three joint audit proposals to perform audit work together and was successful in one of the bids. Therefore, PWC engaged in business and generated fees together with the audit firm owned by the chairwoman of the SAA audit committee that they were currently auditing. It must be noted that the audit committee confirms its independence and ensures that the auditor is independent in the SAA annual report (SAA,2017) and therefore if the chairwoman of the committee has a business relationship with the auditor that it is appointing, that will create a conflict of interest.

PWC paid Ms Kwinana's audit firm R6.1million for the audit work performed together. PWC's independence rule, based on the rule contained in the International Ethics Standards Board for Accountants' Code (2022), was that the amount of the fee cannot

exceed 5% of the business partner's total revenue. Ms Kwinana disclosed total revenue more than R50 million and expected the revenue from the contract awarded with PWC to amount to R4million (this ended up being R6.1million). Ms Kwinana's company used 10% of total revenue as the threshold and was therefore satisfied that R4million was less than R50 million and that no threat was created. It is unclear why PWC deviated from their threshold of 5% and adopted Ms Kwinana's company threshold of 10%. It is noted that had PWC applied its own independence threshold of 5%, even the revenue disclosed of R4million would have breached that threshold being 8% of R50 million.

PWC therefore did not comply with its own independence policy.

Analysis

It is ironic that the appointment of the auditor itself was irregular and did not follow supply chain procedures. One would expect that the appointment of the public watchdog, the entity that is meant to give assurance on the supply chain process, followed the supply chain process itself. This may reflect an attitude of greed from the firm as the subsequent appointment without a tender process being followed was never challenged by the firm. It is noted that the PWC audit partner for the 2015/2016 year only joined for the 2013/2014 audit. The fees earned after the appointment that followed procedure was R69.7 million-an incentive for any fee-earning business to lower their hand and maintain their silence. The SAICA Code of Ethics (2022) and the AP Act (2005) should have guided the appointment process by addressing the self-interest threat to independence by at least terminating the relationship with the audit firm owned by the SAA audit committee chairwoman.

The lack of reporting of deficiencies in internal controls and missing tender documents as well as the inappropriate audit work performed makes sense with the backdrop of a conflict of interest. The audit partner, who is required to be independent faced two conflicts of interest. One is that the audit fees from SAA and the second was the relationship that PWC enjoyed with the chairwoman of the SAA audit committee-the very committee that is meant to ensure that the auditor is independent.

Irrespective of the rules contained in the IESBA code of conduct and PWC's own policies, bidding for work together with the audit firm owned by the chairwoman of your audit client's audit committee just cannot be considered ethical. Despite thresholds and safeguards, any third party looking in will have questions-and they are right to do

so. What was worse was that the relationship with the chairwoman even exceeded the limitations of the firm's own policies. Auditors are supposed to be independent in mind and appearance, therefore, merely complying with the minimum standards is not enough- even though the minimum standards were not even complied with.

Secondly, audit partners are generally required to perform audits to a certain value to meet their KPIs and earn their share of the profits. While that control ensures that audit partners pull their weight, it also incentivises partners to behave as the PWC audit partner did and to do anything to achieve those targets-including acting unethically and disregarding the core principles instilled during the process to become an audit partner. The profit-earning nature of audit firms will easily permit an audit partner, with no experience and little knowledge of public sector entities to perform an audit on one of South Africa's largest State-Owned Enterprises-the national flag of aviation in South Africa- an entity that has now nose-dived at the expense of employees, creditors, valued customers who now face steeper flight tickets due to less competition and of course, already-stretched taxpayers. The nature of profit entities is such that auditors are incentivised, and in some cases even threatened, by the management of audit clients to not report identified misstatements, deficiencies in internal controls and reportable irregularities. The audit partner, who is dependent on the audit fee to achieve his/her targets for the year, faces a conundrum: perform his/her duties and risk losing clients for the business or rationalise the action to not report matters. As can be seen above, the audit partner in this case chose the latter.

It is difficult to accept these actions as a series of coincidence. An irregular appointment of the auditor without being reported by the auditor, a business relationship with the decision-maker at SAA that breached the firm's own independence policies, internal control deficiencies not being reported, missing tender documents not reported, reportable irregularities not being reported, SAICA Code of Professional Conduct contraventions not reported and inappropriate audit opinions. This pointed to a blatant disregard for the profession and for the public interest being served.

There was a distinct conflict of interest that the auditor faced. The auditor had two main objectives, namely, the maximisation of profit and the issuance of an appropriate audit opinion coupled with adherence to the professional values. Although the auditor

should be serving the interest of the users of the AFS, the auditor is appointed and remunerated by the those charged with governance of the entity- in this case the chairwoman of the audit committee. If the auditor partner had achieved the latter objective and issued a disclaimer opinion on the compliance audit, reported the deficiencies in internal control and reported the reportable irregularity, the auditor would have had findings against the audit committee chairwoman- the person to essentially controlled the auditor's appointment. The audit committee chairwoman would have most likely then not appointed the auditor in the subsequent year resulting in the auditor not achieving the former objective and vice-versa.

When one sits back and considers the main issues, a possible explanation comes to mind. The main issues relate to the business relationship with the chairwoman of the audit committee of SAA, not reporting the internal control deficiencies, not identifying the reportable irregularity and not reporting the scope limitation of the lack of supporting documents relating to tenders. The auditor has a business relationship with the chairwoman of the audit committee. Firstly, she ultimately appoints the auditor and secondly there was a joint audit relationship with her firm and PWC. The matters that the auditor did not report (the internal control deficiencies and the lack of tender documents) fall within the duties of the audit committee. Therefore, if the auditor had reported the matters to the users of the AFS or the audit committee, it is the chairwoman of the audit committee that may ultimately pay the price. Therefore, it appears that the PWC partner faced a large conflict of interest rather than just a lack of competence.

It is noted that the lack of independence had a direct impact on the professional scepticism, or lack thereof, of the audit partner. When an individual faces an independence threat or threat to his objectivity, professional scepticism appears to be diminished. This relationship was identified in the section dealing with VBS Bank as well.

4.2.2.4 Conclusion

The Commission concluded that "PWC and Nkonki failed in their duties as a watchdog institution. Had they performed their functions properly, the shambolic state of financial and risk management in SAA would have been picked up earlier, and could have been addressed." (Zondo 2022:392)

1. How did the auditor contribute to the entity becoming a corporate scandal?

The auditor contributed by detecting the problems (the missing tender contracts) and not communicating it in the audit report, detecting deficiencies in internal control but not reporting it to the users of the AFS, lacking the competence to perform the audit, lacking professional scepticism in the audit and not evaluating the existence of a reportable irregularity.

However, the auditor's contribution was much larger than the points noted. Essentially, the audit partner seemingly allowed at least two self-interest threats to independence to override his professional obligation. The audit firm was incentivised by their business relationship with the chairwoman of the audit committee and the audit partner was incentivised by his own KPIs to turn the other way and ignore glaring issues that should have set alarm bells ringing. These conflicts resulted in an audit firm not questioning the legality of its own re-appointment. This either shows the incompetence or greed and conflict of interest of the auditor. The incompetence was shown by the lack of knowledge of the entity and its environment as the auditors did not detect and report that after the first audit, they should have tendered again for the subsequent audit. Greed and conflict of interest may have resulted in the audit firm knowing that they should not be auditing SAA in the second year without a new letter of appointment but choosing to audit anyway to earn the large sum of fees.

The audit partner displayed a severe lack of competence of the nature of a public entity and the audit requirements. The audit partner's attitude that the audit of a public and private audit client is very similar in part contributed to not much work being performed on the compliance with laws and regulations as required by the PFMA. However, whether the cause was in fact a lack of competence is questionable. While on the surface the audit partner explained his actions by claiming ignorance, his other actions indicated a lack of ethics and integrity. The audit partner identified deficiencies in internal controls and failed to report it in the audit report. This act resulted in users not being made aware of the problems at SAA. Most importantly, the audit partner was aware that the tender documents that were requested to perform the audit were not provided. He issued an inappropriate audit opinion and subsequently admitted that an inappropriate audit opinion was issued. Therefore the audit partner perpetrated fraud per the ACFE

definition of fraud due to the omission of the effect of this information in the auditor's report.

The audit team performed inadequate audit procedures and to an unsatisfactory standard as the AG could not rely on the work performed in the subsequent year.

It appeared that the auditor's conflict of interest with the individual within the audit committee that appointed them, was the reason that the auditor did not report the issues detected. Had the auditor reported the issues detected, the individual that ultimately appointed the auditor (who the auditor in addition also has an external business relationship with) would be held responsible for the findings.

2. What was the nature of the material misstatements contained in the financial statements of entities that became corporate scandals?

The amounts disclosed as fruitless and wasteful expenditure and irregular expenditure respectively were found in the subsequent year to be materially misstated (qualitatively and quantitatively). These amounts should possibly have had a disqualified opinion issued as the tender documents could not be provided to the audit team.

The auditor had issued an unqualified audit opinion whereas the auditor could not have concluded on the audit of compliance with laws and regulations as the tender contracts that were subject to audit were not provided to the audit team. The auditor's performance was severely deficient because of self-interest threats to independence as well as a lack of competence on public sector entities.

3. What was the cause of the material misstatements in the financial statements not being detected and reported in the audit opinion?

The overarching cause appeared to be a lack of independence supported by a lack of competence and ethics. The audit partner faced self-interest threats to independence because of reliance on the audit fee and the audit firm faced self-interest threats to independence because of the business relationship with the chairwoman of the audit committee.

The auditor did not have the appropriate knowledge and skills to perform the audit as he believed that there was not much difference between the audit of a private entity and public entity.

The auditor detected the issues in that the missing tender contracts were identified but not communicated to the users of the AFS and did not correctly evaluate the effect of non-compliance with laws and regulations on the audit report seemingly because of the threats to independence.

The audit committee chairwoman also appeared to play a dominant role in decision-making beyond the role and duties of an audit committee chairwoman. The auditor's sampling methodology appeared to not have selected one of the largest tenders which is not in accordance with industry practise.

The underlying cause appeared to be a financial conflict of interest based on the audit fees earned from SAA. The audit partner is reliant on these fees to meet his KPIs and earn his bonus and any salary increase and promotion.

Ultimately, it was the audit partner's prioritisation of fees over professional ethics and duty caused by a conflict of interest that contributed to the material misstatements not being detected and reported.

4. What could the auditor have done to detect and report the material misstatements in the annual financial statements?

The auditor should have maintained independence by implementing safeguards to the threats to independence such as terminating the business relationship with the chairwoman of the audit committee and assigning an EQCR to review the audit file.

While the audit partner could have attended training on auditing a public entity, that would not have been sufficient to undertake an audit of this size as he would have still lacked experience. A more suitably qualified and competent public sector auditor should have been the audit partner for this engagement.

The audit partner could have escalated the deficiencies in internal controls in the audit report and to the audit committee and the audit partner should have reported the limitation of scope and its effect on the audit opinion.

The results of the audit procedure on the compliance audit should have been evaluated more thoroughly.

5. What was the appropriateness of the audit opinion issued?

The audit report was not appropriate as an unmodified audit report was issued and the audit report should have been modified to reflect the effect of a lack of supporting documentation by either qualifying or issuing a disclaimer of opinion.

The audit opinion also did not reflect the effect of the reportable irregularity that should have been reported and communicated in the audit report.

6. What were the findings against the auditor by regulators, the investigative journalists and forensic experts?

The audit partner was found to have lacked professional scepticism

The audit partner did not comply with the audit firm's own policies and procedures (with regards to the media searches as well as independence)

The audit firm was not independent of the audit client by its own policy.

The audit partner was deficient in his performance of the audit as he did not perform the audit as required.

4.2.3 Linkway Trading

4.2.3.1 Background

In April 2013, the media reported that a commercial aeroplane landed at a South African Airport Base reserved for military and foreign political leaders. The plane carried approximately 200 guests from India that were attending a wedding of a member of the Gupta family at the Sun City Resort. (Holtzblatt, Foltin and Tschakert,2020) This article threw the family into the spotlight of South African media which further revealed that the family owned many companies, one of which (Linkway Trading (Pty) Ltd) was a project management company that was audited by Big 4 audit firm, KPMG.

In 2016, the Gupta family's business activities, political connections and ethics received negative media coverage which prompted KPMG to terminate their business relationship with the family. (Essop,2017) However, KPMG's executives were dismissed after an internal investigation found that the auditing firm failed to identify indicators of high risk in its auditing of the Gupta-owned companies and had received warnings prior to the decision to terminate the business relationship with the Gupta family that were not acted upon. The Gupta family allegedly claimed the expenses incurred for the wedding in Sun City as a tax-deductible business expense in the AFS of Linkway Trading which KPMG audited and signed off on. (Cotterhill, Marriage and England,2017).

In 2017, the IRBA had announced that it would institute an investigation of its own into the audit work performed by KPMG on the 2014 audit of Linkway Trading. (IRBA,2017)

4.2.3.2 Internal investigation by KPMG International

A statement issued by KPMG International stated that its investigation of KPMG South Africa had revealed that KPMG South Africa had “fell well short of the quality expected and that the audit teams failed to apply sufficient professional scepticism and to comply fully with auditing standards, particularly in relation to the company Linkway Trading” (KPMG 2017:5)

The report further stated that four KPMG partners (one of which was the audit partner) attended the wedding festivities at the Sun City Resort and this did not amount to a breach of independence.

Analysis

Independence in appearance

The Gupta wedding festivities was, in the opinion of the author, the breaking point of State Capture, the Gupta’s business shenanigans and the beginning of a very dark period for KPMG. The landing of the Gupta family and wedding guests at an army base in South Africa, highlighted to the country just how much of privilege the Gupta family enjoyed in the country. This display of authority by the Gupta family had cost them dearly.

KPMG’s role in the fiasco was exemplified by their attendance at the wedding festivities. KPMG International down-played the enormity of this act in their publication. The question to be asked is how close was the audit partner and the audit client relationship that the client deemed it necessary to invite the audit partner (and others from KPMG) to their child’s wedding? While business relationships are common and often underpin the foundation of business, relationships to this extent cannot exist in the audit business which requires the auditor to be independent and objective. What was even more surprising was that the audit partner accepted the invitation and attended the wedding. Auditors are drilled from university, through articles, every year in practise thereafter and on every engagement that they should be independent of their audit clients. However, the audit partner’s attitude by attending the wedding indicated that he either did not care about the consequences or thought that there would not be any.

Section 400.5 of the IESBA Code of Conduct (2022) which requires the auditor to be independent in mind and in appearance. While the KPMG International statement stated that KPMG South Africa did not breach any independence this statement

cannot be taken at face value. A reasonably informed third party looking in at the wedding and spotting the audit partner in attendance will not reasonably deem the audit partner to be independent. The audit partner in attendance at the wedding gave the impression of being business partners rather than an audit partner. While the requirement is for the audit partner to be independent in mind and appearance, it may be concluded that the audit partner was neither.

Independence in mind

Apart from the wedding, the audit partner faced the conflict of interest in that the Gupta family paid the audit fees for the services rendered but the users of the AFS are the parties that the auditor represents (in this case the South African Revenue Service (SARS) as the AFS were used to submit the entity's tax returns and included the wedding expenditure as tax deductible). This conflict of interest materialised in that the entity's management (The Gupta family) paid the auditors to provide assurance to the users (SARS) that the AFS are fairly presented. The auditor succumbed to the threat to independence and served the interest of the management of the entity rather than the users of the AFS whose interest the auditor should have served. Apart from the audit of the entity in question, the threat to independence was quite large as the Gupta family had several other companies being audited by KPMG. The Gupta family also had companies that engaged KPMG to perform non-audit services as well such as due diligence on the Optimum mine for the Oakbay Resources listing on the JSE. Therefore, if the audit partner had detected the misstatement and reported it, it is likely that KPMG would have lost a lot of audit and non-audit fees and the audit partner's ability to achieve his own KPIs within the firm would be adversely affected.

There were no findings of any direct financial conflict. However, the audit partner does benefit by generating fees and achieving KPIs and therefore benefits in the form of salary increases, bonuses and promotions. The audit partner's behaviour indicates that the lack of independence in appearance by attending the wedding festivities was more indicative of a problem and his independence in mind than any conflict of interest.

The section below details the effect of the audit partner's lack of independence in mind and appearance.

4.2.3.3 IRBA investigation findings

On 28 March 2019, the IRBA issued a statement that the auditor of the Linkway Trading 2014 audit was removed from the register of registered auditors in South Africa as pleaded guilty to six charges of improper conduct as summarised below:

- Three charges of negligence;
- Two charges of dishonesty; and
- One charge of a breach of independence.

The auditor was found guilty of the following in relation to the 2014 audit file of Linkway Trading:

- Failing to design and perform sufficient audit procedures in response to the assessed risk of fraud;
- Failure to investigate unusual transactions reflected in the financial records of Linkway including transactions relating to the wedding (this amounts to a lack of professional scepticism as the business rationale was not assessed); and
- Failure to perform appropriate audit procedures regarding the client acceptance and continuance. (IRBA,2019)

Analysis

The findings against the auditor were critical and represent the effect of the lack of ethics and independence. The result of a lack of independence is firstly a lack of professional scepticism. Without a questioning mindset, the audit partner could not design appropriate audit procedures to respond to the risk of fraud as he was found guilty of not doing. This was evident in the seven unusual transactions (including the wedding expenses) that the audit partner failed to identify and evaluate as being out of the course of normal business activities. The lack of independence resulted in the audit partner restating R6.9 million in wedding expenses (which were not business-related and should not have been reflected in the AFS in the first place) from operating expenses to cost of sales which resulted in the amount being tax deductible. Before the change in classification, the amount would have been listed as an operating expense which is usually broken down in the AFS.

This act of blatant dishonesty reflected the extent of the lack of independence faced by the partner. The audit partner was prepared to go to such lengths that he himself swapped out initialled pages of the AFS to effect the change in classification of the

wedding expenses. The audit partner also agreed in conversations with KPMG staff prior to effecting the change that the amount should not be tax deductible but made this change anyway. (IRBA,2019) With such an act, it is no surprise that the audit partner attended the wedding festivities without a thought of the independence and ethical contraventions that it may cause- by the time of the wedding, it appears that all independence was far gone.

What differentiated the audit partner of Linkway Trading to the audit partner of VBS and SAA is that while the audit partners of the latter two entities were aware of the material misstatements or issues present and failed to report it, the audit partner of Linkway Trading effected the fraudulent misrepresentation himself. This blatant dishonesty and blurred lines in his role set him apart from the other two audit partners.

4.2.3.4 Conclusion

1. How did the auditor contribute to the entity becoming a corporate scandal?

The audit partner lacked independence, ethics and professional scepticism evidenced by his attendance the wedding of the audit client and effecting the change to the AFS to reflect the wedding expenses as a cost of sale. The auditor was reliant on the audit fees generated by the entities owned by the Gupta family and over time seemed to have got too close to the audit client.

The audit partner was grossly dishonest in the performance of the audit engagement by executing the change in the AFS by reflecting the wedding expenses as a cost of sale and a tax-deductible amount when the amount should not have been included in the AFS as a business expense. This act constitutes fraud. What made matters worse was that the audit partner did not just detect the material misstatement and fail to report it, in addition, he executed the change to give effect to the material misstatement. This act sets the nature of dishonesty apart. Whereas in the other cases, the audit partner was aware of the problems but failed to report it, in this case, the audit partner knew of the issue and changed the financials to reflect the misstatement.

2. What was the nature of the material misstatements contained in the financial statements of entities that became corporate scandals?

An amount incurred in relation to the wedding expenses was incorrectly classified as cost of sales when it should not have been treated as a business expense in

the AFS of the audit client. The amount was further allowed as a tax deduction by the audit partner when it should not have been.

3. What was the cause of the material misstatements in the financial statements not being detected and reported in the audit opinion?

The audit partner was dishonest, lacked independence and professional scepticism. The lack of independence was evidenced in the invitation extended to the audit partner and his subsequent acceptance and attendance at the wedding. He showed complete disregard for the professional ethics and duties of an auditor. The underlying cause appears to be a financial conflict of interest based on the audit fees earned from the Gupta family entities. The audit partner was reliant on these fees to meet his KPIs, earn his bonus and any salary increase and promotion.

The audit partner also failed to adequately perform the client acceptance procedures. While KPMG declined to continue business with the Gupta families, this decision was too little too late and the damage had been done by then.

The audit partner appeared to have prioritised revenue and profits over his professional duties and ethics.

4. What could the auditor have done to detect and report the material misstatements in the annual financial statements?

The audit partner should have been independent and more sceptical by mitigating any familiarity threat either through the appointment of an EQCR or if that was not deemed to be sufficient, appointing another audit partner to the engagement. However, due to the media coverage of the client, the audit partner should have discontinued the business relationship earlier than the decision was made to do so.

The audit partner should have not effected the change to the AFS and rather reported the material misstatement in the auditor's report.

5. What was the appropriateness of the audit opinion issued?

The audit report was inappropriate as an unmodified audit opinion was issued yet the AFS contained material misstatements.

6. What were the findings against the auditor by regulators, the investigative journalists and forensic experts?

The audit regulator found the auditor to have been negligent, dishonest and lacking independence. The audit partner was stripped of his title as a CA(SA) and removed from the list of registered auditors.

4.3 Chapter summary

This chapter provided detailed analyses, interpretation and discussion of the data collected to answer the research questions objective and aim. It was found that in all three cases, a financial conflict of interest resulted in the audit partners turning a blind eye to material misstatements and not reporting deficiencies that should have otherwise been reported. This conflict of interest resulted in a lack of independence, objectivity and professional scepticism. Although these three things resulted in deficient audit work, ultimately it was the financial conflict of interest that caused the auditor to contribute to the corporate scandal not being detected and reported. Deficient performance resulted in inappropriate audit opinions and therefore audit failures in all the cases examined.

In each of the cases studied, the audit team obtained either insufficient or inappropriate audit evidence and therefore did not have sufficient and appropriate audit evidence to support the audit opinion. The auditor did not perform their duties in terms of the auditing standards and had the auditor complied with the auditing standards, the corporate scandal would have been detected and reported. In the cases examined, the auditor cannot argue that there was a reasonableness gap and they cannot be expected by the users to detect fraud because in the three cases examined the auditor did in fact detect the fraud but failed to report it to the users of the financial statements. Therefore, in terms of the audit expectation gap, it was deficient performance that resulted in the corporate scandal not being detected and reported and not deficient standards or a reasonableness gap.

What differentiates the audit partners in the three cases examined is that while the audit partners were aware of the material misstatements or issues in all three cases, in one case the audit partner effected the material misstatement. In all cases, the audit partner perpetrated fraud per the ACFE definition and prioritised fee generation (in one case it was for personal gain and in the other two cases it was for the firm) over professional ethics, duties and the responsibility to the users of the AFS. This indicates that there may be a bigger systemic problem within the audit industry. Are auditors so reliant on audit fees generated from clients that they fail in their duties to report issues

to the users of the AFS? There appears to be a difference between whose interest the auditors believe they serve and whose interest they were meant to serve. Table 5 in chapter 5 provides a summary of the findings and the key themes identified in the study as noted in chapter 3.

As noted in the literature review, the audit profession arose because of agency theory in that the providers of capital to the business (shareholders and banks) are not involved in the management of the business and therefore rely on the AFS prepared by management to make economic decisions. In terms of the agency theory and based on the findings, the irony is that the auditor who is appointed to protect the shareholder, is the very entity that is serving management to the detriment of the shareholders resulting in losses being incurred by the shareholders. Therefore, the very purpose of the audit profession has been lost due to the profit maximisation nature of audit firms.

The findings of this study support the previous studies discussed in the literature review whereby individuals surveyed believed auditors are influenced by management (Gloek and de Jager, 1994:23), (Kose and Erdoğan, 2015) and that an audit firm's large clients may exert pressure on the auditor to act in contravention to the Code of Professional Conduct (Ramsarghey and Hardman, 2020)

Alabede (2012) concluded that there are auditors who are discarding their professional ethics in the pursuit of monetary gains. The finding by Alabede is corroborated in all three cases analysed in this chapter. Even though there was only evidence of direct financial monetary gain in one case study, the KPIs of audit partners and the profit-earning nature of audit firms are monetary gains resulting in audit firms discarding their professional ethics.

This is further supported by Hurley, Mayhew and Obermire (2019) who found that changing the auditor's financial relationship with management to one of psychological accountability to investors significantly increased audit quality. As seen in the three case studies, the audit partners have financial relationships with the management of the companies that appoint them. Audit partners then become financially dependent on these relationships in order to generate audit revenue and achieve their KPIs.

Ferreira (2020) also considered the role that auditors played in the corporate scandals in the United States of America and found that a lack of auditor independence, poor

quality and conflicts of interest contributed to corporate failures not being detected and reported. This finding is critical in that these three main themes underpin the reason for the examined corporate scandals in South Africa not being detected and reported. However, it is noted that the study did not evaluate documents pertaining to the performance of the auditor during the audits.

Although the findings of the study are consistent with the studies performed in the literature review, this study highlighted the problem of deficient performance in terms of the audit expectation gap. This study further provided evidence that in the cases examined, the material misstatements were in fact detected but not reported due to financial conflicts of interest.

Chapter 5 presents a summary of the study, limitations and recommendations for future studies.

Chapter 5: Summary, conclusions and recommendations

5.1 Introduction

The document analysis of the case studies sufficiently addressed the research questions as set out in Chapter 1. In answering the research questions, the study found that the auditor contributed significantly in the material misstatements contained in the AFS not being detected and reported in that the auditor detected the material misstatements in the AFS but failed to report it. It was also found that the auditor was not independent in all three cases analysed. This chapter will provide the summary, conclusions, limitations of the study and recommendations for future research.

5.2 Summary of the study

A document analysis was performed on all corporate scandals that occurred in South Africa since 2000 that related to financial reporting fraud and that publicly available information is available regarding the auditor's performance. This resulted in a population and sample of three which was suitable for a qualitative study as the objective of the study was to gain deep insight in to the event or occurrence. The findings were then categorised using a self-developed framework analysis and is included in this chapter.

Salient research findings are as follows:

With regards to the first objective, evaluating whether an audit failure existed by assessing the appropriateness of the audit report issued to the entity, it was found that in all three of the cases studied that an audit failure did exist as the audit opinion was inappropriate. In the case of VBS Bank, the AFS included an amount of approximately R700 million that did not exist. An unmodified audit report was issued even though the AFS contained material misstatements that the audit partner was aware of and did not communicate in the audit report. The AFS of SAA contained potentially materially misstated information pertaining to the amount of fruitless and wasteful expenditure incurred as well as irregular expenditure incurred. Furthermore, the supporting documents relating to the tenders were not able to be provided by the staff and management of SAA. Therefore, the audit report was inappropriate as an unmodified audit opinion was issued whereas the AFS contained possible material misstatements and insufficient audit evidence was obtained and a modified report should have been issued as it related to the amount of fruitless and wasteful expenditure and irregular expenditure incurred. These issues were known to the audit partner but not reported

in the audit report for reasons discussed below. Lastly, the AFS of Linkway Trading contained a material misstatement in that non-business expenditure was firstly included in the AFS and secondly classified as a cost of sale and allowed as a tax deduction where as it should not have been included in the financial records of Linkway Trading. An unmodified audit opinion was issued even though the AFS contained material misstatements that the audit partner was aware of.

With regards to the second objective, assessing whether the audit failure contributed to the corporate scandal not being detected or reported, it was found in all three cases that the audit failure contributed to the corporate scandal not being detected or prevented. In all three cases, the audit partner detected the issues or material misstatements but failed to report the issues in the audit report. In the case of VBS, the audit partner was aware of the approximately R700 million cash that was missing from the balance sheet but did not modify the audit report and had no valid reason for not modifying the audit report. Likewise, the audit partner of SAA knew that the supporting documents was not provided to the audit team but issued an unmodified report. The audit partner of Linkway Trading authorised and effected the reclassification of the wedding expenses from operating expenses to cost of sales to hide the nature of the expense and ensure that the amount was tax deductible.

The reason for the audit partners detecting the issues and not reporting and therefore the reason for the contribution, was a financial conflict of interest resulting in a lack of independence on the part of the audit partners. This deficient performance also constitutes fraud per the ACFE definition as the audit partners concealed material misstatements in the AFS. However, it was only found in the instance of VBS Bank that the audit partner benefited financially directly. In the other two instances the audit partner benefited due to audit fees generated from the clients as audit partners aim to achieve their KPIs, to earn their bonuses and any salary increases and promotions. In the case of Linkway Trading, the audit partner played a more direct role in the execution of the corporate scandal not being reported as he himself effected the change in the AFS resulting in the material misstatement. The financial conflict of interest resulted in the audit partners abandoning their professional ethics and duties, as well as impairing independence, objectivity and professional scepticism.

Therefore, the auditor contributed significantly to the corporate scandal not being detected and reported by not reporting the material misstatements or issues detected. The reason for this was a lack of independence. Audit firms also served the interests of the management of audit clients who appoint them rather than the users of AFS.

The findings of this study are significant for audit committees and shareholders who oversee and are impacted by the audit report respectively. Shareholders must be more aware of the auditors being appointed and the process followed where as audit committees must be aware of the decreased independence that can result from long audit tenure. Shareholders and audit committees both must be aware of the impact of a relationship between the auditors and management of the entity. Regulators should also take heed of the findings especially in South Africa as the MAFR was overruled by the Supreme Court of Appeal. Audit firms, regulators and audit committees should be aware of the possible deficient performance of auditors and take this into account when deciding which audit firm to use. Audit firms should also be weary of the financial dependence on clients by audit partners and implement more stringent measures to reduce the risk to an appropriate level.

A summary of the findings has been tabled below:

Table 5: Summary of findings from the study (Source: student's own work)

| Failure/Auditee | VBS | Linkway | SAA |
|--|------------|----------------|------------|
| Type of fraud | | | |
| -Misappropriation of assets | ✓ | | |
| -Financial reporting | ✓ | ✓ | ✓ |
| | | | |
| Findings against the Auditor | | | |
| Lack of independence | ✓ | ✓ | ✓ |
| Lack of ethics | ✓ | ✓ | ✓ |
| Lack of professional scepticism | ✓ | ✓ | ✓ |
| Insufficient audit evidence | ✓ | | ✓ |
| Audit partner found guilty of dishonesty and fraud | ✓ | ✓ | ✓ |

| | | | |
|--|---|---|---|
| Inappropriate audit evidence (documents not agreeing to recorded amounts or not factual) | ✓ | ✓ | |
| Material misstatements detected and not reported | ✓ | ✓ | ✓ |
| Reportable irregularity not reported | ✓ | ✓ | ✓ |
| Auditor found guilty of not implementing the auditing standards correctly | ✓ | ✓ | ✓ |
| Auditor not performing their own methodology/policies) | ✓ | ✓ | ✓ |
| Inappropriate audit report issued | ✓ | ✓ | ✓ |

5.3 Conclusion

This study highlighted the contribution of the auditor to audit failures in South Africa since 2000. The study has found that, in so far as the sample selected, the material misstatements were detected by the auditors but not reported in the audit report because of impaired independence. The study has found that deficient performance of the auditor was the greatest contributor to material misstatements not being detected and reported. Deficient performance included a lack of independence and objectivity as well as unethical behaviour and succumbing to conflicts of interest.

The reason for deficient performance was the financial conflict of interest faced by audit partners resulting in a lack of independence and the audit partner being dishonest. The study has also found that contrary to the claims of auditors that it is not their responsibility to detect fraud (Kose and Erdoğan,2015), in the cases studied, the material misstatements were detected but not reported. Therefore, had the auditors reported the detected material misstatements, they would have reported the fraud-irrespective of whether they knew it was fraudulent or not. It was also found that the audit report was inappropriate in all the cases examined in that an unmodified audit opinion was issued in all cases examined whereas the AFS contained material misstatements and therefore, an audit failure existed.

The study found that in the cases examined, the auditor significantly contributed to the corporate scandal not being detected and reported. Supporting these conclusions, the study found that in the cases examined, the auditors lacked independence, ethics, professional scepticism and either obtained insufficient audit evidence or inappropriate audit evidence- in either instance, the auditor did not have sufficient audit evidence to support an unmodified audit opinion. The study critically found that in all the instances noted, the auditor's performance of the audit was not in accordance with the audit standards and therefore deficient performance resulted in the auditor contributing significantly to the corporate scandal not being detected and reported.

5.4 Limitations of the study

As a result of the nature of the study, there were limitations in the study. Based on the research methodology of a document analysis, it required subjectivity and level of judgement and interpretation in the codification, however, this was reduced by using publicly available information that can be verified. Instances of corporate fraud result in long-drawn out court cases and forensic investigations that are confidential and not always in the public domain, therefore only three case studies were available with sufficient information. Lastly, specific details of audit work performed that is contained in the audit engagement files is confidential and held within audit firms. As time progresses, more case studies will be available to analyse documents.

5.5 Recommendations

As a result of the findings and the demands of investors, financiers, shareholders and other stakeholders, it is recommended that shareholders and financiers would benefit if auditors face stricter sanctions for audit failures. This can be achieved by imposing stricter monetary and non-monetary sanctions. It is noted that the Minister of Finance recently implemented legislation that allows the IRBA to issue much stricter financial penalties up to R5 million for an individual and R15 million for a firm if there is admission of guilt and R10 million for an individual and R25 million for a firm if a disciplinary hearing is required. (IRBA,2023 b)

It is also recommended that a new system of auditor appointment and remuneration be developed to assist the IRBA in addressing the agency problem which would benefit shareholders and financiers as well as the perception and attractiveness of the audit profession. In all three cases studied, although the auditor should be acting on behalf of the users of the AFS, the auditors are selected and remunerated by

management and those charged with governance of the entity. This results in a conflict of interest for the auditor. Being a profit generating business, audit firm's objective is to maximise profit, comply with professional standards and consistently issue appropriate audit reports. However, the achievement of the latter two objectives will result in the auditor reporting on the shortcomings of the individuals who appoint and remunerate the auditor. Reporting on the shortcomings of these individuals may therefore result in those individuals appointing new auditors in the subsequent year and adversely affecting the first objective of the auditor.

It is recommended that the role and scope of the EQCR be reviewed with guidance provided on the significant risks present per industry to enable a common approach to be applied by all audit firms and more training be provided to audit firms on the topics of professional scepticism, independence and issuing appropriate audit opinions. This would assist audit firms in being able to assess the completeness of work performed by the EQCR as well as audit committees in assessing the completeness of work performed by audit firms on areas of significant risks and significant risks identified for their entity. It is also recommended that the decision to set-aside MAFR be reviewed. The findings of this study assist the audit regulator, shareholders and propagators of MAFR in identifying and assessing the benefits of MAFR, particularly as it relates to adding independence to auditors by removing a financial conflict of interest.

5.6 Suggestions for further research

It is recommended that more studies of this nature be performed that highlight the contribution of the auditor to the corporate scandal not being detected and reported. Based on the gaps identified in the literature review, it is suggested that more research be performed on the existence of the audit expectation gap in South Africa. It is also suggested that more research be performed on the extent of the audit expectation gap in South Africa in terms of deficient performance, deficient standards and unreasonable gap. The future studies can include items in the population such as Tongaat Hulett Limited and Steinhoff Limited which are two of South Africa's largest corporate scandals that occurred but as the legal process is still underway and information pertaining to the performance of the auditor in both instances is limited. A theme has been identified of the relationship between the level of independence and objectivity and the level of professional scepticism. Future research can explore the nature of this relationship further. The reasons for audit partners lacking independence

should also be explored further as it was found that in only one of the three cases examined did the audit partner benefit directly with the evidence available thus far.

The method of selecting and appointing audit firms to audit clients should be explored further as it appears that audit firms are conflicted between maximising revenue and ensuring recurring audit work and serving the interest of those that they were meant to serve. It is also recommended that further research be performed on the benefits of MAFR obtained by the companies that voluntarily rotated audit firms given the Supreme Court Ruling setting aside the requirement.

5.7 Chapter summary

This chapter included a summary of the study performed, the conclusions, limitations and recommendations for further research.

The study employed a qualitative interpretive document analysis method using the framework analysis method of document analysis. The study found that in all three of the cases studied that an audit failure did exist as the audit opinion was inappropriate and that the audit failure contributed to the corporate scandal not being detected or prevented. In all three cases, the audit partner detected the issues or material misstatements but failed to report the issues in the audit report due to a financial conflict of interest between the auditor and the audit client.

The study has found that deficient performance of the auditor was the greatest contributor to material misstatements not being detected and reported. Deficient performance included a lack of independence and objectivity as well as unethical behaviour and succumbing to conflicts of interest.

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Appendix 1: Turnitin Report

Qualitative analysis of audit failures

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Appendix 2: Ethical Clearance Letter



1 Dec 2023

Mr Kenthran Govender (212503323)
School Of Acc. Economics&Fin
Westville

Dear Mr Kenthran Govender,

Original application number: 00024415

Project title: A qualitative analysis of auditors responsibility in South African corporate scandals

Exemption from Ethics Review

In response to your application received on 30 Nov 2023, your school has indicated that the protocol has been granted EXEMPTION FROM ETHICS REVIEW.

Any alteration/s to the exempted research protocol, e.g., Title of the Project, Location of the Study, Research Approach and Methods must be reviewed and approved through an amendment/modification prior to its implementation. The original exemption number must be cited.

For any changes that could result in potential risk, an ethics application including the proposed amendments must be submitted to the relevant UKZN Research Ethics Committee. The original exemption number must be cited.

In case you have further queries, please quote the above reference number.

PLEASE NOTE:

Research data should be securely stored in the discipline/department for a period of 5 years.

I take this opportunity of wishing you everything of the best with your study.

Yours sincerely,



Prof Josua Mbonigaba
Academic Leader Research
School Of Acc. Economics&Fin

UKZN Research Ethics Office
Westville Campus, Govan Mbeki Building
Postal Address: Private Bag X54001, Durban 4000
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