AUDITORS' ASSESSMENT OF A COMPANY'S 'TONE AT THE TOP'

by

FAEEZA FAROUK JAFFER

submitted in accordance with the requirements

for the degree of

MASTER OF PHILOSOPHY IN ACCOUNTING SCIENCES

at the

UNIVERSITY OF SOUTH AFRICA

SUPERVISOR: PROF EM ODENDAAL

CO-SUPERVISOR: PROF HJ THERON

NOVEMBER 2018

DECLARATION

Student number: 51628716

I declare that **AUDITORS' ASSESSMENT OF A COMPANY'S 'TONE AT THE TOP'** is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

I further declare that I submitted the dissertation to originality checking software and that it falls within the accepted requirements for originality.

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November 2018

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FAEEZA FAROUK JAFFER

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ABSTRACT

The auditing profession is facing criticism for audit firms being associated with clients with a poor 'tone at the top' despite auditors being required to assess a company's 'tone at the top', both prior to and during an audit. A problem arises if, should auditors perform an inappropriate 'tone at the top' assessment, they may be associated with an unethical company. Moreover, such an inappropriate assessment may result in an incorrect risk of material misstatement assessment and, consequently, an inappropriate audit opinion on the financial statements of the company. A qualitative research approach and a multiple case study design were used to understand how auditors assess a company's 'tone at the top'. An audit partner from six JSE-accredited audit firms and senior inspectors from the IRBA were interviewed. It was found that the participating auditors assess a company's ethical leadership, ethical culture, the governance role of the audit committee and compliance with laws and regulations when assessing a company's 'tone at the top' while adhering to quality control principles. Despite the participants acknowledging both that 'tone at the top' assessments are conducted during the pre-engagement and planning of an audit and that the audit engagement partner is responsible for these assessments, there was a lack of evidence in the audit files supporting these assessments. The study findings may enable audit firms to include guidance in their audit methodologies on 'tone at the top' assessments and in documenting such assessments and may also assist the IRBA in providing guidance and training to auditors on 'tone at the top' assessments.

Key terms

Audit planning; auditor; business ethics; control environment; corporate governance; ethical culture; ethical leadership; management integrity; risk of material misstatement; tone at the top

OUDITEURS SE ASSESSERING VAN 'N MAATSKAPPY SE “KARAKTER AAN DIE HOOF”

ABSTRAK

Die ouditprofessie staar kritiek in die oë as gevolg van die feit dat ouditfirmas geassosieer word met kliënte met 'n swak “karakter aan die hoof”, ten spyte daarvan dat van ouditeurs vereis word om 'n maatskappy se “karakter aan die hoof” voor en tydens 'n oudit te assesseer. Die probleem is dat indien ouditeurs 'n onvanpaste assessering van die “karakter aan die hoof” uitvoer, hulle met 'n onetiese maatskappy geassosieer kan word. Boonop kan so 'n onvanpaste assessering aanleiding gee tot 'n verkeerde assessering van die risiko van wesenlike wanvoorstelling en, gevolglik, 'n onvanpaste ouditmening oor die finansiële state van die maatskappy. 'n Kwalitatiewe navorsingsbenadering en 'n veelvoudige gevallestudie-ontwerp is gebruik om te verstaan hoe ouditeurs 'n maatskappy se “karakter aan die hoof” assesseer. Onderhoude is met ouditvennote van ses ouditfirmas wat deur die JSE geakkrediteer word en senior inspekteurs van die IRBA gevoer. Daar is bevind dat die deelnemende ouditeurs 'n maatskappy se etiese leierskap, etiese kultuur, die beheerrol van die ouditkomitee en voldoening aan wette en regulasies assesseer wanneer 'n maatskappy se “karakter aan die hoof” geassesseer word terwyl aan gehaltebeheerbeginsels voldoen word. Ten spyte daarvan dat die deelnemers erken dat assesserings van “karakter aan die hoof” uitgevoer word tydens die vooraanstelling en beplanning van 'n oudit en dat die ouditaanstellingsvennoot verantwoordelik is vir hierdie assesserings, is daar 'n gebrek aan bewyse in die ouditlêers wat hierdie assesserings steun. Die studie se bevindings kan ouditfirmas in staat stel om leiding in hulle ouditmetodologieë in te sluit vir assesserings van “karakter aan die hoof” en om sodanige assesserings te dokumenteer, en dit kan die IRBA ook help om leiding en opleiding aan ouditeurs te gee vir sulke assesserings.

Sleutelterme

Ouditbeplanning; ouditeur; sake-etiek; beheeromgewing; korporatiewe beheer; etiese kultuur; etiese leierskap; bestuursintegriteit; risiko van wesenlike wanvoorstelling; karakter aan die hoof

TEKOLO YA ‘BOIKGAFO LE BOETAPELE BJA TAOLO’ YA KHAMPHANI

KAKARETŠO

Profešene ya go hlakiša e lebane le tshekatsheko ka lebaka la difeme tša tlhakišo tšeo di amanywago le badirelwa ba ‘boikgafo le boetapele bja taolo’ bja go fokola, le ge bahlakiši ba nyakega go lekola ‘boikgafo le boetapele bja taolo’ bja khamphani, bobedi pele ga le nakong ya tlhakišo. Bothata bo tšwelela ge, go ka direga gore bahlakiši ba dire tekolo ya ‘boikgafo le boetapele bja taolo’ yeo e sego ya maleba, ba ka amanywa le khamphani ya go se be le maitshwaro. Gape, tekolo yeo e sego ya maleba, e ka tšweletša kotsi ya tekolo ya setatamente se se fošagetšego sa materiale gomme, ka gona, kgopolo ya tlhakišo yeo e sego ya maleba mo setatamenteng sa ditšhelete sa khamphani. Mokgwa wa dinyakišišo tša temogo le moakanyetšo wa tshepetšo ya dinyakišišo di šomišitšwe go kwešiša ka moo bahlakiši ba lekolago ‘boikgafo le boetapele bja taolo’ bja khamphani. Badirišani ba tlhakišo go tšwa femeng ya bahlakiši yeo e dumeletšwego ya JSE le bahlahlobibagolo go tšwa IRBA ba boledišitšwe. Go utollotšwe gore bahlakiši bao ba kgathago tema ba lekotše boetapele bja maitshwaro bja khamphani, setšo sa maitshwaro, mošomo wa taolo wa komiti ya tlhakišo le go obamela melao le melawana ge go lekolwa ‘boikgafo le boetapele bja taolo’ wa khamphani mola go latelwa mekgwa ya taolo ya boleng. Le ge bakgathatema ba amogela bobedi gore ditekolo tša ‘boikgafo le boetapele bja taolo’ di dirwa nakong ya peakanyo ya pele le thulaganyo ya difaele tša tlhakišo tšeo di thekgago ditekolo tše, ga se gwa ba le bohlatse ka mo difaeleng tša tlhakišo tšeo di thekgago ditekolo tše. Dikutollo tša dinyakišišo di ka thuša difeme tša tlhakišo go akaretša tlhahlo mo mekgweng ya bona ya tlhakišo mo go ditekolo tša ‘boikgafo le boetapele bja taolo’ le go ngwala ditekolo tšeo, gape di ka thuša gape IRBA ka go fa tlhahli le tlhahlo go bahlakiši mo ditekolong tšeo.

Mantšu a motheo

Peakanyo ya tlhakišo; maitshwaro a kgwebo; tikologo ya maatla, taolo ya tirišano, setšo sa maitshwaro; boetapele bja maitshwaro; taolo ya go hlomphega; kotsi ya setatamente se se fošagetšego sa materiale, boikgafo le boetapele bja taolo

ACKNOWLEDGEMENTS

I would like to take this opportunity to express my thanks to the following:

- The Almighty, for his infinite mercy and blessings bestowed upon me.
- My husband, M Husain, for his unconditional love, support and advice.
- My children, Sameeha, Ayaaz and Adnaan, who give me, renewed hope every day.
- My parents, parents in law and siblings, for their understanding and help during this busy time.
- My supervisors, Professors Elza M Odendaal and Hansja J Theron, for their tireless efforts, constructive and timeous feedback and mentoring.
- Special thanks to Farhaan and Rubeina, for inspiring me and teaching me what true courage is about.

My sincere gratitude also goes to the following individuals and organisations:

- The College of Accounting Sciences and the Research Directorate at UNISA, for providing me with the opportunity and resources required to complete my dissertation.
- Dr Charmaine Williamson and Professor Dave Lubbe, for their expert advice and selfless coaching and mentoring.
- The participants, who availed me of their valuable time.

Dedication

I dedicate this dissertation to:

My children, Sameeha, Ayaaz and Adnaan, and

a special dedication to Zidaan who will always live

in our hearts forever.

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LIST OF ABBREVIATIONS

ACFE	The Association of Certified Fraud Examiners
APA	Auditing Profession Act 26 of 2005
Companies Act	Companies Act 71 of 2008
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IFC	International Finance Corporation
IoDSA	Institute of Directors of South Africa
IRBA	Independent Regulatory Board for Auditors
ISAs	International Standards on Auditing
JSE	Johannesburg Stock Exchange Limited
King IV	The King IV Report on Corporate Governance for South Africa
OECD	The Organisation for Economic Cooperation and Development
PAA	Public Accountants and Auditors Act 23 of 1995
PAAB	Public Accountants and Auditors Board
PEP	Politically exposed person
PwC	PricewaterhouseCoopers
SAICA	South African Institute of Chartered Accountants
Treadway commission	National Commission on Fraudulent Financial Reporting
UNISA	University of South Africa
WEF	World Economic Forum

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND

"If an organisation is great in spirit, it is because the spirit of its top people is great. If it decays, it does so because the top rots: as the proverb has it 'Trees die from the top'"
(Drucker, 1974 cited in Staicu, Tatomir & Linca, 2013:76)

Many companies throughout the world, such as Tesco and Steinhoff International, have collapsed because of the unethical conduct of top management, thus providing testimony to the truth to the words contained in the quotation above (Cronje, 2018; Schwartz, Dunfee & Kline, 2005:80). The top management of Tesco manipulated the company's accounting estimates and improperly booked more than £250 million of profits to maintain the market value of the company (Picking up the pieces after Tesco's affair, 2014) while the directors of Steinhoff International are facing charges for accounting irregularities (Nicolaides, 2017). The Association of Certified Fraud Examiners (ACFE) found that most companies are losing approximately seven percent of their revenue due to fraud each year (ACFE, 2018:4) and that the majority of their losses may be attributed to corruption on the part of the executive management of the companies (ACFE, 2018:33). The ACFE further reports that the fraud losses tend to be higher if the perpetrator's level of authority is relatively high because directors and senior managers have greater access to the company's assets as well as more power to either evade or override controls as compared to junior employees (ACFE, 2018:33).

In South Africa, the corruption on the part of the members of the governing bodies of companies and management is similar to the ACFE's (2018) findings. The Corruption Perceptions Index, which ascribes a score between zero (highly corrupt) and 100 (very clean) to individual countries, accorded South Africa a score of 43 in 2018, ranking South Africa at 73 out of 180 countries around the world (Transparency International, 2018:2). "A poor score is likely a sign of widespread bribery, lack of punishment for corruption and public institutions that don't respond to citizens' needs" (Transparency International,

2018:1). In addition, the ranking of the efficacy of South Africa's corporate boards dropped from third in 2014 (WEF, 2014:341) to 34th in 2017 (WEF, 2017:269) while, the ethical behaviour of companies in South Africa was ranked in 2014 at 72 out of 137 countries (WEF, 2014:341).

According to Bonn and Fisher (2005:731), the responsibility of top management extends beyond mere profit maximisation. In order to combat corruption, it is essential that company directors obey the law, act with integrity and adhere to ethical standards (Lamberton, Mihalek & Smith, 2005:37-39). Furthermore, courageous and ethical leadership from the directors is needed to combat white collar crime (IFC, 2009:VI). A survey conducted by PricewaterhouseCoopers (PwC) found that an ethical 'tone at the top' is important in order to mitigate fraud and corruption and improve ethical behaviour within a company (PwC, 2013:5). In addition, the Global Economic Crime Survey (PwC, 2014a:4) highlighted that it is incumbent on companies to focus, inter alia, on their 'tone at the top' to decrease the risk of white-collar crime being committed by top management.

The importance of ethical values on the part of the members of the governing body and management of companies was recognised by the National Commission on Fraudulent Financial Reporting (Treadway Commission) which stated that the fundamental component of reliable financial reporting is 'tone at the top' (COSO, 2013). 'Tone at the top' also has a major impact on internal controls, ethical values, and the organisational behaviour of a company (Staicu et al., 2013:77). 'Tone at the top' refers to the ethical climate which prevails at a company as implemented by the company management (Lail, MacGregor, Stuebs & Thomasson, 2015:26) and is a construct of both ethical leadership and ethical climate (Berdard, 2011:1226).

Ethical company leadership involves setting an example by living ethically, fostering an ethical culture and being committed to a company's interests over self-interest (IFAC, 2007:8). Ethical leadership also refers to the company's leaders' "commitment to openness, honesty, integrity and ethical behaviour" (Hersch, 2016). Ethical leadership is important in setting the 'tone at the top' because people may be influenced by both good and bad behaviour and thus when the leader of a company behaves unethically, the employees may emulate such behaviour (Derr, 2012:69). In addition, fraud often occurs in a company in which there is a culture that fosters fraudulent behaviour and thus a company should demonstrate a strong ethical leadership if it intends to minimise fraud

(D'Aquila & Bean, 2003:42). Ethical climate refers to the prevailing attributes of a company that either support or do not support ethical behaviour (Brown & Trevino, 2006:601). It also includes the formal and informal systems that support ethical decision-making such as leadership, reward systems, a code of ethics and policies (Brown & Trevino, 2006:601).

According to the King IV Report on Corporate Governance for South Africa 2016 (hereafter referred to as the King IV Report), corporate governance includes ethical leadership and the fostering of an ethical climate (IoDSA, 2016:20) and thus, by implication, 'tone at the top' forms part of the corporate governance of a company. The governing body is the custodian of corporate governance within a company (IoDSA, 2016:principle 6) and, among other things, is responsible for oversight of the company's financial statements as prepared by management (IoD, 2015; IAASB, 2009a:ISA 200.4). In terms of agency theory (i.e. the conflict between the interests of the governing body and management (agents) and the company's shareholders (principals)), there is a need for an independent verification of the company's results and, consequently, a third party (external auditor) is appointed to confirm what the governing body and management are doing (Rossouw, Van der Watt & Malan, 2002:289) (refer to section 2.2.2 for a discussion of agency theory). The external auditor (hereafter referred to as the auditor) provides an independent opinion on the financial statements as to whether they are free of material misstatement, in all material respects, due to fraud or error (IAASB, 2009a:ISA 200.11).

In order to achieve the objective of providing an independent opinion, an auditor should carry out specific responsibilities as stipulated in legislation and relevant standards. In South Africa, such legislation and standards include the Companies Act 71 of 2008 (Companies Act), the Auditing Profession Act 26 of 2005 (APA) and the standards of the Independent Regulatory Board for Auditors (IRBA) (IRBA, 2017b). The IRBA conforms to the International Standards on Auditing (ISAs) and, by implication, an auditor must comply with the ISAs to ensure a quality and independent audit (IRBA, 2017b).

With respect to 'tone at the top', the International Standard on Quality Control (ISQC1), which forms part of the ISAs, states that an auditor must assess the integrity of the client both prior to associating with a potential client and also when deciding whether or not to continue to audit a client's financial statements (IAASB, 2009k:ISQC1.26(c), .27). In addition, the auditor should assess, during the audit planning phase, the 'tone at the top'

as part of his/her understanding and evaluation of the control environment of the company during his/her assessment of the risk of material misstatement, due to fraud or error (IAASB, 2013a:ISA 315R.14). Such an understanding and evaluation of the control environment includes an evaluation of whether management, with the oversight of those charged with governance, has maintained a culture of honesty and ethical behaviour and also whether the elements of the control environment, collectively, promote a foundation for all the other components of internal control (IAASB, 2013a:ISA 315R.14).

Researchers have studied the implications of a company's 'tone at the top' in respect of an audit of financial statements. For example, Cohen, Krishnamoorthy and Wright (2002:583) studied the impact of corporate governance factors, including a company's board of directors and its 'tone at the top', on the audit process while Cohen and Hanno (2000:133) considered the effect of both management's control philosophy (i.e. management's attitude towards controls which constitutes part of an auditor's 'tone at the top' assessment) and corporate governance on the auditors' planning and preplanning judgements. Schmidt (2014:73) examined the way in which external auditors' access to 'tone at the top' knowledge impacts on subsequent audit judgements. In addition, researchers considered the effect of 'tone at the top' on both the fraud risk attached to an audit engagement (Alexander, 2012:102; Lamberton et al., 2005:38) and the extent of substantive audit procedures (Beaulieu, 2001:96; Cohen & Hanno 2000:133). Studies have also been conducted on the impact of corporate governance (including 'tone at the top') on the control environment and control risk (Sharma, Boo & Sharma, 2008:105; Sneathen Jr, Kizirian & Mayhew, 2003:49-67). Kassem (2018:A29-A30) examined the methods used by auditors in Egypt in assessing management integrity. This study aimed to contribute to existing literature by understanding "how" auditors assess the client's integrity both during the pre-engagement phase of an audit and during the planning phase when obtaining an understanding of and evaluating a company's 'tone at the top' as part of the risk of material misstatement, due to fraud or error (hereafter referred to as 'tone at the top' assessment).

1.2 PROBLEM STATEMENT

Despite the ISA requirements that an auditor should assess a company's 'tone at the top', both prior to and during an audit engagement, the auditing profession is facing criticism on the grounds of audit firms being associated with clients with a poor 'tone at the top'.

For example, KPMG is questioned about its association with Linkway Trading Limited while Deloitte is being questioned about its association with Steinhoff International as these clients are suspected of dishonesty and intimidation (Chabalala, 2018; Mangena, 2018). The problem arises that if auditors were to perform an inappropriate ‘tone at the top’ assessment, they could become associated with an unethical company. Moreover, such an inappropriate ‘tone at the top’ assessment may also result in an incorrect risk of material misstatement assessment and, consequently, an inappropriate audit opinion on the financial statements of the company.

1.3 RESEARCH OBJECTIVE

The objective of the study was to understand how auditors assess a company’s ‘tone at the top’.

1.4 RESEARCH METHODOLOGY

The study adopted a qualitative research approach because it was felt that this would enable the researcher to address the research objective. Creswell (2007:39) recommends that qualitative research be conducted when the researcher aims to explore or understand a problem. The qualitative research process followed in this study is depicted in figure 1.1.

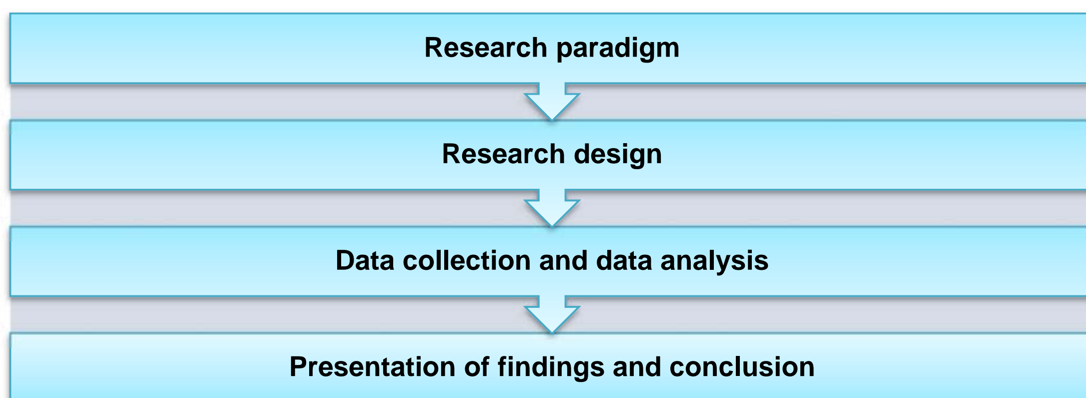

FIGURE 1.1 Research process

Source: Own compilation

Research paradigm

A paradigm is a "model or frame of reference through which to observe and understand" (Babbie, 2010). It depends on certain assumptions made by the researcher i.e. the ontological, epistemological and methodological assumptions. This study fell within the ambit of the constructivist paradigm as reality is created through human interactions by those who are experiencing the reality in question (Guba & Lincoln, 1994:109). The study was based on the following ontological, epistemological and methodological assumptions:

Ontology: The researcher aimed to interact with human beings to determine how auditors assess a company's 'tone at the top'. Knowledge is gained and understood through interpretation and social interaction (Guba & Lincoln, 1994:111).

Epistemology: Knowledge regarding the auditors' 'tone at the top' assessments was acquired through both the participants' interpretation of the phenomenon under investigation as well as the researcher's own background and understanding of the research topic (Creswell, 2013:36; Guba & Lincoln, 1994).

Methodology: The study was an inductive inquiry into auditors' assessment of a company's 'tone at the top'. The researcher used interviews and field notes to seek an understanding of such 'tone at the top' assessments.

Research design

There are various research designs which are applicable to qualitative research within the constructivist paradigm. A multiple case study design was deemed the most appropriate for the purposes of this study as the researcher intended to obtain an in-depth understanding of a particular phenomenon with the study responding to a 'how' question (Yin, 2009:2). The phenomenon of interest to the researcher was how auditors assess a company's 'tone at the top'. The study used non-probability, purposive sampling to select the cases and the participants who would be of the most use in understanding the research phenomenon (Babbie, 2010:193). Multi-stage sampling was used to select, firstly, the cases and, secondly, the participants in each case.

Selection of cases: According to the ACFE, corruption is more prominent in larger companies (ACFE, 2018:4), such as the Johannesburg Stock Exchange Limited (JSE) companies, than in smaller companies. Accordingly, audit firms which had been appointed as the auditors of JSE listed companies were selected as cases for the purposes of the study. The list of the Top 40 JSE companies were obtained (FTSE Group, 2017) and the JSE-accredited audit firms determined. There were six JSE-accredited audit firms.

The IRBA is the sole statutory regulatory body for the auditing profession in South Africa (RSA, 2005). It is the responsibility of the IRBA inspection's department to, at least every three years, inspect or review the practice of a registered auditor who audits any public company (IRBA, 2017a). The IRBA's inspection department was, therefore, also selected as a case for the purposes of the study.

Selection of participants: The researcher selected an audit partner from each of the six JSE-accredited audit firms responsible for the audit of a JSE listed company and who, at the time of the study, had been with the audit firm for at least five years. The audit engagement partner is responsible for a company's 'tone at the top' assessment (IFAC, 2010:26). The IRBA's senior inspectors who were responsible for the inspection of the audit files of JSE-accredited audit firms during the most recent audit quality control cycle were selected as it was felt that they would be acquainted with how auditors perform 'tone at the top' assessments.

The participants of the study (audit partners and senior inspectors) were seen as the informants in the study as the researcher was interested in understanding how auditors assess a company's 'tone at the top' and they would enable the researcher to acquire knowledge on the research phenomenon and not the cases themselves (Eriksson & Kovalainen, 2008:124). Furthermore, case study research in business uses empirical evidence from one or more organisations to study a particular subject matter (Myers, 2009:76). Triangulation from various data sources proved to be feasible for the purposes of the study since the study participants comprised both audit partners of JSE-accredited audit firms and senior inspectors from the IRBA.

Data collection and data analysis

Data was collected through semi-structured interviews, which were conducted with the selected audit partners and senior inspectors from the IRBA. The interviews lasted approximately 60 minutes each. Field notes were also used as a further data collection method. Prior to conducting the interviews, a pilot study was performed to give the researcher the opportunity to refine the interview questions, if necessary, and to familiarise herself with the questions (De Vos, Strydom, Fouchè & Delport, 2011). Thus, the pilot study strengthened the reliability of the data gathered during the interviews (Yin, 2013:92). An independent transcriber then transcribed the digitally recorded interviews.

The data, which had been collected, was analysed inductively. The transcriptions and field notes were initially coded manually. Thereafter, the interview transcripts and field notes were imported into ATLAS.ti™ (a computer-aided qualitative analysis software) and recoded using the codes, which had been derived during the manual coding of the interview data, refining or changing the codes where necessary. The codes were then categorised. The data which had been collected was also coded and categorised by an independent coder after which the researcher and the independent coder reached consensus on any discrepancies. The coding by the independent coder was aimed at enhancing the credibility and reliability of the data coding. Thereafter, the relationships between the different categories were explored to identify common themes among the categories.

Methodological norms

It is important that the trustworthiness of the research is established in order to justify the research findings (Lincoln & Guba, 1985:290). This is achieved by ensuring that the research is credible, transferable, dependable (Lincoln & Guba, 1985:300) and authentic (Lincoln & Guba, 1986:76).

The researcher described the steps, which were followed to achieve the research objective, and the conclusions reached in detail. A comprehensive literature review was also carried out with existing literature on corporate governance, its relation to ethical leadership and the role of the auditor in this respect, being examined. The literature review informed the questions, which were posed during the semi-structured, interviews

as well as provided the guiding principles underlying the data analysis.

1.5 IMPORTANCE OF THE STUDY

This study responded to the call for more research into auditors' assessment of management's integrity ('tone at the top') (Kassem, 2018:A33) and thus the study may be said to have contributed to the existing body of such knowledge by understanding how auditors assess a company's 'tone at the top'. It is hoped that the study will enable audit firms to include guidance in their audit methodologies to assist auditors in conducting appropriate 'tone at the top' assessments. In addition, the findings of the study may assist the IRBA in providing guidance to and training auditors on their 'tone at the top' assessments.

1.6 DELIMITATIONS OF THE STUDY

In light of the objective of the study, this study focused only on the risk assessment decisions made by auditors regarding a company's 'tone at the top'. In addition, the study also limited the audit firms represented in the study to audit firms, which were appointed as the auditors of JSE listed companies while one audit partner only from each of the selected audit firms was interviewed. However, senior inspectors from the IRBA were also interviewed to obtain their understanding of how auditors assess a company's 'tone at the top'.

1.7 ETHICAL CONSIDERATIONS

Ethics in research involves determining what is considered proper or improper when conducting such research (Babbie, 2010:64). Research ethics involves reporting results accurately and fully, disclosing the limitations or shortcomings of a study and ensuing that the participants involved are not harmed in anyway (Babbie, 2010:84). Prior to the data collection the researcher obtained ethical clearance from the Research Ethics Review Committee of the College of Accounting Sciences at the University of South Africa (UNISA). The researcher ensured that the study conformed to the ethical principles of respect for persons, beneficence and justice (Marshall & Rossman, 2016:51).

In adhering to the ethical principles, the researcher obtained permission from both the audit firms selected and the IRBA for their audit partners and senior inspectors to participate in the study. In addition, the researcher informed the participants that their participation in the interviews was voluntary and that the interview will be conducted only if the researcher had obtained the informed consent of the participants to participate in the interview process. Informed consent means that the participant is provided with background to the study, the objective of the study, the extent of his/her involvement in the study and the consequences of not participating (Eriksson & Kovalainen; 2008:70) (refer Annexures A and B) with the researcher also signing an informed consent agreement with each participant. The researcher also signed confidentiality agreements with the professional transcriber who assisted with the transcribing of the interviews and with the independent coder.

1.8 DEFINITIONS OF KEY TERMS

The following key terms, together with their definitions, were used in the study:

Audit objective: The objective of an audit is "to provide reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an independent opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and to report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings" (IAASB, 2009a:ISA 200.11(a-b)).

Board: The board of a company refers to the board of directors of the said company (RSA, 2008:s1) and forms a subset of the wider term governing body (see definition below) (IoDSA, 2016:10).

Business ethics: Business ethics is the study of moral standards (what is morally right or wrong) in respect of the principles which apply to the business activities of an organisation (Velasquez, 2014:15; Abdullah & Valentine, 2009:93).

Corporate governance: Corporate governance includes the policies, practices and processes by which a company's goals are identified and achieved as well as the mechanisms that are in place to monitor the attainment of such goals (OECD, 2004:11). In addition, corporate governance refers to the relationship between the company's board and other key stakeholders including, but not limited to, shareholders, suppliers, financiers and investors (OECD, 2004:11).

Director: A director of a company is a member of the board of the company (or an alternative director of the company) and includes any person occupying such a position, irrespective of the term designated by the company (RSA, 2008:s1).

Engagement partner: Engagement partner refers to the "audit partner or other person in the audit firm who is responsible for the audit engagement and its performance, and for the report that is issued on behalf of the audit firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body" (IAASB, 2016:Glossary of terms).

Ethics: Ethics refers to the standards of right behaviour or the study of morality (Oxford Dictionary, 2004). Ethics is not only about the standards (rules and principles) of right and wrong behaviour but also the application of reasoning to shed light on such rules and principles and the application of such rules and principles at the time of a dilemma (Abdullah & Valentine, 2009:93; Banerji & Krishnan, 2000:405; Lewis, 1985:383).

Ethical leadership: Ethical leadership refers to the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships, and the promotion of such conduct to followers through two way communication, reinforcement and decision-making (Brown, Trevino & Harrison, 2005:120).

Fraud: Fraud in the organisational context refers to an "intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage" (IAASB, 2009d:ISA 240.11(a)).

Governing body: "The governing body is the structure that has the primary accountability for the governance and performance of the organisation" and includes the board of directors of a company (IoDSA, 2016:12). The governing body of an organisation delegates to management the implementation and execution of approved strategy through policy and operational plans (IoDSA, 2016:29).

Management: Management includes both senior management and executive management. Senior management is "the level of management reporting to executive management" (IoDSA, 2016:14) while executive management is "after the governing body, the highest decision-making authority in the organisation and includes executive members of the governing body" (IoDSA, 2016:14).

Partner: Partner in the firm context refers to any "individual with authority to bind the firm with respect to the performance of a professional services engagement" (IAASB, 2016:Glossary of terms).

Professional judgement: Professional judgement in the audit sphere refers to the application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in the making of informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement (IAASB, 2009a:ISA 200.13(k)).

Professional skepticism: Professional skepticism in the audit context refers to the auditor's questioning mind when assessing audit evidence received from the client (IAASB, 2009a:ISA 200.13(l)).

Risk of material misstatement: The risk of material misstatement refers to the risk that the financial statements will be materially misstated prior to the audit and consists of two components, namely, inherent risk and control risk (IAASB, 2009a:ISA 200.A39).

Stakeholder theory: According to the stakeholder theory, a company should act responsibly to its stakeholders and participate in social issues (Claessens, 2006:108).

Those charged with governance: Those charged with governance refers to the members of the governing body (see definition above) who are appointed to serve on the governing body and/or its committees (IoDSA, 2016:12), such as the audit committee.

1.9 STRUCTURE OF THE STUDY

This dissertation consists of six chapters as detailed below.

Chapter 1 provides the background to the study and outlines the problem statement as well as the research objective. The chapter also outlines the research methodology used, the importance of the study, the delimitations of the study and the ethical considerations that underpinned the study. In addition, the researcher defined key terms to ensure that the reader would consistently understand the meanings given to the terms as used in the study.

Chapter 2 comprises the first part of the literature review. The chapter focuses first on a discussion of corporate governance i.e. definition of corporate governance, applicable approaches and theories to corporate governance, the corporate governance structure of South Africa as well as the link between corporate governance and ethics. Secondly, the chapter focuses on ethics and includes a description of ethics (specifically business ethics) and the ethical theories that are used to discern ethical reasoning. In addition, the chapter describes what the 'tone at the top' of a company entails to serve as the theoretical underpinning of the study.

Chapter 3 constitutes an extension of the literature review. The chapter describes the development of the auditing profession in general as well as the auditing profession in South Africa. The chapter also discusses an audit engagement and how the auditor should assess a company's 'tone at the top' in terms of the legislation, professional regulations, academic literature and the ISAs.

Chapter 4 discusses the research paradigm, research approach and design and research method (data collection and data analysis) used in the study as well as the methodological norms applicable to the study. The ethical considerations surrounding the study are also discussed.

Chapter 5 presents and discusses the findings of the study based on the analysis of the data which was obtained both from the semi-structured individual interviews which were conducted with the research participants and the field notes.

Chapter 6 concludes the study by providing an overview of the study, aligning the research objective of the study to the study findings and outlining the contribution of the study. The chapter also discusses the limitations of the study as well as the recommendations for further research that arose from the study.

1.10 CONCLUSION

This chapter provided the background to the study. In South Africa, corruption on the part of members of the governing bodies of companies and management is on the increase. In order to reduce such corruption, the members of the governing body and management should uphold ethical norms. ‘Tone at the top’ is cited as the fundamental component of reliable financial reporting. The ‘tone at the top’ of a company, which forms part of both the corporate governance of a company and the governing body as the custodian of corporate governance, plays a major role in oversight over the preparation and presentation of the financial statements of the company by management. As a result of the agent-principal conflict, an auditor is appointed to audit a company’s financial statements.

The chapter highlighted that as part of the audit of financial statements, auditors must assess the ‘tone at the top’ of a company prior to accepting the client and also when considering continuing with the client engagement. In addition, auditors should also assess, during the audit planning phase, ‘tone at the top’ as part of their understanding and evaluation of the control environment of the company during their assessment of the risk of material misstatement, due to fraud or error. However, the problem arises that if auditors were to perform an inappropriate ‘tone at the top’ assessment, these auditors may be associated with an unethical company. Moreover, such an inappropriate ‘tone at the top’ assessment may result in an incorrect risk of material misstatement assessment and, consequently, an inappropriate audit opinion on the financial statements of the company. The research objective of this study was, therefore, to understand how auditors assess a company’s ‘tone at the top’. In order to realise the research objective, the researcher followed a qualitative research approach and interviewed both audit partners

and senior inspectors from the IRBA to determining how ‘tone at the top’ assessments are performed.

Chapter 2 discusses corporate governance, ethics and the link between the two concepts. In addition, the chapter also discusses the term ‘tone at the top’.

CHAPTER 2

A COMPANY'S 'TONE AT THE TOP'

2.1 INTRODUCTION

Chapter 1 provided the background to the study and highlighted that 'tone at the top' is a fundamental component in achieving reliable financial reporting (COSO, 2013). Setting the right 'tone at the top' is a phrase that is becoming increasingly popular and is viewed as a prerequisite for the effective leadership (members of the governing body and management) of a company (PwC, 2013:5). Given the significance of 'tone at the top', auditors are required to assess a company's 'tone at the top' during the audit of a company's financial statements (IAASB, 2013a:ISA 315R.14; IAASB, 2009k:ISQC1.26(c), .27). In order to understand how auditors assess a company's 'tone at the top', an understanding of the term 'tone at the top' is essential. Accordingly, this chapter focuses on describing the term 'tone at the top'.

Before describing the term 'tone at the top', it was deemed necessary to discuss the concept of corporate governance as 'tone at the top' entails ethical leadership and ethical climate – both constructs of corporate governance (IoDSA, 2016:20). Moreover, the 'tone at the top' of a company and the ethical leadership of a company's governing body and management fall within the ambit of both the Companies Act (RSA, 2008) and the King IV Report (IoDSA, 2016). Chapter 2 discusses the link between corporate governance and ethics and then ethics itself (specifically business ethics) as 'tone at the top' has been found to be the driver of ethical decision-making. Finally, the chapter provides a description and discussion of 'tone at the top' in the context provided.

2.2 CORPORATE GOVERNANCE

This section presents a description of corporate governance by defining corporate governance and discussing corporate governance approaches and theories. In addition, the section also describes the corporate governance structure in South Africa as well as the link between corporate governance and ethics.

2.2.1 Defining corporate governance

There are two categories of definitions of corporate governance. The first category of definitions is applicable to the study of a single country or company as it focuses on the actual behaviour within a company, such as the role of the directors of the company, the rights of shareholders and other stakeholders as well as the governance mechanisms specific to the company (Claessens, 2006:93). The second category of definitions is applicable to comparative studies because it focuses on the differences between the corporate governance mechanisms of companies in various countries or dual listed companies in relation to legislation, principles and finance (Claessens, 2006:93). In view of the fact that this study was concerned with corporate governance in South African companies definitions related to category one were deemed to be appropriate to the purposes of the study and are discussed below.

Corporate governance may be broadly defined as a "system by which companies are directed and controlled" (COSO, 1992). The Organisation for Economic Cooperation and Development (OECD) (2004:11) provides an explicit definition of corporate governance, stating that corporate governance includes the policies, practices and processes by which a company's goals are identified and achieved as well as the mechanisms that are in place to monitor the attainment of such goals. In addition, corporate governance is concerned with the relationship between the company's management and other key stakeholders including, but not limited to, shareholders, suppliers, financiers and investors. According to the King IV Report, corporate governance is about the application of "ethical and effective leadership" by the governing body of a company (IoDSA, 2016:20). The King IV Report further states that corporate governance includes the implementation of an ethical culture that promotes ethical decision-making (IoDSA, 2016:22).

Based on the discussion above corporate governance may be described as the design, implementation and monitoring of the policies, practices and processes established to direct and achieve the objectives of the company in question. In addition, corporate governance mechanisms assist in managing the relationships between management and the company stakeholders, including its shareholders, and include the implementation and maintenance of an ethical culture (the concept of ethics is elaborated upon in section 2.3.1 and ethical culture in section 2.3.3).

2.2.2 Corporate governance approaches and theories

There are two approaches to corporate governance, namely, the Anglo-American (or common law) approach and the European (or civil law) approach (Windsor, 2009:312; Aguilera & Jackson, 2003:447). The Anglo-American approach is popular in both the United States of America and the United Kingdom and is known for its adoption of agency theory i.e. the shareholder is the dominant concern of the company (Mallin, 2013:78). In addition, this approach favours a single board of directors and raising funds from investors (through financial markets), not by obtaining loans from banks (Aguilera & Jackson, 2003:447; Reed, 2002:230). In terms of this approach, government and labour cooperation is kept to a minimum (Aguilera & Jackson, 2003:447; Reed, 2002:230). The European approach, on the other hand, supports stakeholder theory by favouring a two-tiered board consisting of management and labour representatives. This structure is adopted to emphasise that welfare should be created for all who are affected by a company (West, 2006:434; Aguilera & Jackson, 2003:447). Japan is an example of a country that follows the European approach.

The corporate governance theories highlighted by the above approaches include the agency and stakeholder theories and are explained below. The shareholder and enlightened shareholder theories are also discussed as they may be seen as an extension of agency theory.

Agency theory – This theory is predominant in the Anglo-American approach to corporate governance and is based on the seminal work of Berle and Means in 1932 which was further developed by Jensen and Meckling in 1976 (Donaldson & Davis, 1991:49). In terms of agency theory, there is a principal–agent relationship between the individuals who own the company (shareholders) and those who manage or control the company (governing body and management) (Rossouw et al., 2002:289). This theory suggests that the agent will be driven by self-interest rather than maximising the principal's interest in the company (Okpara, 2011:185). In other words, the owners no longer manage or control the company with the management and control of the company having been handed over to the governing body and management (agents). There is, however, a risk that the governing body and management may misuse such control for personal gain (Rossouw et al., 2002:289). Shareholders require a return from their investment in the company through dividends and capital growth whereas management

prefer higher profits in order to justify higher salaries than may otherwise have been the case (Aguilera & Jackson, 2003:447). Thus, the goals of the principals and the agents are different. As a result, shareholders have to turn to various corporate governance mechanisms to verify what the governing body and management are actually doing (Rossouw et al., 2002:289), thus giving rise to agency costs (Aguilera & Jackson, 2003:447; Eisenhardt, 1989a:58).

Agency theory has been criticised for overlooking the importance of other stakeholders of the company (i.e. their role within the company and their interdependencies) and for not giving due recognition to the environment in which the company operates (Aguilera & Jackson, 2003:448-449). However, the proponents of this theory argue that despite the fact that the interest of the shareholders is the main focus of the theory, this focus improves the efficiency of the company and benefits all stakeholders (Rossouw, 2009:7).

Shareholder theory – Shareholder theory was conceptualised by Friedman in 1962 and states that the most important duty of a company is to make a profit, thus maximising shareholder wealth (Gamble & Kelly, 2001:110). The interests of the shareholders are considered important because the shareholders have a residual claim on the company i.e. their claim is met first after all claims in terms of law have been met, for example, the claims of creditors or revenue services (Gamble & Kelly, 2001:110). However, according to critiques of this theory, the theory takes into account only the short-term view of a company and not the implications of profit maximisation in the long run (Danielson, Heck & Shaffer, 2008). Furthermore, the theory has been criticised for violating the rights of other interested parties who may have a claim in the company, for example, employees and suppliers (Danielson et al., 2008).

Enlightened shareholder theory – Enlightened shareholder theory differs from shareholder theory in that it states that the governing body should pursue the interest of shareholders first but that in doing so, the directors must take into account the interests of other stakeholders (Muswaka, 2013:6; Esser & Havenga, 2008:89). However, the governing body does not take into account the interests of all stakeholders but only the interests of those stakeholders who contribute to maximising the company’s profits. The theory further recognises that the governing body’s consideration of other stakeholders will benefit the shareholders in the long term (IoDSA, 2016:25).

Stakeholder theory – Stakeholder theory, which is dominant in the European approach to corporate governance, was gradually developed by Freeman (1983), and incorporates corporate accountability to a broad range of stakeholders (Abdullah & Valentine, 2009:91). In terms of stakeholder theory, the two main concerns of a company include acting responsibly towards its stakeholders and participating in social issues (Claessens, 2006:108). Acting responsibly to stakeholders implies treating the stakeholders well as they have alternative opportunities available to them, for example, employees may find jobs elsewhere, while participating in social issues would typically involve the company committing to safeguarding the environment (Claessens, 2006:108).

According to Freeman and Reed (1983:91), a stakeholder is "any identifiable individual or group on which the organisation is dependent for its continued survival". In a broader sense the definition would include protestors, public interest groups and trade unions to the extent that they affect the realisation of the company's objectives (Freeman & Reed, 1983:91) whereas a narrow sense of the definition includes owners, employees, suppliers, customers, local communities and management (Freeman & Reed, 1983:91). In addition, stakeholders refer to those individuals or groups who have a legitimate claim in the company rather than only the company having an interest in them (L'Huillier, 2014:310). Each stakeholder group, according to the narrow sense of the definition, is briefly discussed below.

- *Owners* – Owners refer to a group or an individual who has a financial stake in the company, i.e. shares, bonds or other monetary assets. The owners expect a financial return on their investment, usually in the form of capital growth or dividends (Freeman & Evan, 2010:139).
- *Employees* – The jobs and livelihoods of employees are at stake. In return for their labour and skill, employees expect a salary and benefits from the company. In addition, employees also expect the employer to support them in difficult times and, in return, are loyal to the company (Freeman & Evan, 2010:139).
- *Suppliers* – Suppliers provide the company with resources or material for the company's final products. If a company maintains a good relationship with its suppliers (for example, pays them on time) the suppliers are often willing to assist the company in a time of need (for example providing the company with extended credit terms) (Freeman & Evan, 2010:140).

- *Customers* – Customers purchase the products or services of the company, thus providing the company with revenue. If customers are satisfied with the company, the company will reap benefits in the form of a good reputation and a loyal customer base (Freeman & Evan, 2010:140).
- *Local community* – The company is expected to be socially responsible and, in return, the local community will support the initiatives of the company (for example, expand the company within the vicinity of the local community) (Freeman & Evan, 2010:140).
- *Management* – Management's role is similar to that of the employee. In exchange for high compensation, the management of the company is expected to look after the welfare of the company and balance the needs of the various stakeholders (Freeman & Evan, 2010:141).

South Africa's corporate governance structure is very similar to the Anglo-American structure described above due to its company law being entrenched in British law (Reed, 2002:230). However, South Africa's structure differs from the Anglo-American model in certain respects, for example, government and labour may intervene in a company through the Employment Equity Act 55 of 1998 and the Broad Based Black Economic Empowerment Act 53 of 2003 (West, 2006:435). Furthermore, the Anglo-American approach supports agency theory of corporate governance whereas South Africa's corporate governance model promotes stakeholder theory. This is evident from section 76(3)(b) of the Companies Act (RSA, 2008) that states that a director must perform his/her functions in a manner that takes into account the "best interests of the company". Although what is considered to be the "best interests of the company" is not defined in the Companies Act (RSA, 2008), section 76(3)(b) should be read in conjunction with section 7 (Purpose of the Companies Act) (RSA, 2008) which states that a company must conduct itself in a manner that does not contravene the Constitution of the Republic of South Africa, 1996 (hereafter referred to as the Constitution) and its Bill of Rights. By implication, this means that a company should act in a fashion that does not violate human rights, as promoted in section 8 of the Constitution (Gwanyanya, 2015:3114; Muswaka, 2013:3), thus taking into account the rights of all the stakeholders. Moreover, the Companies Act makes provision for the protection of minority stakeholders through the derivative actions it allows for them in section 165 (RSA, 2008). This provision encourages the notion that directors consider the interests of stakeholders other than the interests of shareholders only. Stakeholders are also considered in the Companies Act

(RSA, 2008) in section 72(4) that requires the establishment of a social and ethics committee whose duties, among others, are to monitor the company's activities in respect of social and economic development, good corporate citizenship, the environment, health and safety, consumer relations and labour and employment matters.

South Africa's corporate governance approach includes the recommendations of the King IV Report. The King IV Report clearly states that it follows the stakeholder theory of corporate governance and requires that the governing body considers the needs and expectations of all material stakeholders when making decisions on behalf of the company (IoDSA, 2016:25). The King IV Report intentionally follows this theory because the authors of the report believe that a company will be aware of the opportunities and challenges facing it only if it considers all material stakeholders (IoDSA, 2016:25).

2.2.3 Corporate governance in South Africa

Prior to 1994, South Africa was excluded from participating in the global economy due to sanctions which had been imposed on the country by the United Nations (Vaughn & Verstegen Ryan, 2006:505). As a result, the country was lagging behind international norms with respect to company practices, laws and regulations. However, this situation changed post 1994 when foreign investors entered the country and demanded both company reform and the development of corporate governance principles in exchange for their investment in South African companies (Vaughn & Verstegen Ryan, 2006:505).

In response to this international expectation, Mervyn King was appointed in 1994 to set up a commission to establish a code of governance principles for South Africa (West, 2006:435). Accordingly, the King Committee was appointed under the auspices of the Institute of Directors of South Africa (IoDSA) and supported by the JSE and the South African Chamber for Business (Esser, 2009:189). The first King Report on Corporate Governance (King I) was issued in 1994 and replaced with the King Report on Corporate Governance for South Africa (King II) in 2002. King II was commissioned due to the changes to corporate governance worldwide and changes in South Africa since 1994 (West, 2006:436). The King II report was updated and the King Report on Governance for South Africa 2009 (King III) was issued in 2009 due to changes to much of South African legislation, specifically the Companies Act (RSA, 2008) and the APA (RSA, 2005). In 2016 King III was updated to King IV in order to align the report to various governance

developments since 2009 (IoDSA, 2016:3) and also as a result of changes in global trends, the country's commitment to the United Nations Sustainable Goals, the Africa 2063 Agenda and the National Development Plan (IoDSA, 2016:3).

The King IV Report's recommendations demonstrate the characteristics of a sound governance system for companies. It is, however, not possible for such a governance system to exist separately from the law while it must be supported by a well-functioning legal structure (IoDSA, 2016:35; Todorovic & Todorovic, 2012:311; OECD, 2004:12). There are several laws which apply to South African companies, including the Labour Relations Act, the Basic Conditions of Employment Act and the Taxation Act. These laws and regulations provide for the structure and safeguarding of companies. However, the Companies Act is the main piece of legislation in South Africa that governs companies.

The Companies Act was amended in 2008 as its predecessor (Companies Act 61 of 1973) was almost 40 years old. The Companies Act is supported by the Companies Regulations, which the Minister of Trade and Industry published in terms of section 223, and Item 14 of Schedule 5 of the Companies Act. The Companies Regulations became effective on 1 May 2011 which was the same date on which the Companies Act No 71, 2008, became effective (KPMG, 2011:2). It is recommended that they are read together.

It is compulsory for companies to conform to company law. On the other hand, the King IV Report consists of recommended governance principles for South African companies and operates on an 'apply and explain' basis (IoDSA, 2016:7). This means that there is no legal obligation to comply with King IV but that instead a company should indicate the principles with which it is complying and explain how the company achieved or gave effect to such principles (IoDSA, 2016:37). Nevertheless, although adherence to the King IV Report is recommended, if a company is listed on the JSE, adherence to the King IV Report is compulsory (JSE, 2015: listing requirement 8.63(a)).

2.2.4 Corporate governance and ethics

Ethics is deemed to be the foundation for good governance (IoDSA, 2016:4). Ethics is related to governance in two ways, namely, the ethics of governance and the governance of ethics and both should be in place within a company (Rossouw & Sison, 2006:2). The value and trust in businesses that corporate governance structures aim to bring about are

referred to as the ethics of governance whereas the governance of ethics refers to the way in which the governing body directs the company such that the company performs in an ethical manner (IoDSA, 2016:principle 2, practice 4; Rossouw & Sison, 2006:2).

Both the ethics of governance and the governance of ethics were seen to be of relevance to this study because the study aimed to determine both what the governing body does to ensure that the company is ethical and also how the governing body monitors the ethical standards set for the company (Rossouw & Sison, 2006:2) when exploring the way in which auditors assess a company's 'tone at the top'. Specifically, the governance of ethics deals with codes of conduct, staff training on ethics, whistleblowing and reporting on ethical performance (Rossouw, 2009:5). Moreover, ethics is intertwined with corporate governance because ethics and ethical theories provide the thinking or notions on how directors should respond to an ethical dilemma (Jones, Felps & Bigley, 2007:153). Ethics, as a phenomenon, is explored in the next section.

2.3 ETHICS

This section contains a description of ethics and explains the ethical theories that are used to discern ethical reasoning. Business ethics is then discussed specifically because this study was concerned with how auditors assess a company's 'tone at the top'.

2.3.1 Describing ethics

Ethical decision-making is encountered in various aspects of life. According to the Oxford Dictionary, ethics refers to the standards of right behaviour or the study of morality (Oxford Dictionary, 2004). Morality refers to the standards that an individual or group hold in relation to right and wrong and/or good and evil (Velasquez, 2014:8; Raga & Taylor, 2005:22) with moral standards being absorbed or learnt through encounters with and the teachings of religion, church, family and/or friends. The following provides an example of this statement. Mr X has been raised with the moral standard that he has an obligation to tell the truth. However, Mr X's employer requires him to falsify a report. As an employee he has an obligation to obey his employer. Mr X, therefore, has to determine which obligation outweighs the other – the obligation to tell the truth or his obligation to obey his employer. The questions Mr X would ask himself to justify his choices and the applications of such choices are regarded as ethical decision-making.

Ethics is, thus, not only about the standards (rules and principles) of right and wrong behaviour but also the application of reasoning to shed light on such rules and principles as well as the application of these rules and principles in a time of a dilemma (Abdullah & Valentine, 2009:93; Banerji & Krishnan, 2000:405; Lewis, 1985:383). It must be pointed out that what is considered morally right for one group of individuals is not necessarily considered acceptable to another. For example, in Saudi Arabia it is a social norm that when travelling, a woman must be accompanied by either her husband or another close male family member such as a brother or father while in Europe or other Western states this is not the case. The King IV Report further states that ethics includes a company's responsibility to manage its resources efficiently, and to make decisions that invoke trust in the company when the company addresses its stakeholder relations as well as economic and environmental issues (IoDSA, 2016:24).

In short, ethics is about the moral standards that an individual considers in his/her ethical reasoning in order to differentiate between right and wrong and the application of these standards to situations that the individual confronts. In the company context ethical decision-making must be practised in all situations confronted and in dealings with all stakeholders (this is in line with stakeholder theory discussed in section 2.2.2).

2.3.2 Ethical theories

Common approaches or theories that may be used in ethical reasoning include utilitarian theory, deontological theory and virtue ethics theory.

Utilitarian theory – Bentham and Mill are considered the founders of utilitarianism (Weiss, 2006:120). There are two forms of utilitarianism, namely, act and rule utilitarianism (Jones et al., 2007:138). According to act utilitarianism, from an ethical point of view, the right course of action would be the one that when compared to all other actions, will produce the greatest balance of benefits over costs for everyone affected and not just for an individual or organisation (Velasquez, 2014:84). On the other hand, according to rule utilitarianism, however, human benefit will be promoted through actions that will result in the "greatest total beneficial consequences minus harmful consequences" (Jones et al., 2007:138).

Thus, utilitarianism focuses on the consequences of an action. This may be explained by way of the following example (Velasquez, 2014). In the late twentieth century, the Ford Motor Company (Ford) began to lose market share to the Japanese companies because the Japanese companies were making more fuel-efficient and compact cars as compared to Ford. Ford, in response to this, developed a small car known as the Pinto. The Pinto's design required the gas tank to be placed at the back of the rear axle and thus a rear-end collision could cause the tank to be punctured. When Ford tested the design, it was found that when the car was struck behind at 20 miles per hour or more, the gas tank would break open and possibly start a fire and even kill the passengers. Thus, Ford faced a decision – either go ahead with the design as was or change the fuel tank design. Applying a cost versus benefit analysis (utilitarian theory), the Ford managers concluded that the best course of action would not be to modify the fuel tank design and to leave things as they were as the cost of modification outweighed the benefits in monetary terms. The modification of the car would have cost buyers more money but the benefit of the modification would be far less than leaving the design as is, because, in either scenario, it would be the buyer who would be paying the cost involved. Ford managers further argued that the car met all safety and government regulations at the time and was comparable to other cars in the same category of vehicles. Thus, the Ford managers' decision took into account the greatest net beneficial consequences over time.

Utilitarian theory is not about saving money but rather about considering the interests of everyone as a whole (Velasquez, 2014:83). This theory has been criticised because of both measurement problems and the lack of agreement on what is considered 'good' for all concerned (Gustafson, 2013:335). However, the theory remains popular with policy makers, economists and businesses when, for example, resources are scarce or when no one choice will meet everyone's needs (Velasquez, 2014:95).

Deonotological theory – This theory, also known as duty-based theory, was developed by Kant. The term *deontological* is derived from the Greek word *deon* which means duty (Weiss, 2006:124). Deontology differs from utilitarianism in that deontology focuses on the principles of an action rather than its consequences (Jones et al., 2007:138). According to deontological theory, people have certain rights and duties regardless of the cost or benefits that such rights and duties provide. Moreover, people should not be used as a means of advancement and should be treated fairly – humanity should be considered above all else (Velasquez, 2014:106). Kant argued that the right thing must always be

done, irrespective of the costs and benefits of the alternative. Thus, deonotological theory forces decision makers to acknowledge their duty to treat everyone affected in a responsible and respectful manner (Jones et al., 2007:139). In the Ford scenario discussed above, the right thing to do would have been to modify the car irrespective of the net benefit as the human being or humanity must be considered above all else. In other words, the rule 'Do unto others as you would have them do unto you' applies (Jones et al., 2007:139).

Deontological theory is, however, considered impractical because it is difficult to consider everyone's rights and duties for every decision to be taken. In addition, it is difficult to prioritise rights and duties when facing an ethical dilemma (Weiss, 2006:125).

Virtue ethics – The Greek philosopher, Aristotle, proposed the theory of virtue. This theory argues that an action of an individual is considered morally correct if the person carries out the action in a morally correct or virtuous manner while the action is immoral if the person carries out such action in an immoral or bad manner (Velasquez, 2014:135). Therefore, the ethics of the action is dependent upon the virtues or vices of the person exhibiting such virtues or vices (Velasquez, 2014:135). Virtue ethics theory focuses on moral excellence, goodness, chastity and good character (Abdullah & Valentine, 2009:93). Aristotle believed that ethical behaviour is a habit that may be taught because it may be instilled through education (Abdullah & Valentine, 2009:93).

Virtue ethics consists of two elements, namely, affective and intellectual. Affective in this theory means doing the right thing in order to feel good whereas the latter suggests doing the right thing for the right reasons (Abdullah & Valentine, 2009:94). The rightfulness of an action may, therefore, be determined by examining the type of person the action produces. For example, if an action causes the person to act honestly and in a principled and/or cooperative way then the action is morally good. On the other hand, if the action makes a person dishonest, careless or selfish then the action is morally wrong (Weiss, 2006:131).

The focus of the ethical theories discussed above differs when assessing an action as either morally right or immoral while there are arguments for and against each theory. However, the theories all touch on one essential point, namely, that the interests of others should be considered above self-interest. In particular, each theory provides an important

ethical perspective when doing the right thing – utilitarianism considers the consequences of an action on those affected, deontology indicates that an individual's rights and humanity should be respected at all times while, according to virtue ethics, actions taken as a result of a decision should demonstrate good moral character (for example, honesty or accountability). It is equally important to note that the ethical theories discussed support stakeholder theory (refer to section 2.2.2) in that these ethical theories require that an individual or company considers the interests of all affected and not only the interests of the shareholders.

2.3.3 Business ethics

Thus far, in the chapter the focus has been on ethics in general in order to provide an indication of what ethics is about. However, this study was concerned with ethics in business. Ethical conduct in business is important because it should result in millions of rand in lawsuits, settlements, and thefts being saved (Weiss, 2006:11). In addition, a company's reputation and brand may also be damaged because unethical conduct may result in a loss of trust in the company. As aptly described by Mahatma Gandhi (1925 cited in Covey SR, 1990) "There are 7 things that will destroy us" of which one is "business without ethics".

Business ethics is the study of moral standards (what is morally right or wrong) insofar as the principles apply to the business activities of an organisation (Velasquez, 2014:15; Abdullah & Valentine, 2009:93). Business ethics operate at various levels, for example, the systemic, corporate and individual levels (Velasquez, 2014:15; Weiss, 2006:14).

Systemic level – Ethics on the systemic level refers to the national and international economic, political and legal frameworks within which a business operates (Velasquez, 2014:15; Weiss, 2006:14). On an international level, business ethics refers to multilateral and/or international trade agreements (Archie, 1978:7). The companies of today are often multinational and, as such, operate in countries in which the laws, government and culture are different to that of the company's home country (Donaldson, 1996:48). The managers of these companies are often faced with ethical dilemmas, for example, bribery is considered illegal in South Africa and, if caught, a company will be fined. However, in another country, such as Indonesia, bribery may be an acceptable practice in order to get the work done (Donaldson, 1996:48).

In an effort to assist multinational companies to manage their ethical conduct; international organisations have been instrumental in developing corporate governance guidelines and policies on issues such as consumer protection, pollution and labour rights. These organisations include the OECD, the United Nations and the World Economic Forum (WEF) (Windsor, 2009:309).

Corporate level – Ethics on the corporate level refers to ethical questions about the ethical culture of an organisation as well as its policies and practices (Velasquez, 2014:15; Weiss, 2006:14). Culture may be seen as the way of life within a company (Ojo, 2010:2; Somers, 2001:194) and represents a company's beliefs and values (Schwartz, 2013:40). The key elements required to build an ethical culture within a company include a set of core ethical values, a formal ethics programme and ongoing ethical leadership (Schwartz, 2013:41). Although each element is distinct, each separate element is required to support the other elements.

Ethics at this level also refers to the ethical impact that a company has on its stakeholders (i.e. society, the natural environment, customers and suppliers) (Weiss, 2006:14). This impact may be either positive or negative and includes a company's responsibility towards its stakeholders.

Individual level – Ethics on the individual level concerns those issues that raise questions about the ethics of a particular individual within an organisation, for example, a director (Velasquez, 2014:15; Weiss, 2006:14). It is important to note that the ethical intentions of all employees are significant. However, this study was concerned with the ethical intention of the leaders (the governing body and management) in an organisation and consequently, the discussion that follows will consider the qualities and traits of leaders.

Ethical leadership is important in a business because if a leader behaves in an ethical manner, there is a high probability that the staff will also behave ethically (Minkes, Small & Chatterjee, 1999:329) while, on the other hand, if a leader is observed to be immoral and inconsiderate, the chances are that the employees will behave in a similar way (Bello, 2012:229). The familiar phrase 'when in Rome do as the Romans do' provides an apt description of human behaviour and highlights that the behaviour of a company's staff will imitate the behaviour of its leaders (Staicu et al., 2013:86).

There are two dominant leadership styles in business, namely, the transactional and the transformational leadership styles (Groves & La Rocca, 2011:512; Kunungo, 2001:257). Transactional leaders control behaviour by rewarding agreed-upon behaviour and eliminate performance problems by correcting unsuitable behaviour (Banerji & Krishnan, 2000:411). Thus, the transactional leader will reward the follower if the agreed-upon task is completed. Transactional leadership is based on bureaucratic authority and relies on a system of reward and punishment (Stone, Russel & Patterson, 2004:350). When a transactional leadership style is used, an employee will not carry out a task out of loyalty towards the company but only in order to receive payment (Bello, 2012:229). The decision a transactional leader makes depends on the outcome of the decision (i.e. the consequence of the decision for the majority). Thus, the transactional leader's moral justification is associated with utilitarianism (Kunungo, 2001:263).

Transformational leaders, on the other hand, do not consider only the consequences of the decision for the majority but are also concerned with the action that is best for all concerned (deontology ethics) (Kunungo, 2001:257). Furthermore, transformational leadership differs from transactional leadership in that it promotes progress and development (Stone et al., 2004:351). A transformational leader leads by inspiring employees to look beyond self-interest for the good of an organisation (Banerji & Krishnan, 2000:411). Transformational leaders are often described as charismatic, thus implying that the leader is enthusiastic, commands respect and increases motivation (Banerji & Krishnan, 2000:411). It is thus clear that the leadership style of the governing body and management affects the behaviour of the employees.

The above discussion highlights that business ethics are important at all three levels within an organisation and not just at the individual level. Nevertheless, members of the governing body and management influence each of the other levels within an organisation and thus the tone set by them is important in order to ensure ethical decision-making within an organisation. 'Tone at the top' is discussed next.

2.4 'TONE AT THE TOP'

'Tone at the top' is not a new concept and, in fact, its importance was recognised as far back as 1987 by the Treadway Commission which recognised the 'tone at the top' of a company as the most important factor that would ensure trustworthy financial reporting

(COSO, 1987:32). However, 'tone at the top' is not limited to ensuring reliable financial reporting only. 'Tone at the top' also contributes both to the long-term success of a company and to building a culture of trust and honesty (NBA, 2012:18) not only among employees but also with other stakeholders (Deloitte, 2014:3). This point is illustrated in the study conducted by Staicu et al. (2013:76) who established that a poor 'tone at the top' was one of the reasons why companies failed while D'Aquila and Bean (2003:45) confirmed that 'tone at the top' influences both financial reporting decisions and the behaviour of the employees. Moreover, a positive 'tone at the top' reflects the directors' commitment and support in respect of maintaining an efficient internal control system and promoting procedures and practices that are ethical, economical and efficient (Soltani, 2014:255).

However, despite the obvious importance of 'tone at the top', there is no consensus on what the concept actually entails. Nevertheless, it may be said that 'tone at the top' describes the ethical climate or atmosphere that is established within a company by management (Lail et al., 2015:26; IFAC, 2007:8) and represents the prioritisation, by the governing body and management, of the company's values above other values (NBA, 2012:5). Ethical leadership is also relevant to the tone of the company because the only way in which to understand why an organisation performs in a certain way or does things (operate) in a certain manner is to understand the actions and behaviour of the organisation's governing body and management (Soltani, 2014:255). The governing body's responsibilities stem from its legal obligation to provide oversight over the company's performance in all respects (Schwartz et al., 2005:85). Moreover, the tone set by the governing body and management has a trickle-down effect on employees (Payne & Raiborn, 2018:479). Hence, it is imperative that the governing body and management demonstrate that they are living the company's values through their actions and decisions (NBA, 2012:18).

The King IV Report supports ethical culture (i.e. ethical behaviour, governance of ethics and corporate citizenship) as a key governance outcome for a company (IoDSA, 2016:20). According to the King IV Report, an ethical culture may be established if the governing body sets the tone of the company by providing ethical and effective leadership (IoDSA, 2016:principle 1), ensuring that the company's ethics are managed effectively (IoDSA, 2016:principle 1) and ensuring that the company behaves as a responsible corporate citizen (IoDSA, 2016:principle 3). Corporate citizenship in the company context

means that the company takes into account its obligations and responsibilities to society (broad range of stakeholders) (IoDSA, 2016:10).

It is clear from the discussion above that a company's 'tone at the top' entails the governing body and management implementing and promoting an ethical culture within the organisation, conducting themselves ethically (ethical leadership), maintaining healthy relationships with all stakeholders and fulfilling their responsibilities in terms of legislation and other applicable governance standards. These aspects are discussed below.

2.4.1 Implementing and promoting an ethical culture

The key elements required to build an ethical culture within a company were highlighted in the discussion of business ethics in section 2.3.3. These elements include a set of core ethical values, a formal ethics programme and ongoing ethical leadership (Schwartz, 2013:41).

A set of core ethical values – A set of core ethical values, which are included in a code of ethics, is generally accepted as the root of any company's ethical policy (IoDSA, 2016:5; Webley & Werner, 2008:406). A code of ethics is also referred to as a code of conduct, value statement or code of practice (Kaptein & Schwartz, 2008:111). Many companies are either obliged by legislation to have in place a code of ethics or are pressured by stakeholders to do this (Kaptein, 2011:233). The reason for this is that a code of ethics implies that a company takes the issue of ethics seriously and considers ethical behaviour as a precondition for doing business (Webley & Werner, 2008:404).

A code of ethics encompasses those values which have been identified by an organisation as universal and significant to the organisation as an entity (Schwartz, 2013:41) and include guidance on matters such as the treatment of stakeholders, the goals of the company, and the expectations of internal and external stakeholders (IoDSA, 2016:44). These values must be infused through the organisation's policies, practices and processes and must be clearly articulated in the code of ethics (IoDSA, 2016:principle 2, practice 5). According to Schwartz (2004:324), a code of ethics is an official written document that articulates the moral standards (right and wrong behaviour) that are used to guide employee behaviour at all levels. In other words, the code of ethics outlines the

values that the company has adopted in respect of what is considered to constitute acceptable behaviour and what is not regarded as acceptable behaviour. In addition, the ethical values, as set out in the code of ethics, are developed with both the present and future in mind and pertain to the multiple issues facing managers and employees in their interactions with each other, the company's stakeholders and/or society in general (Kaptein, 2011:234). In addition, the code of ethics must also address the company's ethical risk profile (IoDSA, 2016:principle 2, practice 6(b)).

It is essential that the employees must be consulted when a code of ethics is drawn up for it is only then that employees will take the code of ethics seriously and consider it relevant (Webley & Werner, 2008:407). Employees must perceive the code of ethics as a personal document and take ownership of it while the code of ethics must be central to the company's strategic decisions (Stevens, 2008:607).

However, the establishment of a code of ethics alone does not necessarily promote a culture of ethical behaviour. Although Enron[1] had an ethical code it also had a culture where rules were broken and unethical behaviour rewarded with WorldCom's code of ethics being adopted only after the demise of Enron (Barry, 2002:38). It is clearly vital that a formal ethics programme is put in place to support the code of ethics (Sauser Jr, 2013:17).

Formal ethics programme – A formal ethics programme entails enforcing the code of ethics consistently and impartially, communicating the code of ethics to employees, training employees on the code of ethics, providing anonymous telephone lines to report non-adherence to the code of ethics and recruiting and promoting ethical employees (IoDSA, 2016:principle 2, practice 7-10; Sauser Jr, 2013:17; Schwartz, 2004:340).

- *Enforcing the code of ethics* – The code of ethics must be embedded in the company's philosophy i.e. leaders must refer to the code of ethics for guidance in difficult circumstances and apply it accordingly (Stevens, 2009:14). In addition,

[1] Enron and Worldcom are two companies that had collapsed due to fraudulent management conduct. Enron's top management misrepresented the company's financial condition and designed and implemented controls inadequately, while WorldCom's top management manipulated results to meet market and security expectations (Schwartz, Dunfee & Kline, 2005:80)

management should reward employees who conduct themselves in an ethical way and discipline employees who exhibit unethical behaviour (Archie, 1978:9).

- *Communicating the code of ethics* – If a code of ethics is to be effective, it is important that the code of ethics is communicated to the staff of a company and reinforced by supporting organisational values (Somers, 2001:194). The governing body of an organisation should, therefore, ensure that there are mechanisms in place so that all employees and relevant associates are informed of the code of ethics by incorporating it into all contracts entered into (IoDSA, 2016:principle 2, practice 7(b)). It is imperative that employees are aware that there is a code of ethics and know why it exists (Stevens, 2009:15). A code of ethics is usually communicated during a company's orientation of new employees and via the company's website (Stevens, 2009:15). However, the quality of the communication in respect of the content of the code of ethics is vital for its success (Kaptein, 2011:247). It often happens that the code of ethics is not actually read until a crisis occurs (Stevens, 2009:15). A study conducted by Somers (2001:192) found that 42% of the respondents were unsure as to whether the company they worked for even had a code of ethics or not. Employees may also be overwhelmed by the messages to which they need to respond and, thus, they often do not have sufficient time in which to reflect on the code of ethics, thereby resulting in the code of ethics becoming just another compliance document (Stevens, 2008:605). Kaptein (2011:247) confirmed that the poorer the quality of communication in relation to the code of ethics, the higher the likelihood of unethical behaviour.

- *Training on the code of ethics* – Promoting the code of ethics and ethical behaviour tends to result in there being less wrongdoing and higher levels of employee commitment to the company's ethical values than may otherwise have been the case (Somers, 2001:194). Consequently, training employees on the code of ethics is regarded as the most important component of an effective code of ethics. Training sessions should be presented across all levels of the organisation (Ruiz, Martinez, Rodrigo & Diaz, 2015:737) with employees being trained on the ethical issues that relate to their jobs. Face-to-face training is recommended so that employees have an opportunity to ask questions and clarify any misunderstandings. In addition, such training must also be ongoing (Webley & Werner, 2008:411). Researchers Warren, Gaspar and Laufer (2014:109) found

that training on the code of ethics impacts on the ethical decisions made members of an organisation.

- *Providing anonymous telephone lines* – Employees should have a channel through which they may speak up and raise ethical concerns. This is often done by means of a telephone line that employees may use to raise an ethical question or report a wrongdoing (Webley & Werner, 2008:410). In addition, employees should be able to do so without fear or prejudice. In other words, employees should be allowed to report any wrongdoing anonymously (IoDSA, 2016:principle 2, practice 9(c)).

- *Recruiting and promoting ethical employees* – It is essential that ethical behaviour is rewarded and unethical behaviour punished. Companies should investigate people whom they intend to hire and try to recruit people who demonstrate a high moral standing (Sauser Jr, 2005:353). Furthermore, ethical behaviour should be a requirement for promotion (IoDSA, 2016:principle 2, practice 9(a)).

The 2016 Ethics Survey conducted by The Ethics Institute in South Africa confirmed that companies are increasingly incorporating a code of ethics and a formal ethics programme into their company culture. As a result, there has been a decrease in the number of misconduct incidents with employees seemingly under less pressure to report unethical behaviour than was previously the case (The Ethics Institute, 2016:9).

Continuous presence of ethical leadership – Ethics begins with leadership (governing body and management) because neither a formal code of ethics nor ethics training will have an effect unless the actions and behaviour of the company's leaders are in line with the code of ethics and the training provided (Bello, 2012:229). The leaders of a company are expected to create the ethical culture in the company by leading in such a manner that all members of the company "know what's right, value what's right and do what's right" (Sauser Jr, 2013:16).

The governing body and management promote the ethical culture of the company when they practise what they preach. Living by example may be achieved when management's messages, statements, actions and explanations are consistent with the company's

ethical culture (Staicu et al., 2013:76; IFAC, 2007:8). The ethical leadership of the governing body and management is discussed next.

2.4.2 Ethical leadership

Ethical leadership is regarded as the most critical factor in ensuring ethical behaviour in a company (Van Vuuren, 2016:22). It is imperative that a company's leaders (governing body and management) promote the company's values from top to bottom and ensure that every member of the company is a custodian of the company's values (Sauser JR, 2013:17).

Brown et al. (2005:120) introduced the concept of ethical leadership and their definition of ethical leadership is widely accepted (Frisch & Huppenbauer, 2014:37; Eisenbeiß & Brodbeck, 2013:344). Brown et al. (2005:120) define ethical leadership as "the demonstration of normatively appropriate conduct through personal actions and interpersonal relationships, and the promotion of such conduct to followers through two-way communication, reinforcement and, decision-making". Brown et al. (2005:120) further describe an ethical leader as a person who demonstrates attributes such as honesty, trustworthiness, fairness and care (i.e. the ethical leader is a moral person). An ethical leader not only provides the employees with a voice but is also just (Eisenbeiß & Brodbeck's, 2013:353) and promotes ethical behaviour through communicating ethical behaviour, rewarding ethical conduct, disciplining unethical behaviour and holding people accountable (i.e. an ethical leader is also a moral manager) (Brown, 2007:141). In addition, an ethical leader considers the consequences of his/her actions and makes choices that may be emulated by others.

However, Frisch and Huppenbauer (2014:25) criticised Brown et al.'s (2005:120) definition of ethical leadership and argued that the definition of ethical leadership should be broadened to include all stakeholders and not just ethical behaviour towards employees. Thus, the ethical leader would link the goals of the organisation with the goals of the employees as well as those of the external stakeholders (customers, suppliers and the environment) (Bello, 2012:230). Ethical leaders should behave ethically towards both their customers by ensuring that customers receive quality products and their suppliers by paying them within the agreed-upon timeframe (Frisch & Huppenbauer, 2014:37). Furthermore, they should show concern for the environment and their use of resources

(Eisenbeiß & Brodbeck, 2013:353-354). An example of the governing body and/or management taking a decision harmful to the environment is provided by the Volkswagen scandal where certain of the manufacturer's cars emitted more pollutants than the regulations allowed and the board of directors of the company hiding this fact (Hotten, 2015).

It is clear from the discussion above that ethical members of the governing body and management would lead by example, i.e. they would define the behaviour expected of them and live up to the expectations set. They would also not only behave ethically in their relationships with employees but also in their dealings with other stakeholders of the organisation. The following ethical character traits are considered important in ethical leadership, namely, trust, honesty, fairness or justice and responsibility. Trust forms the foundation of all relationships and creates the expectation the other individual(s) would not act opportunistically (Bello, 2012:232). If followers trust their leader, they believe that the leader has the group's interest at heart and are likely to work towards the goals of the organisation (Grojean, Resick, Dickson & Smith, 2004:235). Honesty refers to telling the truth at all times (Brown et al., 2005:118) while fairness or justice means that leaders are able to deliver justice and fair treatment because of their unique position in the company (Brown et al., 2005:119). Justice involves making a decision by evaluating the evidence provided and the actions of followers (Brown et al., 2005:119) and then making a decision accordingly while responsibility implies that the leader is liable to be called to account for his/her decisions and actions (West, 2006:436).

The King IV Report also provides an indication of the characteristics expected of the members of the governing body of an organisation. These characteristics complement the ethical traits discussed above and are additional to those already discussed. According to the King IV Report, the members of the governing body should demonstrate that they have integrity and that they are competent, responsible, accountable, fair and transparent (IoDSA, 2016:principle 1). The members of the governing body are deemed to have integrity when they make decisions that are best suited for the company and that do not give rise to a conflict of interest (IoDSA, 2016:principle1, practice 1(a)). In addition, they will act ethically beyond mere legal compliance, they will act in good faith and in the best interests of a company and they will set the tone for an ethical culture in the company (IoDSA, 2016:principle1, practice 1(a)). Members are deemed to be competent when they continually develop themselves and accord all decisions made the attention, the diligence

and time they deserve (IoDSA, 2016:principle1, practice 1(b)). Furthermore, the members of the governing body should be informed about the industry, laws, codes and standards applicable to the company in question (IoDSA, 2016:principle1, practice 1(b)). Responsibility entails the members assuming both responsibility and accountability for the actions of the company and taking corrective actions to ensure the company remains on its strategic path (IoDSA, 2016:principle 1, practice 1(c(i))). In addition, responsibility also includes courage while being courageous means taking risks and utilising opportunities in a responsible manner and in the best interests of the company (IoDSA, 2016:principle 1, practice 1(c(ii))). Moreover, a responsible member of the governing body would anticipate and prevent negative outcomes for the company and ensure both that all meetings are attended and that sufficient time and effort is devoted to preparing for meetings (IoDSA, 2016:principle 1, practice 1(c(iii)(iv)). Accountability requires a member to be able to justify his/her decisions and actions (IoDSA, 2016:principle 1, practice 1(d)) while fairness implies that a member should adopt a stakeholder-inclusive approach to governance in the execution of his/her governance role and responsibilities and direct the company in a manner that does not impact adversely on the environment, society or future generations (IoDSA, 2016:principle 1, practice 1 (e)). Finally, transparency means that the members of the governing body should be transparent in the manner in which they exercise their governance role and responsibilities (IoDSA, 2016:principle 1, practice 1 (f)).

From the discussion above, it is evident that a high degree of trust is placed in the hands of the governing body and management and thus the members of the governing body and management should govern the company responsibly. This is supported by the Companies Act which requires directors to make decisions ethically while stating that any breach of duties by a director will result in him/her being liable for the losses suffered by the company as a result of such breach of duties (RSA, 2008:s77(3)).

2.4.3 Maintaining healthy relations with stakeholders

It is incumbent on a leader to promote behaviour that is acceptable within the environment in which he/she finds himself/herself (Eisenbeiß & Brodbeck, 2013:343). Companies today operate in environments that are virtual and globalised, thus requiring a leader to display conduct that is acceptable to people from diverse cultures and backgrounds. This statement is in line with the definition of ethics that indicates that an ethical individual

would apply moral reasoning to the situation which he/she is confronting (refer section 2.3.1).

In addition, according to stakeholder theory of corporate governance (refer section 2.2.2), a company should consider the relationship it has with its stakeholders in both the broad and narrow sense of the definition of a stakeholder. Thus, it is important that management identifies whom the company's stakeholders are and how relationships with these stakeholders will be managed. If stakeholder claims in the company are not balanced, the survival of the company may be jeopardised (Freeman & Evan, 2010:141). According to Freeman in 1984, management must conduct a stakeholder analysis to identify and understand its relationship with the stakeholders (Weiss, 2006:55). This analysis must include a series of questions designed to ascertain whom the company's stakeholders (current and potential) are; the effect of the relationship between management and such stakeholders on the company and how are such relationships managed (Weiss, 2006:55). Ethical decision-making must be part of such an analysis to ensure that stakeholder decisions are equitable, just and fair (Weiss, 2006:65).

Linked to stakeholder relations is the identification and accounting of transactions with related parties. A related party is a party that controls or has significant influence over the company, or a company that the client controls or over which the client has significant influence (IAASB, 2009j:ISA 550.10(b)). This study was concerned with related party transactions that influence the 'tone at the top' of a company. 'Tone at the top' related party transactions may be described as those transactions, such as loans, guarantees or consulting arrangements, with a director or officer as a counterparty to such a transaction as the director or officer concerned are then in a position to benefit from the transaction (Kohlberg & Mayhew, 2017:902).

2.4.4 Compliance with laws and regulations

In South Africa, the Companies Act promotes the ethical conduct of directors (RSA, 2008). The Companies Act is supported by common law and thus it should be read together with common law which consists of a combination of common principles and judicial precedents (PwC, 2014:9). Some of the duties of a director were initially imposed by common law (Esser & Du Plessis, 2007:346). However, due to these duties' inclusion

in legislation, the duties are now compulsory for a director. The fiduciary duties of a director are outlined in sections 76(2) and 76(3) of the Companies Act (RSA, 2008).

Section 76(2) of the Companies Act requires that a director of a company must not use his/her position to gain undue personal advantage, nor use his/her position for the advantage of any other person other than the company and its related subsidiaries nor should the director knowingly cause harm to the company (RSA, 2008). In other words, this section implies that a director must not place himself/herself in a position that may result in a conflict of interest between such director and the company.

Section 76(3) of the Companies Act cautions the director to act in good faith, perform his/her functions with the company's best interests at heart and conduct himself/herself with the degree of care, skill and diligence reasonably expected of a person in his/her position (RSA, 2008). A director is thus expected to be qualified and sufficiently experienced to perform his/her duties. The King IV Report confirms that members of the governing body should act in good faith and in the best interest of the company (IoDSA, 2016:principle 1, practice 1(a)).

In terms of section 86(1) of the Companies Act (RSA, 2008), the board of every listed company is required to appoint a company secretary. The company secretary is responsible for ensuring that the members of the board, individually and collectively, are aware of their duties, powers and responsibilities and of every law relevant to or affecting the company (RSA, 2008:s88(2)(a)(b)). The company secretary would also certify in the annual financial statements that the company has filed all necessary returns and notices and must report any director who has failed to comply with the memorandum of incorporation, rules of the company or the Companies Act (RSA, 2008 s88(2)(c)(e)). In terms of section 88(1) of the Companies Act (RSA, 2008), the company secretary is accountable to the board and, consequently, the board is accountable for ensuring compliance with laws and regulations relevant to and relating to the company.

The board is also responsible for the establishment of a social and ethics committee. Section 72(4) of the Companies Act (RSA, 2008) requires companies[2] to establish a social and ethics committee. Such a committee should consist of at least one director of the company and thus the actions of the committee are the responsibility of the board. The social and ethics committee's duties include, among others, monitoring the company's activities in respect of the company's ethics, social and economic development, good corporate citizenship, stakeholder relations and employment matters (IoDSA, 2016:principle 8, practice 68). The company's ethical performance should also be assessed, monitored, reported and disclosed by the company's governing body (IoDSA, 2016:principle 2, practice 10).

2.5 CONCLUSION

The introduction to the chapter highlighted that the phrase setting the right 'tone at the top' is being used increasingly and that such tone is considered a necessity for the leadership (members of the governing body and management). The 'tone at the top' of the company must also be assessed during the audit of the financial statements of the company. A company's corporate governance and ethics (specifically business ethics) were discussed first as 'tone at the top' entails ethical leadership and ethical climate – both constructs of corporate governance. The ethical leadership of a company's governing body and management falls within the ambit of the Companies Act and the King IV Report.

The corporate governance practices applicable to a company depend on the theory applied by the company, namely, agency theory, shareholder theory, enlightened shareholder theory or stakeholder theory. The South African approach to corporate governance is best explained by stakeholder theory. In addition, South Africa's corporate governance structure is closely linked to the Anglo-American structure to corporate governance, although with a few exceptions. The Companies Act, the King IV Report and the JSE listing requirements determine the role and responsibilities of the governing body

[2] Section 72(4), read together with Companies regulation 43, prescribes that every listed company, state-owned company and a company with a public interest score over 500 points in any of the preceding five years should establish a social and ethics committee.

and management of a company as the custodians of good corporate governance in South African companies.

Ethics form the foundation of good corporate governance practices. Ethics is about the moral standards that an individual considers in his/her ethical reasoning to differentiate between right and wrong and the application of these standards to situations which the individual encounters. Members of the governing body and management influence each of the decision making levels within an organisation and, thus, the tone set by them is important for ensuring ethical decision-making within an organisation. A company's 'tone at the top' entails the governing body and management's implementation and promotion of an ethical culture as well as their conducting themselves ethically (ethical leadership), maintaining healthy relationships with all stakeholders and fulfilling their responsibilities as stipulated in legislation and other applicable governance standards.

An ethical culture is created by the governing body and management through the implementation and maintenance of a core set of ethical values, a formal ethics programme and ongoing ethical leadership. The code of ethics outlines the ethical values of the company and must be constantly reinforced by management. This is achieved when management rewards behaviour, takes disciplinary action against unethical behaviour, constantly communicates the code of ethics to staff, trains staff on the code of ethics, provides anonymous telephone lines to enable employees to report unethical conduct and hires and promotes ethical employees.

Ethical leadership is the most significant component of both a healthy ethical culture and good corporate governance. Therefore, the ethical character of the members of the governing body and management are vital for a company's 'tone at the top'. It, thus, follows that the members of the governing body and management must demonstrate the ethical traits of trust, honesty, fairness, justice and responsibility. Furthermore, they must also demonstrate that they have integrity and that they are competent, accountable and transparent. It is incumbent on the governing body and management to live in an ethical way to gain the trust and respect of the stakeholders and not just the employees as their decisions influence the decisions and attitudes of both their employees and the other stakeholders. Not only must the governing body and management of the company demonstrate integrity in respect of the financial management of the entity but also in respect of the environment and society within which the company operates. The King IV

Report further states that a company's governing body must manage a company both ethically and effectively to create a positive 'tone at the top'.

In line with the stakeholder approach to corporate governance, the governing body and management must maintain a healthy relationship with all stakeholders, both internal and external. Management must identify the company's stakeholders and manage the company's relationship with them to ensure the company's survival. In addition, management must identify and account for all related party transactions.

The role and responsibilities of the governing body and management are governed by legislation, common law, the King IV Report and JSE listing requirements and thus the governing body and management of an organisation must ensure that they comply with all of these. Non-compliance with such laws and regulations would amount to a breach of the fiduciary duties of the members of the governing body and management and for which they may then be held personally liable. In addition, it is the duty of the members of the governing body and management to remain autonomous and to make decisions which are in the best interest of the company by acting in good faith and with the degree of care and skill expected of individuals in their position.

Chapter 3 is an extension of the literature review presented in chapter 2. Chapter 3 will focus on the auditors' responsibility for assessing a company's 'tone at the top' in terms of legislation, professional guidance, academic literature and the ISAs.

CHAPTER 3

AUDITORS’ RESPONSIBILITY FOR ASSESSING A COMPANY’S ‘TONE AT THE TOP’

3.1 INTRODUCTION

Chapter 2 discussed the concept of a company’s ‘tone at the top’ and outlined that setting the right ‘tone at the top’ for a company is the responsibility of the governing body and management as they are the custodians of the corporate governance of a company. In addition, it is the auditors’ responsibility with regards to a company’s ‘tone at the top’ to assess the ‘tone at the top’ during the audit of a company’s financial statements (IAASB, 2013a:ISA 315R.14; IAASB, 2009k:ISQC1.26(c), .27).

This responsibility of auditors has been the focus of much attention from stakeholders due to company failures such as Masterbond, Regal Treasury, LeisureNet and Steinhoff International (South Africa), Enron (the United States of America) and Tesco (the United Kingdom). With respect to these company failures, the auditing profession has been criticised as to whether they are adding any credibility to the financial statements produced by a company (De Jager, 2002:54). In the case of Enron, the auditors, Arthur Andersen, had failed to report on Enron’s directors’ fraudulent activities as the auditor in charge was afraid of losing Enron as a client (Noviyanti & Winata, 2015:56). Similarly, the investors of Tesco questioned why the auditor had not identified the manipulation of the accounting estimates submitted by Tesco’s management (Picking up the pieces after Tesco’s affair, 2014) while Steinhoff International’s auditors are being questioned on the reasons why they did not identify the accounting irregularities committed by the company’s directors (Nicolaides, 2017) which caused such significant financial losses for the companies. Moreover, the 2016 IRBA inspection outcomes also indicated that auditors were failing to document that the client’s integrity, as required by the ISAs, was considered during the audit of financial statements (IRBA, 2016:29).

The company failures discussed above, together with IRBAs findings, have not only resulted in company stakeholders losing trust and confidence in the auditing profession but have also demonstrated that it would appear that auditors may have difficulty both in

detecting fraud involving the governing body and management and assessing a company's 'tone at the top'. Fraud is defined is an "intentional act by one or more individuals among management, those charged with governance, employees or third parties, involving the use of deception to obtain an unjust or illegal advantage" (IAASB, 2009:ISA 240.11(a)). Thus, this chapter focuses on the auditors' responsibility in assessing a company's 'tone at the top' which is discussed in terms of legislation, professional regulations, academic literature and the ISAs. In order to provide context to the assessment of a company's 'tone at the top' the chapter first discusses the nature of auditing and the audit process and, thereafter, the procedures that an auditor must perform to assess a company's 'tone at the top'.

3.2 THE NATURE OF AUDITING

This section describes the development of the auditing profession in general as well as the auditing profession in South Africa. The section also discusses the concept of an audit engagement.

3.2.1 Development of the auditing profession

The role of the auditor has evolved due to changes in the environment in which auditors function. The history of the auditing profession is for the period prior to 1844 up to the present day.

Prior to 1844 – Approximately two thousand years ago the Egyptians, Greeks and Romans required that officials who were entrusted with public funds had to make an oral presentation on how they had disbursed the public funds (Porter, Simon & Hatherly, 2003:3). This oral form of accountability was termed *auditus*, which means 'a hearing' and is of Latin origin (Porter et al., 2003:3). The English government also adopted this form of accountability (Porter et al., 2003:18) with government officials being sent to inspect the accounts of various estates and manors to ensure that the funds collected and disbursed on behalf of the government were being accounted for (Porter et al., 2003:18).

1844–1920s – Large industrial and commercial companies replaced small businesses during the period 1844 to the 1920s (Porter et al., 2003:20). Various individuals

(shareholders) invested capital for the start-up of these companies with a manager being appointed to run the company (Porter et al., 2003:20). The shareholders required assurance that their funds were being managed appropriately by the appointed managers and so a third party (auditor) was appointed by the shareholders to examine the accuracy of the accounting records (Porter et al., 2003:21). Thus, the role of the auditor in the financial reporting process stemmed from the conflict of interest between the shareholders (principals) and the managers (agents), as explained by agency theory. Agency theory highlights that as a company grows bigger, the owners (principals) of the company have to hire managers (agents) to manage the company on their behalf. Both the principal and the agent seek to maximise their own interest in the company and, since their interests may be in conflict, the agent may not act in the interest of the principal but rather in his/her own interest. Consequently, the principals appoint an independent party (namely, the auditor) to provide an independent opinion on whether the information provided by the agents is a true and fair reflection of the company's financial state. Refer to chapter two (section 2.2.2) for a detailed discussion of agency theory.

The auditor's role during this period involves the detailed checking of transactions and accounts in the preparation of the financial statements (Brown, 1962:698) although little attention was given to the internal controls of the company (Lee & Ali, 2008). Thus, the audit objectives of the auditor included the detection of fraud and determining the solvency of the company (Lee & Ali, 2008).

1920s–1960s – During this period there was a significant increase in the volume of transactions of a company and, thus, detailed checking of such transactions proved expensive. Consequently, sampling was introduced in order to reduce costs and to improve the efficiency of the audit process (Brown, 1962:698). The concept of materiality was also introduced into the auditing principles (Lee & Ali, 2008). Information is considered to be material if the information's omission from or misstatement in the financial statements will affect the decision making of users of such financial statements (IAASB, 2009:ISA 320.2). Materiality levels are a matter of the auditor's professional judgement (IAASB, 2009:ISA 320.4).

As a result of the development of sampling and materiality, it became necessary for the auditor to rely on the internal controls of a company as the internal controls provide the basis for the preparation of a company's financial statements (Lee & Ali, 2008; Brown,

1962:701). In addition, increased importance was attached to the physical verification of assets such as cash and inventories (Porter et al., 2003:27). The audit objective during this period emphasised that the auditor's responsibility was to express an opinion on the fairness of the financial statements with less emphasis on fraud detection (Brown, 1962:701). The viewpoint was that the audit process was not designed to detect fraud within a company and the auditor was not a detective (Brown, 1962:700-701). Thus, misconceptions on the auditor's role began to arise.

1960s–1990s – The misconceptions in respect of what the auditor does and what the public at large expects or perceives the auditor's role to be continued. These misconceptions were referred to as the audit expectation gap (Chye & Woo, 1998:147). Liggio first described the audit expectation gap in 1974 as "the difference between the levels of performance" as perceived by the auditor and the financial statement users (Chye & Woo, 1998:147-148). The audit expectation gap arose mainly due to company failures in the 1970s. Subsequent to these company failures, the Cohen Commission (1978) was set up by the American Institute of Certified Public Accountants and tasked with responding to the criticism faced by the auditing profession (AICPA, 1978:xi). According to the Cohen Commission Report (AICPA, 1978:2), the audit expectation gap existed because the users of financial statements mistakenly believed that the auditor was responsible for the detection of fraud and illegal behaviour on the part of management. Users also interpreted an unmodified audit opinion to mean that the company was financially sound (AICPA, 1978:2). Consequently, the Cohen Commission extended the definition of the audit expectation gap proposed by Liggio (1974) and stated that the audit expectation gap referred to the difference between what is expected of the auditor and what society perceives that it is actually receiving from the auditor (Salehi, Mansoury & Azary, 2009:167). The audit expectation gap still exists today and is regarded as one of the reasons for the loss of trust and confidence in the auditing profession despite ongoing efforts by the auditing profession to better monitor auditors' performance and widespread discussion on corporate governance and financial affairs in general (Gray, Manson & Crawford, 2015:769).

During the 1980s, although the importance of internal controls was still being recognised, auditors were using analytical procedures and the risk-based approach to auditing because of the high cost of testing such internal controls (Lee & Ali, 2008). According to the risk-based approach to auditing, the auditor must be aware of the business risks that

affect a company as these risks will, ultimately, impact on the financial statements of the company (Eilifsen, Messier, Glover & Prawitt, 2010:13). Furthermore, with this approach, audit evidence is collected and examined from a variety of sources, both internal and external to the company, thus rendering the audit process more credible and reliable than may otherwise have been the case (Lee & Ali, 2008).

1990s–present – During this period companies introduced computer systems for the processing of financial and other information (Porter et al., 2003:31). Consequently, the auditor had to examine and assess the controls related to the computer environment and use computers as an auditing tool (Porter et al., 2003:31).

At the time of this study, the audit of financial statements was not as simple as the oral presentations prior to 1844. The objective of the auditor is to examine the financial statements of a company, in accordance with applicable auditing standards, with a view of expressing an independent opinion as to whether the financial statements are fairly presented and are free from material misstatement in accordance with an applicable financial reporting framework (RSA, 2005:s1). The auditor's opinion on the financial statements not only adds credibility to the financial statements (Rezaee, 2004:137) but also gives shareholders, investors and other interested stakeholders the confidence that the information contained in the financial statements is a fair reflection of the affairs of the company and is not based on inaccurate data (Mawutor, 2014:326).

3.2.2 The auditing profession in South Africa

As mentioned in the introduction to the chapter, stakeholders lost confidence in the auditing profession after various company failures. The ineffective regulation of the auditing profession was highlighted as one of the causes of this lack of confidence in auditors (Odendaal & De Jager, 2008:1). In South Africa, after July 1995, the auditing profession was regulated by the Public Accountants and Auditors Act 23 of 1995 (PAA) through the establishment of the Public Accountants and Auditors Board (PAAB) (RSA, 1995:s2(1)). The PAAB was controlled and operated by auditors and thus the auditing profession was self-regulated and not perceived to be independent (Odendaal & De Jager, 2008:3). In 2006, the then Minister of Finance signed into effect the APA (RSA, 2005) which replaced the PAA. In terms of the APA (RSA, 2005) the IRBA (RSA, 2005:s3(1)) was established under the oversight of the Minister of Finance. The APA also

stipulated that no more than forty percent of board members were to be auditors, thereby increasing the independence of the auditing profession (RSA, 2005:s11(4)). In addition to the introduction of the APA, the Companies Act (RSA, 2008) was revised to align it to corporate governance and other legislative developments (Eilifsen et al., 2010:43).

The Companies Act (RSA, 2008:s90(3)) mandates that an auditor of a company must perform his/her duties in accordance with the APA. In terms of the APA (RSA, 2005:s37), an auditor must be registered with the IRBA in order to practise as an auditor in South Africa and must carry out an audit free of any restrictions whatsoever and in accordance with the applicable auditing pronouncements (RSA, 2005:s44(3)(a)) i.e. the ISAs, including application and explanatory material (IRBA, 2017b). The IRBA's duty is to protect the public's financial interest by allowing only auditors who are qualified to be admitted and registered into the profession, thus ensuring that registered auditors adhere to the highest ethical standards and that audits of the highest quality are conducted (RSA, 2005:s2). The IRBA executes its duties through the ongoing monitoring of its members' conduct and qualifications and performing inspections of selected audit engagements (IRBA, 2017a), as required by the APA. In terms of the APA, the IRBA must, every three years, review the practice of auditors that audit public companies (RSA, 2005:s47(b)). The IRBA performs these reviews by considering whether the auditor has complied with the requirements of the ISAs (IRBA, 2017a) (which include an auditor's assessment of a company's 'tone at the top'*)*.

In addition, the APA requires that the auditor must also satisfy himself/herself that all the assets and liabilities of the company do, in fact, exist, that proper accounting records of the audited company are kept in one of the official languages of South Africa and that he/she was able to obtain all the vouchers and other supporting documentation necessary to perform his/her duty (RSA, 2005:s44(3)(b-d)). Moreover, the auditor must ensure that he/she had no reason to report a reportable irregularity in terms of section 45 of the APA, and that all the laws relating to the audit of the company were complied with (RSA, 2005:s44(3)(e-f)). Equally important, the auditor must be satisfied as to the fairness and correctness of the financial statements, having regard to the nature of the company in question (RSA, 2005:s44(3)(g)).

A reportable irregularity refers to any unlawful act or omission committed by a person responsible for the management of the company, which has caused or is likely to cause material financial loss to the company being audited, is fraudulent or amounts to theft or represents a material breach of any fiduciary duty owing by such a person to the company (RSA, 2005:s1)). Thus, if a director, for example, personally benefits from a company contract and fails to disclose his/her benefit, this would amount to a reportable irregularity as it constitutes a breach of the director's fiduciary duties (RSA, 2008:s76(2)).

In addition to the APA and Companies Act, the auditor of a listed company must comply with the JSE listing requirements. In terms of the JSE listing requirements, only an accredited auditor may conduct the audit of a listed company (JSE, 2015:listing requirement 22.1). The accredited auditor is required to carry out his/her duties with "due care and skill" (JSE, 2015:listing requirement 22.5(e)) and must have his/her audit file reviewed by the IRBA (JSE, 2015:listing requirement 22.1(c)), as discussed above.

3.2.3 An audit engagement

An audit engagement should be carried out in accordance with the ISAs, which outline the general responsibilities of the auditor (IAASB, 2009a:ISA 200.1-2). In terms of ISA 200 the objective of an audit is "to provide reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an independent opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and to report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor's findings" (IAASB, 2009a:ISA 200.11(a-b)).

The objective of an audit outlines that the audit engagement is a reasonable assurance engagement and, thus, the auditor should reduce the engagement's audit risk to an acceptably low level while taking into account both the circumstances that surround the engagement and the audit evidence on which the auditor's conclusions are based (IAASB, 2016:ISA Glossary of terms). More specifically, audit risk refers to the risk that an auditor would express an inappropriate audit opinion when the financial statements are materially misstated (IAASB, 2009a:ISA 200.13(c)). It is a function of the risk of material misstatement and detection risk (IAASB, 2009a:ISA 200.13(c); Law, 2008:163).

On the other hand, detection risk refers to the risk that the audit procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a material misstatement that exists (IAASB, 2009a:ISA 200.13(e)). The risk of material misstatement is related to the entity's risks and exists independently of the audit whereas the auditor determines detection risk (Gray et al., 2015:45; Law, 2008:163). The risk of material misstatement is explained in section 3.3 below. Reasonable assurance refers to a high level of assurance but not absolute assurance about whether the financial statements are free from material misstatement, due to fraud or error (IAASB, 2009a:ISA 200.5). Reasonable assurance is not absolute assurance because of the inherent limitations of an audit and the basis of the auditor's opinion being persuasive rather than conclusive (IAASB, 2009a:ISA 200.5).

The first inherent limitation that may arise in an audit relates to the nature of financial reporting (IAASB, 2009a:ISA 200.A47). Financial statements are based on a number of judgements made by the governing body and/or management of a company, for example, determining accounting policies or estimates. The information presented in the financial statements has an inherent level of variability that cannot be removed by performing additional audit procedures (IAASB, 2009a:ISA 200.A48). Estimates inherently contain uncertainties that may be affected by post balance sheet events and contingencies (Law, 2008:163). These estimates may be inaccurate because the evidence supporting them is persuasive and not conclusive in nature.

The second inherent limitation of an audit relates to the nature of the audit procedures performed (IAASB, 2009a:ISA 200.A47). Audit procedures are specific acts performed by the auditor to obtain audit evidence (Eilifsen et al., 2010:120). Audit procedures used to obtain audit evidence include inspection, observation, inquiries, recalculation, analytical procedures and external confirmations (IAASB, 20091:ISA 500.A2). Audit evidence refers to the information collected during the course of the audit which supports the audit conclusion reached (IAASB, 2009a:ISA 200.13(b)). The information collected during an audit consists of both information from the accounting records and other information such as the directors' report or integrated report accompanying the financial statements (IAASB, 2009a:ISA 200.13(b)). The audit evidence collected must be sufficient and appropriate in terms of supporting the auditor's opinion. *Sufficiency* in this context refers to the measure of the quantity of audit evidence required and is dependent on the assessed risk of material misstatement (IAASB, 2009a:ISA 200.13(b)(i)). The higher the

assessed risk of material misstatement, the greater the volume of audit evidence required (IAASB, 2009a:ISA 200.A31). On the hand, *appropriateness* in this context refers to the quality of the audit evidence supporting the audit opinion which must be both relevant and reliable (IAASB, 2009a:ISA 200.13(b)(ii)).

The measure of sufficient and appropriate audit evidence is a matter of professional judgement (IAASB, 2009a:ISA 200.A33). Professional judgement may be evaluated based on whether the appropriate conclusion was reached, taking into account the auditing and accounting principles applied by the auditor, the relevant training, knowledge and experience of the auditor and the related facts and circumstances known to the auditor at the time of the judgement (IAASB, 2009:ISA 200.A28). Professional judgement decisions must be documented and supported (IAASB, 2009a:ISA 200.A29). 'Tone at the top' assessments are a matter of the auditor's professional judgement. The IRBA's 2017 inspections report indicates a decline in audit quality due to a lack of professional judgement on the part of auditors (IRBA, 2017c:9).

The third inherent limitation of an audit mentioned in the ISAs refers to conducting an audit within a reasonable time and at a reasonable cost (IAASB, 2009a:ISA 200.A47). If an auditor had to test all the transactions of a company, the cost of the audit as well as the time taken to complete the audit would increase markedly (Law, 2008:161). As a result, an audit entails testing a sample of data in order to arrive at a conclusion and not testing every transaction that takes place (Mawutor, 2014:327). Thus, reasonable assurance is not a guarantee that there are no misstatements in the financial statements. Nonetheless, time or cost should not be the deciding factor in whether or not an auditor performs an audit procedure (IAASB, 2009a:ISA 200.A50).

The objective of an audit further states that an auditor should obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error. The audit evidence obtained is based on information prepared and presented by management and there is always a possibility that management may conceal evidence, either intentionally or unintentionally (IAASB, 2009a:ISA 200.A49). Consequently, there may be a risk that the information the auditor obtained from management is incomplete and/or misstated due to fraud or error (IAASB, 2009a:ISA 200.A49). Fraud by nature involves deception and thus it is not possible for the auditor to provide absolute assurance that the financial statements are free from misstatement (Law, 2008:163). ISA 240 states

that the auditor must remain alert and continuously question whether the audit information and evidence received from management and those charged with governance suggest that a material misstatement due to fraud or error exists (IAASB, 2009d:ISA 240.A7).

Even if the auditor has, in the past, experienced that the governing body and management of the entity is honest and have integrity, the auditor must, nevertheless, remain aware that circumstances may have changed that may result in the financial statements being susceptible to fraud (IAASB, 2009d:ISA 240.A8). An auditor should, therefore, exercise professional skepticism and professional judgement when conducting an audit so that he/she may recognise circumstances that may exist that may cause the financial statements to be materially misstated (IAASB, 2018:13; IAASB, 2009a:ISA 200.15). Professional skepticism means the auditor should maintain a questioning mindset when assessing the audit evidence received (IAASB, 2009a:ISA 200.13(l)). For example, the auditor should be alert for audit evidence that contradicts other audit evidence obtained (IAASB, 2009a:ISA 200.A20-A22). The auditor should also remain alert to the sufficiency and appropriateness of the audit evidence obtained, especially where conditions may indicate possible fraud (IAASB, 2009a:ISA 200.A22).

Professional skepticism refers to an attitude on the part of the auditor when he/she exercises the professional judgement(s) that forms the basis of an auditor's actions (IAASB, 2018:13). The terms professional skepticism and professional judgement are, therefore, closely related and interlinked. Noviyanti and Winata (2015:59) explain that exercising professional skepticism does not mean being too cynical of management but that a skeptical attitude ensures that the auditor corroborates any information received from management with supporting evidence. Moreover, professional skepticism on the part of the auditor may be enhanced if the auditor obtains more knowledge on fraud and is more made aware of fraud by receiving training and attending workshops on fraud (Noviyanti & Winata, 2015:61).

The objective of an audit, furthermore, requires that the auditor express an independent opinion. However, an auditor's opinion must not only be independent but it must also be credible so that stakeholders are able to trust the opinion expressed by the auditor (Gray et al., 2015:42). Credibility thus also refers to the auditor being competent, and conducting himself/herself with integrity and/or in an ethical way (Gray et al., 2015:38; Porter et al., 2003:45). In addition, there is an inseparable link between the auditor's professional

judgement and professional skepticism and the ethical aspects of objectivity and independence (Penning, 2014). Professional judgement and professional skepticism can diminish in instances where there is a lack of independence from the information being audited (Penning, 2014).

The auditor's independence is fundamental to good corporate governance (IFC, 2006). Independence safeguards the auditor's ability not to influenced to compromise his/her opinion (JSE, 2015:listing requirement 8.45; IAASB, 2009a:ISA 200.A18). Thus, independence implies that the auditor must not perform any audit or other services for a company that may result in a conflict of interest between the auditor and the company concerned (RSA, 2008:s93(3)(a)). Thus, the auditor must be independent in both mind and appearance. *Independence in mind* means that the auditor will conduct the audit in an unbiased and objective manner, and with integrity and professional skepticism (explained above) (SAICA, 2014:290.6(a)). On the other hand, *independence in appearance* refers to a situation in which an informed third party, possessing the relevant knowledge, including that of the safeguards applied, would conclude that the auditor's integrity, objectivity and professional skepticism have not been compromised (SAICA, 2014:290.6(b)). To this end, the Companies Act includes provisions intended to preserve the independence of auditors in South Africa. These provisions include the rotation of the engagement partner every five years (RSA, 2008:s92), the prohibition of certain non-audit services to audit clients (RSA, 2008:s90(2)) and the nomination, by the audit committee, for the appointment of the auditor by shareholders (RSA, 2008:s94(7)(a)).

Competent in the audit context means that an auditor must possess the necessary professional competence and exercise due care when performing an audit (SAICA, 2014:100.5(c)). The auditor must maintain an awareness of current developments in legislation and professional standards (SAICA, 2014:130) and, in addition, the auditor must possess the knowledge and experience necessary to ensure that the client receives a competent and professional service.

Conducting himself/herself with integrity and in an ethical way means that an auditor should comply with the ethical requirements of the professional body to which the auditor belongs. Ethical conduct is crucial to the work of the auditor because adhering to ethical requirements indicates that the auditor understands the value of the trust placed in him/her by the public and this enhances his/her independence (Ardelean, 2013:59). The

fundamental principles with which the auditor has to comply include integrity, objectivity, professional competence, due care (discussed above), confidentiality and professional behaviour (IAASB, 2009:ISA 200.A17). Integrity means that the auditor is honest and fair in all his/her professional relationships (SAICA, 2014:110). It also means the auditor is truthful (SAICA, 2014:110). Objectivity means that the auditor is not influenced by bias, conflict of interest or undue influence from others (SAICA, 2014:120) while confidentiality refers to the auditor's obligation not to disclose to anyone confidential information that has come to his/her knowledge due to his/her professional relationships unless required by law or there is a professional obligation to do so (SAICA, 2014:140). It also refers to his/her duty not to use such information to his/her personal advantage (SAICA, 2014:140). On the other hand, professional behaviour obliges the auditor to conduct himself/herself in a manner that will not bring the profession into disrepute (SAICA, 2014:150).

Absolute assurance is also not possible because the auditor is searching for material misstatements in the financial statements and not minor misstatements (Law, 2008:162). Minor misstatements may sometimes not be adjusted as adjustments are dependent on the auditor's materiality levels and thus financial statements may contain minor errors (Law, 2008:162). A misstatement in, including an omission from, the financial statements of a company is considered material if the misstatement, individually or collectively, may influence the economic decisions made by the users of such financial statements (IAASB, 2009f:ISA 320.2). Materiality levels are based on the auditor's professional judgement and play an important role in determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures (IAASB, 2009f:ISA 320.6).

The objective of an audit also states that the auditor must ensure that the financial statements are prepared in accordance with an applicable financial reporting framework. The governing body and/or management of a company are responsible for preparing and presenting the financial statements of a company in accordance with an applicable financial reporting framework and relevant laws and regulations (IAASB, 2009a:ISA 200.A2). The auditor is responsible only for expressing an independent opinion on the financial statements. In South Africa, the International Financial Reporting Standards is the applicable financial reporting framework for listed companies (JSE, 2015:listing requirement 8.3). The governing body and management are also responsible for ensuring

that the auditor has access to all the information required or requested by him/her for the purpose of the audit (IAASB, 2009a:ISA 200.A2).

The audit objective also states that the auditor must report to the shareholders on his/her findings. Communication of the audit findings refers to the auditor's ability to clearly report on his/her opinion (Gray et al., 2015:49; Porter et al., 2003:45). The auditor's responsibility is to express an audit opinion on the financial statements of a company (IAASB, 2016c:ISA 700R.1) in writing (IAASB, 2016c:ISA 700R.20) so that users of the financial statements may have assurance that an audit was conducted in accordance with the ISAs (IAASB, 2016c:ISA 700R.A33). The auditor follows an audit process to arrive at his/her audit opinion – discussed next.

3.3 THE AUDIT PROCESS

Broadly speaking the audit process consists of four phases, namely, pre-engagement, planning, obtaining audit evidence and concluding and reporting (see figure 3.1).

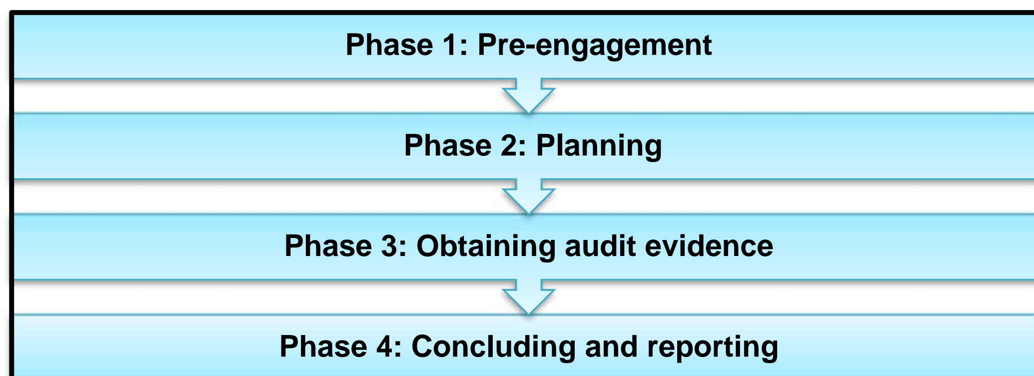

FIGURE 3.1 Audit process

Source: Own compilation

During the pre-engagement phase the auditor must determine whether a prospective audit client should be accepted or, in the case of a recurring client, whether it is possible to continue such client relationship as required by both ISQC1 (IAASB, 2009k:ISQC1.26) and ISA 220 (IAASB, 2009c:ISA 220.12). ISQC1 states that an audit firm must establish and maintain a process of quality control for the audits of financial statements of listed companies (IAASB, 2009k:ISQC1.35(a)). The aim of the engagement quality control

process is to provide reasonable assurance that the audit engagement team complied with the relevant legal, professional and ethical standards when conducting the audit and to ensure that reports issued by the audit firm are appropriate in the circumstances under which the audit was conducted (IAASB, 2009k:ISQC1.11). In addition, the audit engagement team and audit firm must be independent of an audit client (IAASB, 2009b:ISA 210.A1).

As part of the auditor's client acceptance and continuance, an auditor must assess the integrity of the client's management prior to associating with a potential client and when deciding to continue to audit a client's financial statements (IAASB, 2009c:ISA 220.A8; IAASB, 2009k:ISQC1.26(c)). The pre-engagement phase also requires that the auditor agree to the terms of the audit engagement with management and, where appropriate, with those charged with governance of the company in question (IAASB, 2009b:ISA 210.1). This includes the responsibilities of each party, assistance required from the client, for example from their internal auditors, the timing of the audit and the audit fee (Eilifsen et al., 2010:17).

In addition to adhering to the ISAs, an auditor would also assess the level of the auditor's business risk involved. The auditor's business risk refers to the loss that an auditor may suffer due to his/her relationship with the client concerned (Houston, Peters & Pratt, 1999:282). For example, clients who have conflicting ethical standards (Kueppers & Sullivan, 2010:289) or a bad business reputation (IAASB, 2009k:ISQC1.A19) may result in negative publicity for the auditor or possible litigation because of the auditor's association with the client (Carpenter & Reimers, 2013:49-50). A recent example illustrating the significance of assessing the associational risk with clients is the resignation of SizweNtsalubaGobodo as the auditor of Oakbay Resources and Energy Limited (SNG resigns as auditors of Oakbay, 2017).

When considering the auditor's business risk involved an auditor typically considers the client's financial position, internal control structure and whether the client has a generally good reputation (Johnstone, 2000:3). The governing body and management of the prospective client will also be evaluated to determine their experience and knowledge (Sharma et al., 2008:107). If the governing body and management have a poor reputation or are considered unqualified for the position at the company, the auditor's business risk when accepting the company as a client would increase (Sharma et al., 2008:108). In

addition, the auditor should question whether there is a possibility that the potential client is opinion shopping (Decker, Ray & Kizirian, 2016:101). In other words, the auditor should question whether a change in auditors was made because the potential client was unhappy with the audit opinion issued by the previous auditor.

Phase two of the audit process entails planning an audit. This involves establishing the overall audit strategy that shapes the scope, timing and direction of the audit (IAASB, 2009e:ISA 300.7). When formulating the overall audit strategy, the auditor will consider the assessed risk of material misstatement due to fraud or error to determine the resources required by the auditor, the expertise of the engagement staff and the audit budget (IAASB, 2009e:ISA 300.A8). The overall audit strategy guides the development of the audit plan (IAASB, 2009e:ISA 300.7) which is more detailed than the overall audit strategy and includes the nature, timing and extent of the audit procedures to be performed (IAASB, 2009e:ISA 300.A12). The audit plan is developed as the audit progresses. For example, the auditor plans the company's risk assessment procedures at the beginning of the audit but would plan the nature, timing and extent of the audit procedures only once the risks have been identified and assessed (IAASB, 2009e:ISA 300.A12).

The risk of material misstatement refers to the risk that the financial statements were materially misstated prior to the audit. The risk of material misstatement comprises two components, namely, inherent risk and control risk (IAASB, 2009a:ISA 200.A39). Inherent risk refers to the susceptibility of an assertion about a class of transaction, account balance or disclosure being materially misstated before considering any related controls (IAASB, 2009a:ISA 200.13(n)). On the other hand, control risk is the risk that a misstatement could occur in an assertion about a class of transaction, account balance or disclosure that could be material and will not be prevented, or detected and corrected, by an entity's internal controls (IAASB, 2009a:ISA 200.13(n)).

An auditor must first identify and assess the risk of material misstatement of the financial statements due to fraud or error before he/she is able to determine the nature, timing and extent of the audit procedures that he/she would have to perform (IAASB, 2013a:ISA 315R.5). The risk of material misstatement exists at two levels, namely, the overall financial statement level and the assertion level (IAASB, 2009a:ISA 200.A36). On the overall financial statement level, the auditor identifies and assesses the risk of material

misstatement that are pervasive to the financial statements and which affect several assertions (IAASB, 2009a:ISA 200.A37) whereas, on the assertion level, the inherent risk and control risk are assessed in relation to classes of transactions, account balances and disclosures (IAASB, 2009a:ISA 200.A36). An assertion is a representation by management regarding the recognition, measurement and disclosure of elements of the financial statements and is used by the auditor to consider the various types of potential misstatements that may occur (IAASB, 2013a:ISA 315R.4(a)). The information obtained by the auditor in evaluating his/her business risk during the pre-engagement phase may be used in the identification and assessment of the risk of material misstatement, due to fraud or error, when planning the audit (IAASB, 2013a:ISA 315R.7).

The risk assessment procedures that are performed during planning include obtaining an understanding of the entity and its environment, including internal control (IAASB, 2013a:ISA 315R.4(d)). In obtaining an understanding of the entity and its environment, the auditor would consider the company's industry, applicable regulations, operations and governance structures (IAASB, 2013a:ISA 315R.11) with such an understanding of the entity and its environment providing the auditor with an overview of the business risks faced by the company (IAASB, 2013a:ISA 315R.A39).

Understanding internal control involves obtaining an understanding of the controls relevant to the audit and evaluating the design of such controls and whether they are being implemented as designed (IAASB, 2013a:ISA 315R.13). There are five components of internal control that should be considered, namely, the control environment, the entity's risk assessment process, the information system, control activities and the monitoring of the controls (IAASB, 2013a:ISA 315R.14-24). The control environment component may be seen as the foundation of all the other components of internal control as it sets the tone of the entity and influences the control consciousness of the employees (IAASB, 2013a:ISA 315R.A77; Ramos, 2004:75). Furthermore, understanding and evaluating the control environment allows auditors to evaluate whether management, with the oversight of those charged with governance, has created a culture of honesty and integrity (IAASB, 2013a:ISA 315R.14). The control environment component of internal control was deemed to be particularly relevant for the purposes of this study. The audit planning phase is presented in figure 3.2.

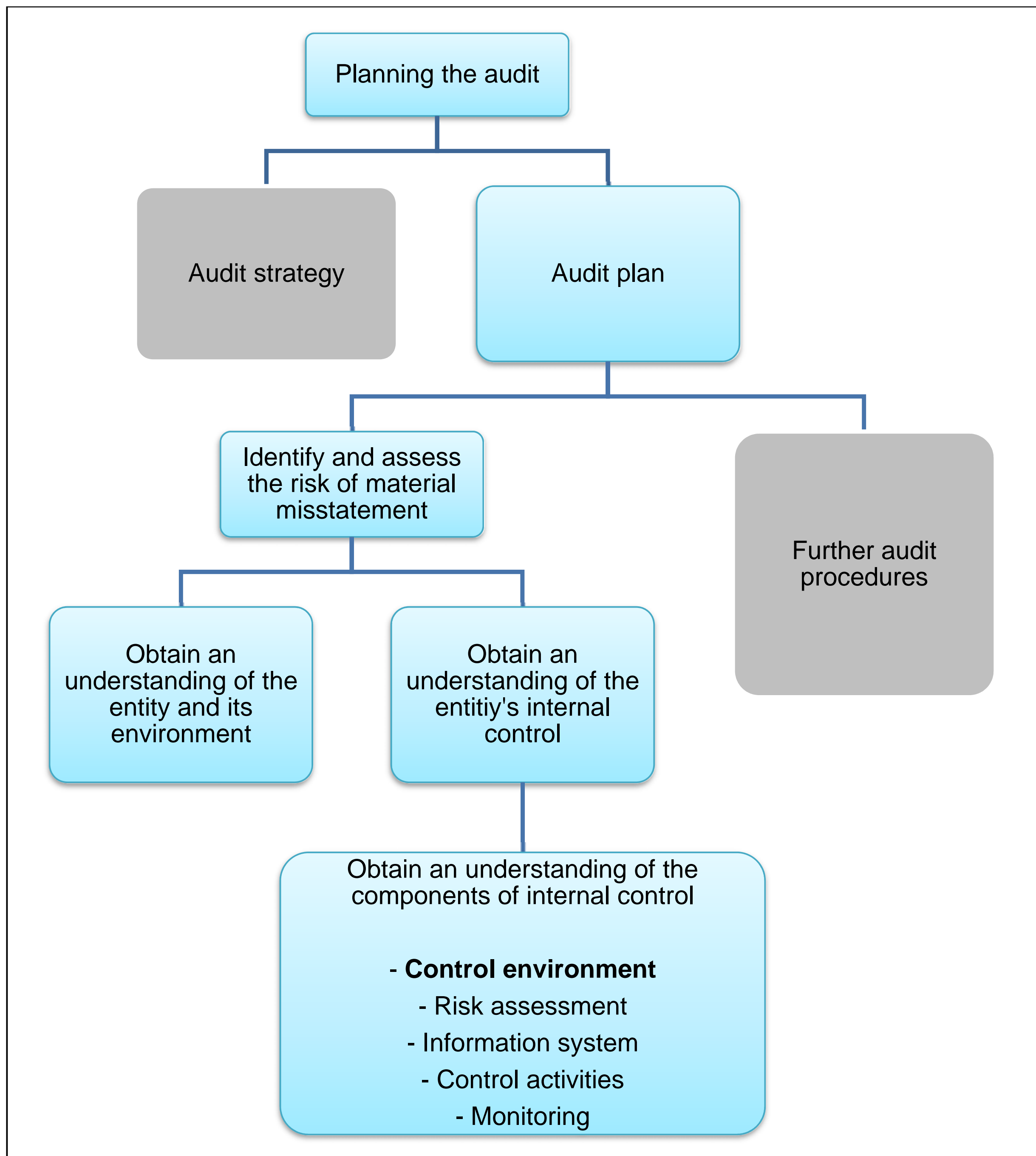

FIGURE 3.2 Audit planning phase

Source: Own compilation based on ISA 315R (IAASB, 2013a)

The third phase of the audit process involves obtaining audit evidence. Once the auditor has planned the audit engagement, including identifying and assessing the risk of material misstatement of the financial statements due to fraud or error, the auditor will perform further audit procedures to obtain audit evidence linked to the assessed risks. The audit evidence gained from the performance of the audit procedures must be sufficient and

appropriate to enable a conclusion to be drawn on which to base the auditor's opinion (IAASB, 2009i:ISA 500.4). The following further audit procedures are performed to acquire audit evidence, namely, tests of controls and substantive procedures (IAASB, 2009i:ISA 500.A10). *Tests of controls* are audit procedures designed to evaluate the operating effectiveness of the controls identified in preventing or detecting and correcting material misstatements at the assertion level (IAASB, 2009g:ISA 330.4(b)) while s*ubstantive procedures* consist of tests of detail and substantive analytical procedures designed to detect material misstatements at the assertion level (IAASB, 2009g:ISA 330.4(a)).

Phase four of the audit process involves the concluding and reporting phase of the audit. The auditor must conclude whether he/she has obtained reasonable assurance that the financial statements, as a whole, are free from material misstatement due to fraud or error (IAASB, 2016c:ISA 700R.11). The auditor may do this only after considering whether sufficient and appropriate audit evidence has been obtained and whether the uncorrected misstatements identified are not material, either individually or in aggregate (IAASB, 2016c:ISA 700R.11).

3.4 PROCEDURES FOR ASSESSING A COMPANY'S 'TONE AT THE TOP'

The risk of material misstatement of the financial statements due to fraud or error, based on poor management integrity, is important to an auditor because it is inversely correlated to the nature and extent of the audit evidence collected and the audit fees charged by the auditor (Beaulieu, 2001:96). Thus, if the auditor assesses the risk of material misstatement due to fraud or error, based on an assessment of the company's 'tone at the top', as low, the extent of the substantive testing would be decreased and the auditor would be able to place a higher reliance on the internal control than may otherwise have been the case (Cohen & Hanno, 2000:141). Likewise, if an auditor assesses the risk of material misstatement due to fraud or error, based on an assessment of the company's 'tone at the top, as high, the auditor should increase both the quantity and quality of the audit evidence acquired (Sneathen Jr et al., 2003:54).

The audit engagement partner must assess a company's 'tone at the top' (IFAC, 2010:26) because such an understanding involves a high degree of professional judgement (Cohen et al., 2002:589). Based on their experience and extensive knowledge of the

company being audited the audit engagement partner and key audit engagement team members must discuss and evaluate the susceptibility of the company's financial statements being misstated due to fraud or error (Carpenter & Reimers, 2013:66; IAASB, 2013a:ISA 315R.10, .A21; Kueppers & Sullivan, 2010:291; Cohen et al., 2002:589; Abdolmohammadi, 1999:60). However, the study conducted by Cohen et al. (2002:589) found that the senior trainees on the audit generally gather the information used by the key audit engagement team members and the audit engagement partner in evaluating the corporate governance structure of a company. However, this may pose a risk to the audit firm if these trainees do not gather either the appropriate or complete and relevant information.

As mentioned above, an auditor would identify and assess the risk of material misstatement due to fraud or error associated with a company's 'tone at the top' when the auditor obtains an understanding of the internal controls of the company (IAASB, 2013a:ISA 315R.A124; Cohen & Hanno, 2000:134), specifically the control environment. The control environment consists of seven elements, namely, communication and enforcement of integrity and ethical values, commitment to competence, participation by those charged with governance, management's philosophy and operating style, organisational structure, assignment of authority and responsibility and human resource policies and practices (IAASB, 2013a:ISA 315R.A78). However, each element of the control environment may be aligned to an aspect of a company's 'tone at the top' as described in chapter 2 (section 2.4) and as indicated in table 3.1 below.

TABLE 3.1 Aligning the elements of the control environment to aspects of a company's 'tone at the top'

<table>
<tr><th>Control environment element</th><th>'Tone at the top' aspect</th></tr>
<tr><td>Communication and enforcement of integrity and ethical values</td><td rowspan="2">Implementing and promoting an ethical culture</td></tr>
<tr><td>Human resource policies and practices</td></tr>
<tr><td>Commitment to competence</td><td rowspan="4">Ethical leadership</td></tr>
<tr><td>Management's philosophy and operating style</td></tr>
<tr><td>Organisational structure</td></tr>
<tr><td>Assignment of authority and responsibility</td></tr>
<tr><td>Participation by those charged with governance</td><td>Maintaining healthy relations with stakeholders</td></tr>
</table>

Source: Own compilation based on ISA 315R.78(a)-(f) (IAASB, 2013a)

An auditor should obtain an understanding of and evaluate all the aspects of a company's 'tone at the top' in order to identify and assess the risk of material misstatement due to fraud and error associated with such 'tone at the top'. In addition to the three aspects of a company's 'tone at the top' listed in table 3.1 above (implementation and promotion of an ethical culture, ethical leadership and maintaining healthy relations with stakeholders), the auditor must also consider the fourth aspect of 'tone at the top', namely, compliance with relevant laws and regulations. ISA 250 supports the notion that the auditor must obtain an understanding of the laws and regulations applicable to the company as part of his/her understanding of the company and its environment (IAASB, 2016b:ISA 250.13).

As illustrated in table 3.1, two of the seven control environment elements align to the implementation and promotion of an ethical culture, namely, communication and enforcement of integrity and ethical values and understanding the company's human resources policies and practices. The first element of the control environment, communication and enforcement of integrity and ethical values, influences the effectiveness of the design, administration and monitoring of controls (IAASB, 2013a:ISA 315R.A78(a)). The second element of the control environment mentioned, human resource policies and practices, relates to the policies and practices in respect of, for example recruitment, orientation, training, promotion and compensation (IAASB, 2013a:ISA 315R.A78(g)) and underpins the ethical consciousness of people, which are important since ethical behaviour has a direct impact on the effectiveness of controls (IAASB, 2013a:ISA 315R.App 1.2(a)).

As indicated in table 3.1, management's commitment to competence, management's philosophy and operating style, the company's organisational structure and the company's assignment of authority and responsibility align to the 'tone at the top' aspect of ethical leadership. Commitment to competence means that it is incumbent on management to consider the competency levels for specific jobs and the skills and knowledge required for a particular level (IAASB, 2013a:ISA 315R.A78(b)). Organisational structure and assignment of authority and responsibility refers to whether employees are assigned authority and responsibility based on their competence, skills and knowledge in relation to their particular jobs within the company's framework/hierarchies (IAASB, 2013a:ISA 315R.A78(e-f)). Management's philosophy and operating style addresses the characteristics expected of the management of a company in terms of their approach to the financial reporting process, managing the

business risk of the company and their attitude toward information processing and accounting functions, and personnel (IAASB, 2013a:ISA 315R.A78(d)).

Participation by those charged with governance aligns to the 'tone at the top' aspect of maintaining healthy relations with stakeholders (see table 3.1) because those charged with governance of a company are also stakeholders of the company. In terms of this control environment element, the auditor must consider the independence, experience, status and activities of those charged with governance (IAASB, 2013a:ISA 315R.A78(c)).

Based on the above the remainder of the section describes the procedures (stipulated in the ISAs, laws and regulations and academic literature) which auditors should perform in order to obtain an understanding of each of the aspects of a company's 'tone at the top' in order to assess the risk of material misstatement due to fraud or error.

3.4.1 Implementing and promoting an ethical culture

As indicated in table 3.1, the control environment elements of communication and enforcement of integrity and ethical values and human resources policies and practices align to this aspect of 'tone at the top'. Communication and enforcement of integrity and ethical values entails that management must be ethical as controls cannot be effective if the people who design, implement and monitor them are unethical (IAASB, 2013a:ISA 315R.App 1.2(a)). Integrity and ethical values stem from the entity's implementation, communication and monitoring of the behavioural standards set (IAASB, 2013a:ISA 315R.App 1.2(a)). Thus, management should establish a code of ethics that is communicated to personnel through policy and procedures and enforced by, for example, removing temptation and incentives to commit fraud (IAASB, 2013a:ISA 315R.App 1.2(a)).

An auditor may obtain an understanding of the communication and enforcement of integrity and ethical values within a company by making inquiries of the employees as to whether management has communicated the code of ethics to them (IAASB, 2013a:ISA 315R.A79). The auditor should also inquire how the code of ethics had been communicated to the employees and whether management behaves in a manner that supports the code of ethics of the company (discussed in section 3.4.2) (IAASB, 2013a:ISA 315R.A79). In addition, the auditor should inquire from management whether

management members have been actively promoting ethical behaviour within the company (IAASB, 2009d:ISA 240.17(d)). Management may promote the code of ethics actively by infusing the values of the code of ethics into its strategic plans (Celikdemir & Tukel, 2015:535) because, if a company reflects its commitment to ethics in its strategy, it will improve the performance and reputation of the company (Celikdemir & Tukel, 2015:534). In addition, the information obtained from management must be corroborated by observing the processes in place and the inspection of documents such as the code of ethics itself (IAASB, 2013a:ISA 315R.A79).

The control environment element of human resource policies and practices relates to the recruitment and promotion of personnel, including the assessment by human resources of the integrity and trustworthiness of the staff hired or promoted (IAASB, 2013a:ISA 315R.App1.2(g)). There should be an emphasis on determining the experience, qualifications and evidence of integrity of prospective staff members before they are hired (IAASB, 2013a:ISA 315R.App1.2(g)). Training policies on ethics and skills are necessary (IAASB, 2013a:ISA 315R.App1) to enable staff to understand the code of ethics (IAASB, 2016b:ISA 250.A2).

In order to obtain an understanding of the above in identifying and assessing the related risk of material misstatement due to fraud or error, auditors may use a structured questionnaire (Callaghan, Savage & Mintz, 2007:61). The questionnaire should take into account the requirements for an ethical culture and the responsibilities of the board and audit committee in this respect (Callaghan et al., 2007:61). The extent of the auditor's procedures performed are dependent on the auditor's professional judgement (IAASB, 2013a:ISA 315R.A3).

In short, the auditor should evaluate the implementation and promotion of an ethical culture by, firstly, considering whether the company has a code of ethics in place. However, the existence of the code of ethics is, in itself, not sufficient. The auditor must determine whether the code of ethics is being communicated to all stakeholders and whether employees are trained on the code of ethics. Furthermore, the auditor should evaluate if there are effective measures in place for addressing non-adherence with the code of ethics. Secondly, the auditor must obtain an understanding of the company's recruitment and promotion criteria while the auditor's evaluation of the company's

recruitment and promotion criteria should determine whether the company screens its employees in respect of their qualifications, skills and integrity.

3.4.2 Ethical leadership

Many of the decisions made by the auditor are based on inquiries of and information received from the governing body and management of the company (Cohen & Hanno, 2000:134). A prospective or recurring client of which the governing body and management are considered to be both independent and ethical provides the auditor with additional confidence that the client–supplied information is credible (Sneathen Jr et al., 2003:49). A company's governing body and management also influences the quality of the financial information and thus an independent and ethical governing body and management will enhance the reliability of the financial statements (Sharma et al., 2008:107). It is, therefore, critical that an auditor obtain an understanding of the governing body and management's ethical leadership and moral character from the outset, i.e. when accepting a new client or continuing an existing client relationship, to determine whether there are issues that may result in the auditor not accepting or continuing with the client (IAASB, 2009c:ISA 220.12, .A8; Ayers & Kaplan, 1998:139).

Once a new client has been accepted or an existing client confirmed, the auditor would further assess the client's ethical leadership by obtaining an understanding of the control environment (IAASB, 2013a:ISA 315R.A77) during the planning phase of the audit process. Specifically, the auditor should consider the four control environment elements aligned to ethical leadership as illustrated in table 3.1, namely, management's commitment to competence, the company's organisational structure, the company's assignment of authority and responsibility and management's philosophy and operating style. Management's commitment to competence, assignment of authority and responsibility and organisational structure highlight the need for people to possess the knowledge and skills required to perform their duties (IAASB, 2013a:ISA 315R.App 1.2(b)), especially key personnel (IAASB, 2013a:ISA 315R.App 1.4). The assignment of authority and responsibility must also take into account the staff resources available as well as the interrelationship between staff actions and accountability (IAASB, 2013a:ISA 315R.App 1.2(e-f)). Management's philosophy and operating style include whether management is conservative or aggressive in selecting accounting policies or either conscious or conservative when making estimates (IAASB, 2013a:ISA 315R.App 1.2(d)).

These control environment elements are vitally important because a lack of competence or oversight by management may have a pervasive effect on the overall financial statements (IAASB, 2013a:ISA 315R.A123).

In addition, the auditor should consider whether any corporate restructuring has taken place since this may result in changes to supervision and the segregation of duties which in turn may change the risk associated with internal control (IAASB, 2013a:ISA 315R.App1.4). Inadequate segregation of duties provides an opportunity for fraud (Van Akkeren & Buckby, 2017:396) and increases the risk of material misstatement. The auditor should also consider whether the accounting personnel possess the skills and experience required to conduct the accounting operations of the company (Decker et al., 2016:101). The auditor should also inquire from management what the turnover rate in accounting personnel has been and why there has been a change in such turnover rate (if any) (Decker et al., 2016:101).

An act of fraud or misstatement may not be an isolated incident (IAASB, 2009d:ISA 240.A51; IAASB, 2009h:ISA 450.A7) and, therefore, an auditor should consider the cumulative effect of the number of audit differences identified (IAASB, 2009h:ISA 450.A7). The evaluation of the misstatements identified may give the auditor a further indication that there is a possible risk of a breakdown in internal control (IAASB, 2009h:ISA 450.A7). In addition, it may also indicate to the auditor that the staff complement does not possess the knowledge and/or skill required to perform their jobs or that management has little or no regard for the correct application of accounting policies and practices (Kerr & Diaz, 2009:8) and/or that management is aggressive in the interpretation of the accounting standards (IAASB, 2009k:ISQC1.A19). The auditor could inquire from management whether there have been any significant accounting estimates during the year. The auditor should then review the transactions for appropriateness as the policy and practices applied to the accounting estimates will provide the auditor with an indication as to whether management is aggressive or committed to the correct interpretation of the accounting standards (Decker et al., 2016:101).

Although a satisfactory control environment may reduce the risk of material misstatement and may limit fraud it cannot prevent fraud completely (IAASB, 2013a:ISA 315R.A83). For example, policies may be directed towards hiring competent people and infuse a code of ethics, as required above, which may possibly reduce errors in the accounting process

but may not prevent management from overstating earnings (IAASB, 2013a:ISA 315R.A82). The risk of material misstatement due to fraud or error committed by management must receive special attention from the auditor when evaluating the integrity of management as poor management integrity is considered a high fraud risk factor (Johnson, Kuhn, Apostolou & Hassel, 2013:213; ARCA, 2007:26). Consequently, the auditor should determine if there are any indications that the governing body and/or management is involved in money laundering or other illegal or fraudulent activities (IAASB, 2009k:ISQC1.A19).

Fraud may take place when there is an incentive or pressure to commit fraud, there is an opportunity to commit fraud and/or rationalisation or justification to commit fraud (IAASB, 2009d:ISA 240.A1). An incentive or pressure to commit fraud may occur when, for example, the management has to meet earning targets (IAASB, 2009d:ISA 240.A1), an opportunity to commit fraud exists when, for example, the person committing the fraud is in a position to override a control while justification for fraud may include a culture of dishonesty (Van Akkeren & Buckby, 2017:396; IAASB, 2009d:ISA 240.A1). Fraud is committed with the intention to conceal the act (as per the definition of fraud in section 3.1) and thus the auditor must remain alert and continuously question whether the audit information and evidence received from management suggest that a material misstatement due to fraud or error exists (IAASB, 2009d:ISA 240.A7). However, the auditor is not expected to disregard the fact that those charged with governance and management have been honest and acted with integrity in the past (IAASB, 2009a:ISA 200.A24).

In considering the risk of fraud committed by management, the auditor should determine the targets used by management in evaluating the company's financial performance (IAASB, 2013a:ISA 315R.A44). For example, if there has been an increase in profits or rapid growth, as compared to similar companies in the same industry, and such increase in profitability is linked to performance-based remuneration, this may indicate the risk of management having manipulated the financial statements (IAASB, 2013a:ISA 315R.A48; IAASB, 2009d:ISA 240. App 1). According to Ogola, K'Aol and Linge (2016:144), performance-based remuneration is often linked to instances of fraud and thus if remuneration is based on performance, the likelihood of fraud increases. Senior audit team members must also discuss the observations made of the culture and environment of the company with the rest of the audit team as the consideration of these factors may

assists in identifying incentives or attitudes that underlie fraud (Cohen, Ding, Lesage & Stolowy, 2010:288). For example, whether the behaviour of employees and/or management encourages the rationalisation of the fraud crimes committed (Cohen et al., 2010:288). Moreover, the audit engagement team members should also consider any lifestyle changes made by key employees in an effort to determine underlying fraud (Makkawi & Schick, 2003:594). The auditor could also consider the results of the planning ratios calculated, such as liquidity, leverage, and risk because such ratios may provide insight into the risk of material misstatement associated with the financial stability of the company (Callaghan et al., 2007:60). If the financial environment of a company is unstable then it may breed the motivation for potential unethical conduct such as earnings management (Callaghan et al., 2007:60). This is echoed in ISA 240 (IAASB, 2009d:ISA 240.A11), which states that the audit team should hold a discussion on circumstances where they believe that the financial statements may be susceptible to fraud, including considering circumstances that indicate earnings management or circumstances that may have occurred and that may have placed management under pressure to commit fraud.

The attitude of management towards the auditor is also an important indicator to the auditor in relation to the identification and assessment of the risk of material misstatement due to fraud or error (IAASB, 2009d:ISA 240.App 1). Hence, the auditor must observe management's attitude when differences in opinion arise with the auditor during the audit. Management may display a negative attitude towards the auditor by being hostile and uncooperative when findings are raised on accounting, auditing or reporting matters (IAASB, 2009d:ISA 240.App 1; Kerr & Diaz, 2009:8). Management may also be unreasonable about the time available to complete the audit or the issuing of the audit report, or management may restrict the auditor's access to information or personnel or be disrespectful to the auditor (IAASB, 2009d:ISA 240.App 1; Kerr & Diaz, 2009:8). According to Sneathen Jr et al. (2003:17), a higher assessment of management integrity based on the relationship between management and the auditor should result in a lower number of audit differences discovered

In addition, the auditor must identify and obtain an understanding of the reputation of the owners, management and those charged with governance and also determine the nature of the client's operations and business practices (IAASB, 2009k:ISQC1.A19). The auditor should also consider whether there are any indications of a possible limitation of scope

(IAASB, 2009c:ISA 220.A8; IAASB, 2009k:ISQC1.26(c), .A19) when assessing leadership integrity. The reasons for not reappointing the previous audit firm (if applicable) should also be considered (IAASB, 2009k:ISCQ1.A19). In order to obtain an understanding of these aspects, the auditor could typically perform background checks on the members of the governing body and management to determine whether they are ethical people (Kueppers & Sullivan, 2010:289; IAASB, 2009k:ISQC1.A20). An auditor could also make inquiries of the client's bankers, legal counsel and industry peers about the client's reputation (IAASB, 2009k:ISQC1.A20). Inquiries to the previous auditor could also be carried out to determine if any reasons exist for not accepting the client (IAASB, 2009e:ISA 300.13(b); IAASB, 2009k:ISQC1.A20). In addition, unless prohibited by law or regulation, the auditor may request to review the previous auditor's working papers (IAASB, 2009e:ISA 300.A22). The auditor should consider whether the reason for the change in auditors provided by the previous auditor is consistent with that provided by management – contradictory reasons may raise doubts about management's integrity (Decker et al., 2016:101). Furthermore, the auditor could enquire from the previous auditor whether he/she had discussions with the audit committee relating to fraud, illegal acts and the internal control of the company (Decker et al., 2016:101).

To conclude, ethical leadership constitutes the central aspect of a company's 'tone at the top'. Ethical leadership will drive the governing body and management's commitment to the implementation and success of the other aspects of 'tone at the top'. When evaluating the ethical leadership the auditor should consider the reputation and background of the governing body and management. Furthermore, such an evaluation should include management's competence in respect of doing the job required (qualifications, skills and experience) and whether the governing body and/or management are associated with any fraudulent activities. The auditor should also determine whether the company's structure supports the employment of people who possess the knowledge and ability required to do the job. The auditor must pay specific attention to the financial structure of the company (internal controls and operations) as this has an impact on the audited financial statements of the company. For example, fraud may occur due to either the overriding of controls or ineffective control. In addition, the auditor must evaluate management's attitude towards the auditor and those charged with governance, including the audit committee and internal audit function as well as management's attitude towards the existing accounting policies and practices. Finally, if the company is a new client of

the audit firm, the auditor should consider the reasons why the previous auditors were not re-appointed.

3.4.3 Maintaining healthy relations with stakeholders

Related parties provide an indication of the attitude and character of both the governing body members and management and thus it is essential that the auditor of a company obtain an understanding of whom the related parties of a company are and what their relation with the company is in order to determine if such relationships could influence the financial statements of the company (IAASB, 2013a:ISA 315R.A31).

The auditor should typically make inquiries of management about the operations of the company (IAASB, 2013a:ISA 315R.A6). Thus, an auditor may inquire of management as to whom the company stakeholders are, including their related parties (IAASB, 2009k:ISCQ1.A19). The study conducted by Kohlberg and Mayhew (2017:924) found that 'tone at the top' related party transactions increase the possibility of a fraud risk attached to such transactions and are more than likely to increase the assessed risk of material misstatement due to fraud or error. An auditor should, therefore, identify both the 'tone at the top' related party transactions as a "red flag" item (Kohlberg & Mayhew, 2017:924) and transactions outside the normal course of business as giving rise to a significant risk (IAASB, 2009j:ISA 550.18). As part of the assessment of the risk of material misstatement, the auditor should request from management a list of related parties, the nature of the relationships between the company and the related parties and whether the company had entered into the transaction with a related party during the period under audit (IAASB, 2009j:ISA 550.13).

The auditor should also make inquiries of those charged with governance, including the audit committee, and the internal audit function (if any) to obtain information about the company's stakeholders (IAASB, 2013a:ISA 315R.A6) and related parties (IAASB, 2009j:ISA 550.A50). The internal audit function and the audit committee are internal stakeholders of the company and, if the auditor perceives that a company is under the oversight of a competent and well-informed internal audit function and audit committee, this may increase his/her trust in the financial reporting of the company (ARCA, 2007:37). Once the external stakeholders have been identified, the auditor should consider the reputation of these stakeholders. For example, are the stakeholders involved in any illegal

dealings or are there negative media reports about an identified stakeholder (Callaghan et al., 2007:60)?

The responsibilities of those charged with governance, including the audit committee, are generally defined in terms of legislation and codes of governance (IAASB, 2013a:ISA 315R.App1). In South Africa, the responsibilities of the audit committee is legislated by the Companies Act (RSA, 2008:s94) which mandates the independence of the audit committee and that the audit committee of a company is responsible for the nomination of the auditor for appointment by shareholders (RSA, 2008:s94(7)). The audit committee is also responsible for agreeing to the audit fee of the auditor, overseeing the financial reporting process of the company and ensuring that the auditor is independent of the company (IoDSA, 2016:principle 8; RSA, 2008:s94(7)). Consequently, both the auditor and the audit committee share an important relationship and open dialogue between the auditor and the audit committee is encouraged as effective communication builds trust between them (ARCA, 2007:37). Effective communication between those charged with governance, including the audit committee, and the auditor will ensure that the auditor and audit committee develop a constructive working relationship (IAASB, 2016a:ISA 260.4). By implication, the auditor and audit committee should understand the different responsibilities of the auditor and management so that there are no misunderstandings regarding either party's responsibilities. In addition, effective communication will assist the auditor in obtaining the information necessary for the audit and also assist those charged with governance, including the audit committee, to fulfil their responsibility in overseeing the financial reporting process (IAASB, 2016a:ISA 260.4).

Those charged with governance, which includes the audit committee, significantly influence the company's control consciousness (IAASB, 2013a:ISA 315R.App 1.2(c)) and are responsible for oversight over the process of reviewing both the company's internal control as well as the design and effectiveness of the company's whistleblowing procedures (IAASB, 2013a:ISA 315R.App 1.2(c)). It is thus important that an auditor should evaluate the independence from management of those charged with governance, their experience and stature, the extent of their involvement in the company, the information they receive and their scrutiny of the company's activities (IAASB, 2013a:ISA 315R.A78(c)). The auditor should also consider the degree to which those charged with governance raise difficult questions with management and interact with both the internal audit function and the auditors (IAASB, 2013a:ISA 315R.A78(c)).

The auditor should evaluate the participation and independence of those charged with governance, including the audit committee, during the auditor's dealings with them. In addition, the auditor should determine the experience of those charged with governance, including the audit committee, and determine whether they are able to take action against management should management violate their fiduciary duties (IAASB, 2013a:ISA 315R.A81, Kalbers, 1992). This is necessary because it is one of the functions of those charged with governance, including the audit committee, to arbitrate on disagreements between the auditor and management (Sharma et al., 2008:108).

The auditor should meet with the internal audit function and the audit committee at least once a year without management being present (IAASB, 2016a:ISA 260R.A7; IoDSA, 2016:principle 8, practice 58; Kalbers, 1992:23). During the meetings with those charged with governance, including the audit committee, the auditor should make inquiries of them about their knowledge of any actual or suspected fraud affecting the entity (IAASB, 2009d:ISA 240.21) and how the audit committee oversees management's processes for identifying and responding to fraud (IAASB, 2009d:ISA 240.20). The auditor should consider management's willingness to allow the auditor to interact privately with the audit committee as this will also provide the auditor with an understanding of management's attitude (IAASB, 2009d:ISA 240.App 3).

The internal audit function of the company evaluates and monitors the effectiveness and efficiency of a company's internal control system, among other activities (Institute of Internal Auditors of South Africa, 2016). The internal audit function performs tests of the controls and other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of the internal control (IAASB, 2013b:ISA 610R.A1). For example, the internal audit function will evaluate whether all transactions are approved and supported by documentation (Arel & Beaudoin, 2012:353). The auditor should also obtain an understanding of the internal audit function because the internal audit function's role in the company and the information the internal audit function may provide may contribute to the auditor's identification and assessment of the risk of material misstatement due to fraud or error (IAASB, 2013a:ISA 315R.A113).

The auditor may make inquiries of individual internal auditors to obtain an understanding of the control environment as they have insight into the company's environment due to

the nature of their work (IAASB, 2013a:ISA 315R.A9). This would include evaluating whether management responds to the recommendations of the internal audit function in relation to deficiencies in internal control (IAASB, 2013a:ISA 315R.A80). The auditor would also inquire of the internal audit function its view on the risk of fraud in the company and whether it has any knowledge of actual or suspected fraud (IAASB, 2009d:ISA 240.19). The auditor should inspect the internal auditor's reports as they may provide an insight into any actual or suspected fraud (IAASB, 2009d:ISA 240.19) by management or otherwise. Fraud is considered a significant risk (IAASB, 2009d:ISA 240.27) which requires special audit consideration (IAASB, 2013a:ISA 315R.4(e)) and, if the auditor determines, from the internal auditor's report, that fraud may have taken place then the auditor will be restricted to limited use of the internal auditor's procedures (IAASB, 2013b:ISA 610R.A21). The auditor will then have to perform more work him/herself rather than gaining assistance from the internal auditor (IAASB, 2013b:ISA 610R.A20).

The auditor would make inquiries of and inspect the reports of the internal audit function only if the auditor determines that he/she may rely on the work of the internal audit function. The auditor will rely on the work performed by the internal audit function of a company if the auditor determines that the organisational status, policies, and procedures of the company ensure that the internal audit function remains objective (IAASB, 2013b:ISA 610R.A6). The auditor must also evaluate whether the internal audit function is competent in the performance of its duties (IAASB, 2013b:ISA 610R.A6).

The objectivity of the internal audit function refers to its ability to complete tasks without "bias, conflict of interest and undue influence of others to override professional judgement" (IAASB, 2013b:ISA 610R.A7). The organisational status and policy of the company ensures that the internal audit function is objective when the internal audit function reports directly to those charged with governance (IAASB, 2013b:ISA 610R.A7; Hermanson, Smith & Stephens, 2012:A31). The scope and objectives of the internal audit function may be set out in the internal audit charter (terms of reference) (IAASB, 2013a:ISA 315R.A114) and, thus, the auditor should consider inspecting the internal audit charter. If the internal audit function reports directly to the audit committee the work of the internal audit function could be considered valuable and of a higher quality than may otherwise have been the case (Arel & Beaudoin, 2012:357). An independent audit committee would safeguard the internal audit function's objectivity specifically in cases

where the internal audit's findings are in conflict with the board's expectations (Wang, 2015:4).

Competence on the part of the internal audit function means that the internal audit function possesses the knowledge and level of skill required to perform its duties (IAASB, 2013b:ISA 610R.A8). This entails evaluating whether the internal audit function has, at its disposal, sufficient resources to conduct its activities, whether it possesses technical training and proficiency in auditing (e.g. belongs to a professional body), whether it possesses knowledge of the financial reporting framework of the company, and whether the internal auditors' professional body obliges the internal auditors to comply with the professional body's standards (IAASB, 2013b:ISA 610R.A8). The auditor should also consider whether the internal auditors are obliged to comply with ongoing professional developments (IAASB, 2013b:ISA 610R.A8).

Interaction between the internal audit function and the auditors is encouraged because their combined efforts may assist the audit committee to better understand the company's business and internal controls and enable the audit committee to become more attuned to the risk of management overriding controls or fraudulent financial reporting (Hermanson et al., 2012:A49). Furthermore, an audit committee would be more supportive of an auditor if the audit committee is better informed by the internal audit function on issues relating to the company's whistleblowing programme and when the financial reporting process is in line with the values discussed in the company's code of ethics (Hermanson et al., 2012:A31, A49)

In short, maintaining healthy relationships with both internal and external stakeholders is important for a company's success. The auditor should consider whom the relevant stakeholders of the company are, including its related parties. The auditor should evaluate the governing body and management's relationship and transactions with such stakeholders. For example, the auditor must determine whether the underlying transactions between these parties are fair and have been declared by the governing body and management.

Those charged with governance, including the audit committee, and the internal audit function are important sources of information for the auditor. The auditor must consider how effective those charged with governance are in assisting the auditor in delivering a

quality audit. For example, the auditor must gauge whether the audit committee is able to arbitrate on disagreements between management and the auditor and if the audit committee is independent of management. The auditor should also determine if he/she may rely on the work of the internal audit function. Reliance on the internal audit function's work will increase the efficiency of the audit and also provide the auditor with information on the internal controls and fraud assessments conducted. The internal audit function and the auditor should meet with the audit committee yearly without management being present.

3.4.4 Compliance with laws and regulations

The auditor must obtain an understanding of the laws and regulations applicable to a company when identifying and assessing the risk of material misstatement due to fraud or error (IAASB, 2016b:ISA 250.A3; IAASB, 2013a:ISA 315R.A27). ISA 250 provides specific audit procedures that the auditor should perform to determine the laws and regulations applicable to the company, whether management has adhered to such laws and regulations and the steps taken when non-adherence is identified (IAASB, 2013a:ISA 315R.A28). In order to obtain such an understanding, the auditor should inquire of management and those charged with governance whether the company has complied with the relevant laws and regulations (IAASB, 2016b:ISA 250.15(a)). The auditor should also inspect correspondence received by the company from licensing and regulatory authorities to identify any possible non-compliance (IAASB, 2016b:ISA 250.15(b))

Other inquiries that the auditor may make of management include inquiring about the company's policy and the procedures followed for identifying non-compliance with laws and regulations, and for identifying, evaluating and accounting for litigation claims (IAASB, 2016b:ISA 250.A12). The auditor should also consider directing inquiries at the company's in-house legal counsel to determine the possibility of litigation and claims made against or by the company, whether legal counsel has knowledge of fraud or suspected fraud and whether warranty arrangements are in place (IAASB, 2013a:ISA 315R.A7).

3.5 CONCLUSION

The introduction to the chapter highlighted the fact that stakeholders of companies are losing trust and confidence in the auditing profession because of the high number of fraud and corruption cases leading to company failures. Furthermore, the IRBA's inspection findings indicate that auditors are not documenting their assessments of management's integrity in their audit files sufficiently. The stakeholders' loss of confidence in auditors due to company collapses, coupled with the IRBA's findings, suggest that auditors may have difficulty in assessing the 'tone at the top' of a company. Thus, the chapter focused on the responsibility of auditors in respect of assessing a company's 'tone at the top'. The auditors' responsibility in assessing a company's 'tone at the top' were described in terms of legislation, professional regulations, academic literature and the ISAs. In order to provide context to auditors' assessment of a company's 'tone at the top' the chapter also outlined the nature of auditing and the audit process.

In terms of the ISAs, the auditor's objective is to provide reasonable assurance that the financial statements of the company, as a whole, are free from material misstatement, whether due to fraud or error, while the auditor must express an independent opinion as to whether the financial statements of the company are prepared, in all material respects, in accordance with an applicable financial reporting framework. The audit opinion expressed provides reasonable assurance and not absolute assurance due to the inherent limitations of the audit.

The Companies Act and the APA regulate the auditing profession in South Africa. The APA established the IRBA that is responsible for the oversight of the profession, setting standards, training, and providing a code for the ethical behaviour for auditors. The IRBA is also responsible for inspecting the audit files of listed companies to determine that the audits were conducted in terms of the ISAs and related explanatory material.

The audit process discussed consists of four phases and demonstrated how the auditor arrives at his/her opinion in terms of the ISAs. Initially, during the pre-engagement phase, an auditor determines whether a company should be accepted as a client or whether an existing client relationship should be continued. Prior to accepting a client or continuing with an existing client relationship an auditor must assess the integrity of the client.

The discussion on the planning phase recognised that the auditor must assess 'tone at the top' as part of his/her understanding and evaluation of the control environment of a company during his/her assessment of the risk of material misstatement, due to fraud or error. The information obtained by the auditor in evaluating his/her business risk during the pre-engagement phase may also be used in the identification and assessment of the risk of material misstatement, due to fraud or error, when planning the audit.

During the pre-engagement phase, the auditor consider his/her firm's policies and procedures for client acceptance and continuance as required by ISQC1 and ISA 220. This includes considering the client's ethical standards or reputation in the market. During the planning phase of the audit, the auditor should obtain an understanding of the entity, including its internal controls. There are five components of internal control. The control environment component was deemed to be relevant to this study because the control environment constitutes the foundation for all the other components of internal control and influences the control consciousness of the company. The control environment consists of seven elements in relation to which the auditor must obtain an understanding and evaluate in order to identify and assess the risk of material misstatement, due to fraud or error. These seven elements include communication and enforcement of integrity and ethical values, commitment to competence, participation by those charged with governance, management's philosophy and operating style, organisational structure, assignment of authority and responsibility and human resource policies and practices.

The seven elements of the control environment mentioned were aligned to three of the four aspects identified as aspects of a company's 'tone at the top' in chapter 2, namely, implementing and promoting an ethical culture, ethical leadership and maintaining healthy relations with stakeholder. An understanding and evaluation of the fourth aspect of 'tone at the top', namely, compliance with laws and regulations, is not an element of the control environment although it is relevant when the auditor obtains an understanding and evaluates the industry and environment in which the company operates.

In obtaining an understanding of and evaluating the first aspect of a company's 'tone at the top', namely, implementing and promoting an ethical culture, the auditor should ascertain whether the company has a code of ethics in place. The auditor should also consider whether the code of ethics is communicated to all the employees and enforced in the event of a breach of such code of ethics. In addition, the auditor should consider

whether the governing body and management live up to the values prescribed in the code of ethics. When obtaining an understanding of and evaluating ethical leadership, the auditor must determine if the governing body and/or management are involved in any fraudulent activities, whether management is receptive to the auditor in its dealings with the auditor and if management is competent to perform its duties. It is important that the governing body and management maintain healthy relations with their stakeholders. Consequently, the auditor should identify the stakeholders of the company, including its related parties. Those charged with governance, including the audit committee, and the internal audit function of the company may play a significant role in the audit of the financial statements of the company if they are independent, competent and objective. The auditor should thus determine if he/she may rely on the work of the internal audit function. The auditor should also consider whether the audit committee is effective in carrying out its mandate, as per the Company's Act (RSA, 2008) and the King IV Report (IoDSA, 2016)). The auditor must determine from the audit committee and internal audit function whether they are aware of any actual or suspected fraud in the company, including fraud conducted by the governing body and/or management. In addition, the auditor should meet with the audit committee and internal audit function on an annual basis without management being present. The last aspect of a company's 'tone at the top', i.e. compliance with laws and regulations, is evaluated by the auditor by considering the laws and regulations applicable to the company and whether such laws and regulations have been complied with and, if not, the implications thereof.

The auditor would obtain an understanding of and evaluate the company's 'tone at the top' as part of the assessment of the risk of material misstatement through inquiries of individuals, observations of processes, performance of analytical procedures and/or obtaining external confirmations. This chapter also highlighted that the audit engagement partner should assess a company's 'tone at the top' because of the level of professional judgement and increased professional skepticism required.

Chapter 4 discusses the research methodology that the researcher followed to understand how auditors assess a company's 'tone at the top'.

CHAPTER 4

RESEARCH METHODOLOGY

4.1 INTRODUCTION

Chapter 3 represented an extension of the study's literature review and described the auditors' responsibility to assess a company's 'tone at the top'. This discussion was guided by legislation, regulations, academic literature and the ISAs.

This chapter discusses the research methodology followed by the researcher to achieve the research objective, namely, to understand how auditors assess a company's 'tone at the top'. The chapter first discusses the research paradigm used, the research approach and the research design. The research method (data collection and data analysis) used are then outlined and the methodological norms for ensuring the trustworthiness of this study are then discussed. Finally, the ethical considerations surrounding the study are explored.

4.2 RESEARCH PARADIGM

A paradigm is defined as "a set of basic belief systems based on ontological, epistemological and methodological assumptions" (Guba & Lincoln, 1994:107). In line with the research objective of the study, the constructivism paradigm was deemed to be the most appropriate to understand how auditors assess a company's 'tone at the top'. The constructivist assumptions underpin how the researcher seeks an understanding of the world in which the researcher works and lives (Creswell, 2013:23; Guba & Lincoln, 1994:109). The ontological, epistemological and methodological assumptions underpinning this study are discussed next.

Ontology refers to the form and nature of reality (Guba & Lincoln, 1994:108). In a constructivism paradigm, reality is multiple as seen by participants in the study and constructed through their lived experiences and interactions with others (Creswell, 2013:36; Guba & Lincoln, 1994:111). In this study, the researcher acted as a constructivist in order to obtain an understanding of how auditors assess a company's

‘tone at the top’. The researcher’s understanding was determined from the multiple experiences of a number of research participants, namely, the experiences of the audit partners and senior inspectors selected to participate in the study.

Epistemology refers to the nature of the relationship between the researcher and the phenomenon(a) being researched (Guba & Lincoln, 1994:108). In terms of a constructivism paradigm, the researcher interacts with that which is being researched while the evidence from the participants is subjective (Creswell, 2013:36; Guba & Lincoln, 1994:108). The epistemology or researcher’s relationship with the participants is subjective as the researcher is not detached from the study as reality is shaped by the lived experiences of both the researcher and the participants (Guba & Lincoln, 1994:108). This implies that the researcher and participants’ experiences will always come to fore since their experiences influence whom they are and what the world is about (Lincoln, Lynham & Guba, 2011:104). The researcher’s subjectivity was evidenced by the researcher having conducted a detailed literature review in order to describe what a company’s ‘tone at the top’ entails and the procedures an auditor should perform to assess a company’s ‘tone at the top’. The researcher interviewed purposively selected participants and asked questions that empirically tested the attributes identified in the literature review, with the researcher inquiring of the participants how auditors assess the ‘tone at the top’ of a company. Consequently, the research participants’ feedback was subjective in that they shared their individual knowledge and experiences. The participants were free both to express their own opinions on the research phenomenon and to add any other information that they considered important (Creswell, 2013:25).

Methodology refers to the researcher finding out what may be known (Guba & Lincoln, 1994:108). The researcher uses inductive logic to understand a phenomenon within the context of a constructivism paradigm (Creswell, 2013:36). The participants were interviewed with the aim of the researcher gaining an understanding of how auditors assess a company’s ‘tone at the top’. The researcher then interpreted the feedback provided by the participants. However, it was not possible to generalise the findings, as the participants were selected based on defined criteria and not through random selection.

4.3 RESEARCH APPROACH AND DESIGN

It was felt that the research problem under investigation would be best addressed using a qualitative research approach. The qualitative research approach was deemed to be the most appropriate because the research objective involved addressing the meaning that individuals or groups assign to a social or human problem (Creswell, 2013:44). The study aimed to explore the meaning that the research participants assigned to how auditors assess a company's 'tone at the top'. The research objective was explored in an attempt to gain a detailed understanding of the research problem (Creswell, 2013:65).

A research design refers to the plan devised for conducting a study (Creswell, 2013:49). In other words, it is the path which is followed to advance from the research objective to the conclusions reached (Yin, 2009:26). There are five central research designs that may be followed in a qualitative study, namely, narrative, grounded theory, ethnography, phenomenology and case study (Creswell, 2013:124). Case study research is relevant when 'how' or 'why' questions are asked about an existing phenomenon within a real-life context (Yin, 2009:2). Consistent with the constructivism paradigm, a multiple case study research design was deemed the most appropriate for the purposes of this study as the researcher intended to obtain an in-depth understanding of an existing phenomenon, namely, how auditors assess a company's 'tone at the top' (how question) from relevant participants (real-life context).

4.4 RESEARCH METHOD

This section describes the research method used in the study i.e. the logical process that the researcher followed to achieve the research objective of the study (Kothari, 2004:8), also known as the research work plan or blueprint of the study (Yin, 2009:27). The selection of the cases and participants, the data collection and the data analysis are discussed in this section.

4.4.1 Selection of cases and participants

This study used multiple cases to gather the requisite data from the participants. Non-probability, purposive sampling was used to select the cases and the participants who would be the most useful in understanding the research phenomenon (auditors'

assessment of a company's 'tone at the top') under study (Babbie, 2010:193). Multi-stage sampling was used to select, firstly, the cases and, secondly, the participants in each case.

Selection of cases

The ACFE has indicated that corruption is more prevalent in larger companies (ACFE, 2018:4), such as JSE listed companies, than in smaller companies. Accordingly, audit firms appointed as the auditors of JSE listed companies were selected as cases for the purposes of this study. The audit firms and not individual auditors of the JSE listed companies were selected as cases because audit partners who are part of the same audit firm would follow the firm's procedures and policies in their risk assessment decisions. The list of the Top 40 JSE companies was obtained on 19 February 2017 (FTSE Group, 2017) and the JSE accredited audit firms appointed as the auditors of these companies determined. There was a total of six JSE accredited audit firms.

The IRBA is the statutory body responsible for the regulation of the auditing profession in South Africa as stipulated in the APA (RSA, 2005). The IRBA inspection's department is required to, at least every three years, inspect or review the practice of a registered auditor who audits a public company (IRBA, 2017a). Therefore, the IRBA was also selected as a case study.

There is no rule for the number of cases that must be included in case study research while the selection of cases is based on theoretical aspects and not on statistical sampling methods (Eriksson & Kovalainen, 2008:122). The cases selected for the purposes of this study comprised six JSE-accredited audit firms and the IRBA.

Access to both the audit firms and the IRBA depended on their willingness to be part of the research as well as the researcher's ability to visit the agreed upon location in order to collect the required data (Rowley, 2012:264). The researcher gained access to the selected cases by considering relationships and friendships with individuals within the organisations and requesting assistance from them to obtain access permission (Myers, 2009:79; Eriksson & Kovalainen, 2008:52). When arranging access the researcher presented the selected audit firms and the IRBA with a brief profile of herself, an explanation of the objective of the study, the length of time required, an assurance of the

confidentiality of information received, the benefits of the research and her contact details as well as those of her supervisors (Rowley, 2012:264). The researcher explained that participation in the study would be both voluntary and anonymous.

Selection of participants

In view of the fact that the audit partner is responsible for 'tone at the top' assessments (IFAC, 2010:26) the researcher selected an audit partner from each of the six JSE accredited audit firms chosen who is responsible for the audit of a JSE listed company and, who at the time of the study, had been with the audit firm for at least five years. The IRBA senior inspectors who were responsible for the inspection of the audit files of JSE accredited audit firms during the most recent audit quality control cycle were selected as it was felt that they would be acquainted with how auditors perform 'tone at the top' assessments.

The participants in the study (audit partners and senior inspectors) may be said to have been informants for the study as the researcher was interested in understanding how auditors assess a company's 'tone at the top' and in generating knowledge on the research phenomenon and not the cases themselves (Eriksson & Kovalainen, 2008:124).

4.4.2 Data collection

Consistent with a case study research design, this study made use of interviews and field notes as data collection methods.

Interviews: An audit partner representing each of the audit firms selected and the team of senior inspectors from IRBA were all interviewed. In the research context an interview is a face-face conversation between the researcher and the participant to enable the researcher to gain an understanding of the topic under investigation (Rowley, 2012:260). Thus, an interview is a conversation with a purpose (Kvale, 2006:483). Interviews were considered a useful data collection method for the purposes of this study for the following reasons:

- the objective of the study required an understanding of the participants' experiences, opinions or processes and

- the participants would be more receptive to a discussion than providing audit firm related documents for the researcher's perusal.

The semi-structured interview method was considered to be the most effective data collection method for the study because, although the questions are asked in a set order, there is room for flexibility in that sub-questions may be used by the researcher to explore the main questions if necessary (Rowley, 2012:262; Kvale, 2006:487). The interviews lasted approximately 60 minutes with the semi-structured interviews being conducted face-to-face between the researcher and the participant. The researcher also developed an interview guide that consisted of open-ended questions. A few sub-questions were also included to prompt the participant if his/her answer to the main question was not sufficiently detailed (Rowley, 2012:263). The researcher prompted the participant in an effort to critically question the participant's understanding of the research topic and not to 'impose' her thoughts (Kvale, 2006:487). The literature review, which had been conducted, formed the theoretical framework for the interview questions with interviews taking the form of an inductive inquiry (Rowley, 2012:263). In line with Yin's (2009:92) recommendation, the researcher conducted a pilot interview to test the interview questions. Pilot testing represents a checking of the interview questions by a friend or colleague to ensure that the questions make sense and are relevant to the research topic (Rowley, 2012:265). The pilot study was conducted with an audit partner of an international audit firm which was not one of the audit firms selected. The audit partner was asked the same questions as the selected participants would be asked. Once the pilot interview was completed, the researcher amended the interview guide where necessary. The interviews took place at a location convenient to the participants.

Field notes: It was felt that the use of field notes made about the interviews would also be appropriate (Eisenhardt, 1989:539). Field notes comprise a commentary of observations made by the researcher during the interviews and notes of impressions and ideas as they occurred before the formal data analysis (Voss, Tsikriktsis & Frohlich, 2002:209; Eisenhardt, 1989:539). Field notes are useful as they may be elaborated upon as soon as possible after the interview to enable the researcher to make use of the opportunity to recall the information received and identify any gaps that may be followed up upon at a later stage. The field notes also allow for 'push-thinking' i.e. asking questions about what the researcher learnt from the interview or the extent to which the interview differed from or was similar to the previous interview (Eisenhardt, 1989:539).

Data triangulation also proved feasible for the study. The use of two data collection methods (interviews and field notes) and various data sources (interviews with more than one group of participants – an audit partner representing each of the six JSE accredited audit firms selected and the team of senior inspectors from the IRBA) allowed the researcher to obtain a broader range of data than may otherwise have been the case in order to understand how auditors assess a company's 'tone at the top' (Krefting, 1991:219). Such triangulation results in the research being more convincing and accurate (Yin, 2009:116) as well as more reliable (Voss et al., 2002:206).

4.4.3 Data analysis

The data, which had been collected, was analysed inductively. Accordingly, the following data analysis process was performed: the researcher organised the data set, became acquainted with the data collected, classified, coded and interpreted the data and then presented the findings (Rowley, 2012:267).

Organising the data set – The data set for this study comprised the seven transcribed interviews conducted as well as field notes that had been compiled by the researcher. The interviews conducted were digitally-recorded after the participants had given their consent for such recordings to be made. The researcher considered it necessary to record the interviews so as to be able to refer back to the recordings for the purposes of accuracy (Yin, 2013:109). In addition, the researcher was able to concentrate on asking questions and listening attentively as opposed to trying to jot down all the information being provided by the participant (Meyer, 2001:339).

The field notes and transcripts were labelled as Field note 1, Field note 2, etc and Interview 1, Interview 2, etc respectively to ensure the anonymity of the participating audit firms while the participants were referred to as D1, D2, etc in order to adhere to the stipulations in the confidentiality agreement.

Becoming acquainted with the data collected – It is imperative that the researcher ensure that he/she has familiarised him/herself with the data collected by reading and rereading the data to immersed him/herself in the data and attain 'a sense of the whole' (Hsieh & Shannon, 2005:1279). This also allows the researcher the opportunity to determine the

key themes for the study. In relation to semi-structured interviews, the interview questions may act as a guide for these themes (Rowley, 2012:268).

The researcher read and reread both the interview transcripts and the field notes, from beginning to end, to obtain an understanding and a sense of the data as a whole. Concepts or thoughts from the texts that captured the researcher's attention were highlighted and/or underlined. The researcher then made notes in the left-hand margin of the transcripts and field notes of any first impressions or ideas.

Classifying and coding the data and interpreting the data – The data that had been collected was coded, the codes were then categorised and emergent themes identified in line with the coding process recommended by Saldaña (2013:13).

In order to reduce a large volume of data, researchers make use of coding which involves grouping the data into categories of information (Saldaña, 2013:3). Data that describes similar ideas or information and which is found in the various interviews transcripts and field notes or in different places in the transcript of the same interview is grouped together and assigned a code label (Rowley, 2012:269, Hsieh & Shannon, 2005:1279). Codes may represent information that the researcher expected to find, unexpected/surprising information and other interesting observations (Creswell, 2013:186). The code label assigned may be theory generated (derived from the literature review) or an in vivo code (names from the words used by the participant(s)) (Marshall & Rossman, 2016:218).

The study followed an inductive approach to the data analysis by analysing the text (sentence or paragraph) and then summarising the analysed text by assigning it a code (Myers, 2011:110). As recommended by Saldaña (2013:26) the data was first coded manually. The codes were written manually in the right-hand margin of the hardcopies of the field notes and transcripts. The researcher used open coding for the first three to four interview transcripts and related field notes after which she decided on preliminary codes. The preliminary codes were then used to code the remaining transcripts and field notes and the original codes were recoded. The researcher added new codes if the existing codes did not fit the data.

Once the data had been manually coded, the researcher numbered the soft copies of the interview transcripts and field notes sequentially (Fieldnote1 to Fieldnote7 and Interview1 to Interview7) in MS Word (Saldaña, 2013:27). The files were then formatted to Rich-text format (a requirement of ATLAS.ti™) and imported into ATLAS.ti™. ATLAS.ti™ is a computer-assisted qualitative data analysis software. This software is a tool that assists the researcher in organising the text, marking the text, searching for text and coding the text, as well as grouping the text into categories and themes (Yin, 2009:128). Using the functionalities of ATLAS.ti™, the text data was coded for a second time with codes being refined or changed where necessary.

Once all the interview transcripts and field notes had been coded, the codes were sorted into categories (referred to as families in ATLAS.ti™). The categories were based on the way in which the codes linked or related to each other (Hsieh & Shannon, 2005:1279). The data which had been collected was also coded and categorised by an independent second coder. The independent coder did not read the literature review before the coding. An intercoder agreement was entered into between the researcher and the independent coder (Campbell, Quincy, Osserman & Pedersen, 2013:297). In terms of this agreement, the independent coder and the researcher discussed the codes and categories that emerged and reached consensus on any discrepancies that may have arisen in the same text of data (Campbell et al., 2013:297). Thereafter, relationships between the different categories were explored to identify common themes among the categories. Overall, the analysis of the data in this study was in line with Yin's (2009:160) recommendation that the data analysis should show that the researcher has engaged with all the evidence collected, dealt with any contradictions, and addressed the main objective of the study and also that the researcher has used knowledge obtained prior to the analysis (Yin, 2009:160).

Presenting and writing up the data – Presenting and writing up a case study involves "bringing the results and findings to a closure" (Yin, 2009:164). Findings are generally presented under the headings of the themes identified. It is important to ensure that the findings address the research objective (Rowley, 2012:269). The following five themes were identified in the study, namely, assessing a company's ethical leadership, assessing a company's ethical culture, assessing the governance role of a company's audit committee, assessing a company's compliance with laws and regulations and quality

control in 'tone at the top' assessments. The findings of this study are presented thematically in chapter 5.

4.5 METHODOLOGICAL NORMS

It is vital that the qualitative research which has been conducted proves to be trustworthy. According to Lincoln and Guba, (1985:290), the main reason for evaluating the trustworthiness of research is to justify the researcher’s findings and persuade his/her audience that his/her findings are worth paying attention to. Trustworthiness should be established during the data collection, data analysis and reporting phases of the study (Elo, Kääriäinen, Kanste, Polkki, Utriainen & Kyngäs, 2014:2). The criteria for evaluating the trustworthiness of research include credibility, dependability, confirmability, transferability (Lincoln & Guba, 1985:301-319) and authenticity (Lincoln & Guba, 1986:76). These criteria of trustworthiness, as applied in this study, are discussed below.

Credibility: Credibility refers to the plausibility or believability of the research findings (Marshall & Rossman, 2016:261; Anney, 2014:276). Credibility in this study was achieved through peer-debriefing, triangulation of data (refer to section 4.4.2), reflexivity and referential adequacy.

Peer-debriefing: During the course of the study, the researcher held discussions with her two supervisors. These discussions were held throughout the research process to ensure that the researcher received constant feedback from her supervisors (Anney, 2014:276). The insight provided by the supervisors helped to ensure that the study was coherent and that the findings were clearly presented. In addition, the supervisors made general comments during the study and also challenged the researcher on the data gathering methods, data analysis, and study findings (Anney, 2014:276; Creswell & Miller, 2000:129). In addition, the researcher also held discussions with a qualitative research expert to gain advice on and insight into the study, for example, in relation to the appropriateness of the data collection method, and the selection of cases and participants.

Reflexivity: Reflexivity refers to the way in which the researcher’s background, experience and prior knowledge may influenced the data collection and data analysis processes because the researcher is part of the research and not separate from it (Krefting,

1991:218). The field notes were used as a tool for eliminating the researcher's bias from the research findings (Krefting, 1991:218). The field notes kept during the study detailed the date and location of each interview (audit trail) and contained reflections of thoughts, questions and ideas that may have influenced the research process.

Referential adequacy*:* Referential adequacy means that the researcher made use of resources such as digital recordings during the data collection (Lincoln & Guba, 1985:313). This allows the researcher to confirm the findings and interpretations against the raw data (Lincoln & Guba, 1985:313). The digitally-recorded conversations allowed the researcher to recall interviews in order to ensure data accuracy and confirm the accuracy of the data interpretation.

Dependability and confirmability: Dependability and confirmability are closely related. Dependability refers to the way in which the data remains stable over time and under changing circumstances (Lincoln & Guba, 1985:300). The dependability of a study is deemed to be high if another researcher may readily follow the steps taken by the initial researcher in conducting the study (Elo et al., 2014:7). Confirmability, on the other hand, refers to the objectivity of the research (Lincoln & Guba, 1985:300) and represents the degree to which the study's findings accurately present the data provided by the participants (Anney: 2014:279; Elo et al., 2014:5). In other words, the data gathered and the findings extracted from the data are derived from the participants and are not a figment of the researcher's imagination (Anney: 2014:279, Elo et al., 2014:5). Dependability and confirmability in the context of this study were established through an audit trail, pilot testing, a coding-recoding strategy, (Krefting, 1991:221) reflexivity (discussed above) and triangulation (discussed in section 4.4.2).

Audit trail*:* The audit trail in this study consisted of field notes, interview recordings and interview transcripts. The audit trail sets out "visible evidence" from the research process to assure the research audience that the researcher did not just find what he set out to explore from the study (Anney, 2014:279) and that the questions asked, data gathered and conclusions drawn were all linked and supported each other (Yin, 2009:98; Voss et al., 2002:209). The researcher enlisted the services of a professional transcriber to transcribe the digital interview recordings to ensure their accuracy and completeness.

Pilot testing: The reliability of interviews is strengthened by conducting a pilot test of the interview questions (Yin, 2013:92). Thus, pilot testing may be seen as a checking of the interview questions by a friend or colleague to ensure that the questions make sense and are relevant to the research topic (Rowley, 2012:265). A pilot test is conducted in order to refine the interviews questions and address any gaps encountered (Yin, 2013:92). For the purposes of this study a pilot interview was conducted with an audit partner of an international firm that had not been included in the sample selected. The audit partner was asked the same questions as the selected participants would be asked. Once the pilot interview was completed, the researcher amended the interview guide where necessary and refined her interviewing skills.

Coding-recoding strategy: The data was coded and categorised by the researcher and also by an independent second coder to ensure that there was consistency between the codes and categories identified (Krefting, 1991:221). In addition, the participants' actual words were quoted in the discussion of the findings to support the interpretation of the data (Elo et al., 2014:7; Williams & Morrow, 2009:578).

Transferability: Transferability refers to the degree that the research may be transferred to other settings/contexts (Anney, 2014:277; Lincoln & Guba, 1985:300). Transferability in this study was achieved through thick descriptions (Anney, 2014:277). Thick descriptions are detailed descriptions of the research process, including a description of the target population, the sampling technique selected and the criteria that were used for selecting the participants for the study (Elo et al., 2014:4).

Transferability is achieved by comparing the evidence from the findings to relevant literature to determine whether the findings are linked to or confirmed by prior theory (Riege, 2003:81). A list of references detailing the literature consulted has been included at the end of this dissertation.

Authenticity: Authenticity refers to the extent to which the researcher shows a range of realities (Lincoln & Guba, 1986:76). It also proves that the researcher did not fabricate the conclusions or findings (Anney, 2014:279). The authenticity of the research was, thus, assured through triangulation, reflexivity and sound interviewing techniques (Anney, 2014:279). The researcher had enlisted the aid of a colleague (who was experienced in conducting interviews) to coach the researcher on interviewing techniques.

4.6 ETHICAL CONSIDERATIONS

In the research context it is vital that ethical implications are considered to ensure that the participants in a study are not harmed in any way. There are three ethical principles that must be reflected upon during any research study, namely, respect for persons, beneficence and justice (Marshall & Rossman, 2016:51). These principles are in line with the international guidelines for research ethics, specifically the Belmont Report (National Commission for the Protection of Human Subjects of Biomedical and Behavioral Research, 1978).

Respect for persons – This principle entails the protection of the participant's right to privacy and anonymity and the right to participate of his/her own free will (Marshall & Rossman, 2016:52). The right to privacy includes autonomy (UNISA, 2016:16; National Commission for the Protection of Human Subjects of Biomedical and Behavioural Research, 1978:4) which, implies that the participants must not be coerced into participating in a research study by being promised gifts or money in return for their contribution to the study (Marshall & Rossman, 2016:51). The researcher obtained permission from the audit firms selected and from the IRBA to conduct the study and access the research participants (UNISA, 2016:15). However, this permission obtained was not a substitute for the participants' willingness to participate in the study (Eriksson & Kovalainen, 2008:70). The selected participants were informed of the objective of the study, they were provided with background information to the study and they were given the opportunity to ask any questions they may wish to ask (Appendix A). The research participants were also informed that they had the right to refuse to participate in the study or to withdraw from the study at any point without explanation (Eriksson & Kovalainen, 2008:70). The participants' consent was obtained in writing before the interviews took place (Annexure B). The researcher also notified the participants that the interviews would be digitally-recorded and obtained the participants' consent for such digital-recording to take place.

The researcher assured the participants that the information obtained from and about them would be kept anonymous and confidential (Eriksson & Kovalainen, 2008:74). The names of the organisations and/or participants were replaced with a pseudonym so that they were not identifiable. Furthermore, the transcriber and the independent coder who had been enlisted to assist the researcher were required to sign confidentiality

agreements prior to their being entrusted with the data that had been collected (i.e. digitally recorded interviews, transcripts and field notes). All the data obtained was kept locked and was accessible only by the researcher.

Beneficence – This principle entails that the research conducted will provide benefit to society and, at the same time, any risks involved are also analysed (UNISA, 2016:11; National Commission for the Protection of Human Subjects of Biomedical and Behavioral Research, 1978:7). In addition, the research must not cause undue harm to the participants involved (Eriksson & Kovalainen, 2008:72) also referred to as non-maleficence (UNISA, 2016:11). The researcher informed the participants of the study of the potential benefits of the study. The participants were also informed that the research may be made available in the public domain but that their identities would be kept confidential and remain anonymous.

As part of adhering to the principle of beneficence, the researcher had attended research methodology and other courses to ensure that she was well-equipped and qualified to conduct the research (UNISA, 2016:11). Of equal importance was the in-depth literature review undertaken by the researcher to provide the researcher with knowledge of the phenomenon under study (UNISA, 2016:11). In order to protect participants further, the research was conducted only after permission had been obtained from the Research Ethics Review Committee of the College of Accounting Sciences at UNISA.

Justice – This principle means "the benefits and risks of research should be fairly distributed among people" (UNISA, 2016:11; National Commission for the Protection of Human Subjects of Biomedical and Behavioral Research, 1978:4). The principle requires that the researcher be fair, objective, transparent, accountable and non-exploitive at all times during the research process (UNISA, 2016:12-13). In addition, the researcher should note the limitations of the study as well as the limitations of his/her skill (UNISA, 2016:12; Babbie, 2010:71). The researcher must also ensure that the information collected is used for the purpose intended. This study ensured that the principle of justice was upheld by informing the study participants about the research objective of the study as well as the potential benefits and risks involved. Furthermore, the researcher was both transparent and accountable in providing a detailed description of the process followed during the data collection and data analysis. The researcher was also fair in selecting the

participants for the study and the limitations of the study were disclosed (refer to section 6.5).

4.7 CONCLUSION

This chapter described the research methodology used in the study. The researcher adopted a qualitative research approach to understand how auditors assess a company's 'tone at the top'. The study fell within the ambit of the constructivism paradigm and a multiple case study research design was applied. The cases were selected using purposive sampling and included JSE-accredited audit firms and the IRBA. The participants were selected based on defined criteria, namely, an audit partner from each of the selected JSE-accredited audit firms who was responsible for the audit of a JSE listed company and who had been with the audit firm for at least five years prior to the study. In the case of the IRBA, the team of senior inspectors involved in the most recent inspections cycle was selected. Semi-structured interviews and field notes were used as data collection methods. Once an interview had been completed, a professional transcriber transcribed the interview to ensure the accuracy and completeness of the information. The data were coded and categorised by the researcher and then again by an independent second coder to enhance the reliability of the researcher's codes and categories. Thereafter relationships between the different categories were explored to identify common themes among the categories.

This chapter also discussed the methodological norms which were applied to ensure the trustworthiness of the research, namely, credibility, dependability, confirmability, transferability and authenticity. The ethical principles, namely, respect for persons, beneficence and justice, as applied in this study, were also discussed. Chapter 5, which follows, presents an analysis and discussion of the empirical findings obtained from the interviews conducted and the field notes recorded.

CHAPTER 5

PRESENTATION AND DISCUSSION OF EMPIRICAL FINDINGS

5.1 INTRODUCTION

Chapter 2 and 3 presented the theoretical framework underpinning the study. Chapter 2 described 'tone at the top' while chapter 3 discussed the auditor's responsibility in respect of assessing a company's 'tone at the top'. Chapter 4 discussed the research methodology used in the study.

This chapter discusses the data analysis and reporting style used in presenting and discussing the empirical findings. Thereafter the chapter thematically presents the empirical findings of the study based on an analysis of the semi-structured interviews conducted and the field notes recorded. Before concluding the chapter, the main study findings are summarised.

5.2 DATA ANALYSIS AND REPORTING STYLE

This section discusses how the data was analysed by the researcher. It also explains, the reporting style of the researcher for ease of reference and understanding.

5.2.1 Data analysis

As explained in chapter 4 (section 4.4.1), the study used multiple cases namely, JSE-accredited audit firms and the IRBA. The participants from the organisations (cases) selected, namely, the audit partners and the team of senior inspectors were informants to the study. The participants enabled the researcher to generate knowledge about how auditors assess a company's 'tone at the top'. However, this goes beyond the case itself. Thus, the participants produced evidence from alternative perspectives so that the researcher could reach an understanding of lived 'tone at the top' assessments.

All participants were of the opinion that the study would be important for the auditing profession and, consequently, they were willing to participate in the study. The interviews

were conducted at the participants' place of business (audit firm or IRBA) during office hours. All the participants were welcoming, punctual and provided a relaxed atmosphere for the interviews. In addition, the participants were professional in their behaviour as the interviews were not interrupted and the researcher was given the participants' undivided attention and time.

Once the 277 minutes of interviews had been completed, an independent transcriber transcribed the interviews. Data consisting of 119 pages of interview transcripts and 13 pages of field notes were inductively coded, using open coding. The researcher had initially coded the data manually on the right-hand margin of the hardcopies of the interview transcripts and field notes. Thereafter, the interview transcripts and field notes were imported into ATLAS.ti™ and recoded using the codes derived during the manual coding of the interviews and the codes were refined or changed where necessary. Once all the transcripts and field notes had been coded, the codes were grouped into categories. In order to confirm the reliability and dependability of the coding, an independent, second coder was used to recode the data. Once consensus between the researcher and the second coder had been reached on the codes and categories, the researcher explored the relationships between the various categories identified and recognised themes among the categories. The researcher noted that recurring categories were starting to emerge and was thus satisfied that data saturation had been reached and no further interviews were necessary. Refer to figure 5.1 below for a schematic representation of the data analysis process.

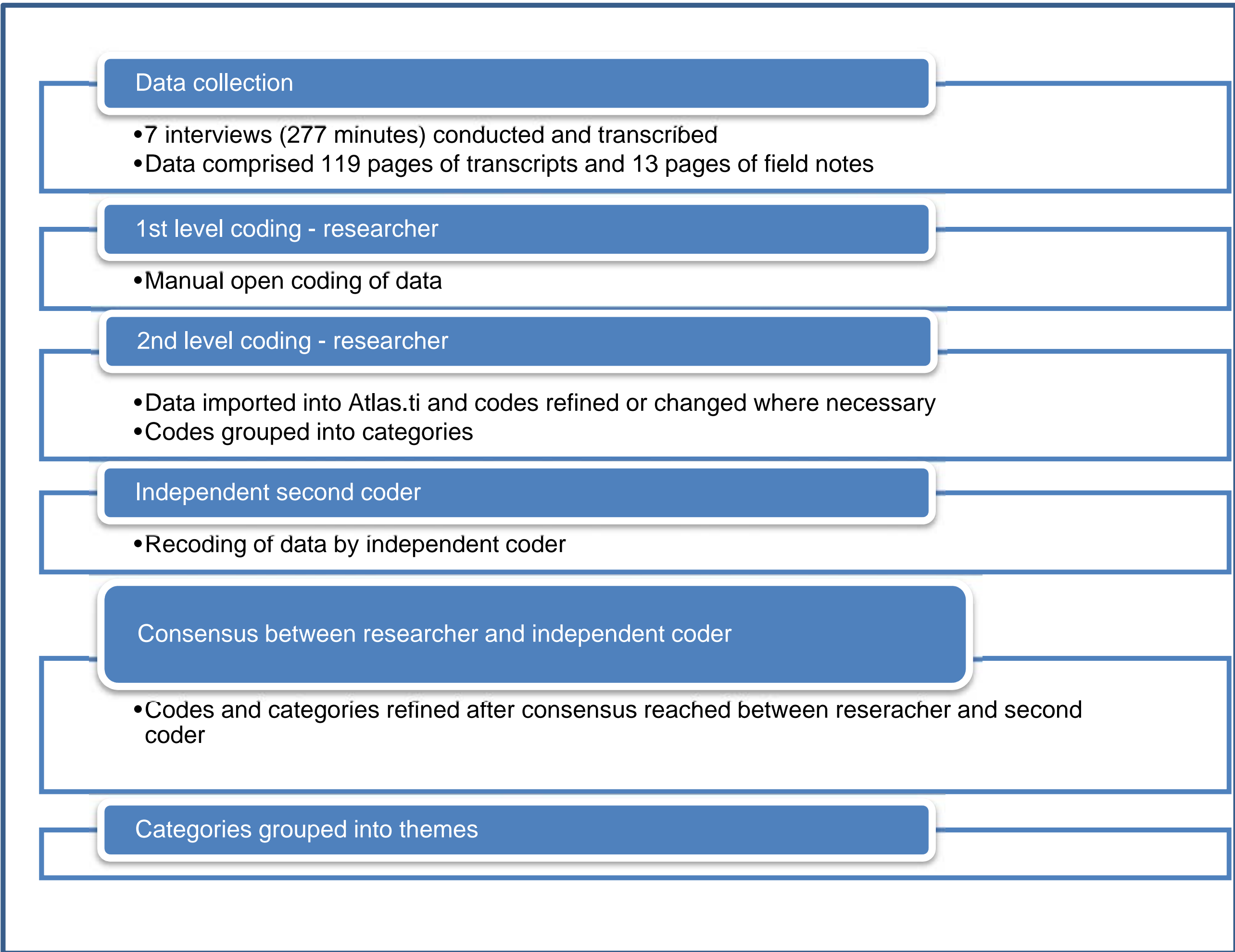

FIGURE 5.1 Schematic representation of data analysis process

Source: Own compilation

The researcher had to wear two hats during the interviews, namely, that of an interviewer and, to a certain extent, that of a co-participant. After reflecting on the interviews with a qualitative research expert, the researcher and the qualitative research expert concluded that wearing two hats during the interviews was necessary because the researcher had to guide the participants in view of the fact that a company's 'tone at the top' assessments are subjective. The role played by the researcher as interviewer and, at times, co-participant also confirmed the importance of the study as it provides an indication that there are differences in the manner in which auditors assess a company's 'tone at the top'.

5.2.2 Reporting style of researcher

Table 5.1 below presents the participant groups and the references used when referring to the empirical findings of the study. ATLAS.ti™ automatically created the references when the transcripts were imported into the software. As such, document 8 to document 14 are the transcripts of the interviews with participants one to seven per ATLAS.ti™. For example, D8:29 refers to document eight, quote 29 in the transcript of the interview conducted with participant one.

TABLE 5.1 Participant references used

Participant groups	References used
Audit partners (hereafter referred to as AP participants)	D8, D9, D11 – D14
Senior inspectors (hereafter referred to as SI participants)	D10

Source: Own compilation

The verbatim quotes presented in the study are indented and indicated with inverted commas. If the researcher paraphrased and used shorter verbatim quotes, these shorter verbatim quotes are non-italicised and in inverted commas. The researcher included 'he/she' or 'him/her' to conceal the gender of the participant. If the participant's name was mentioned, the researcher replaced the name with 'I' or another appropriate referral to protect the anonymity of the participant. If the researcher included additional word(s) or letter(s) within the verbatim quotes, the word(s) or letter(s) were displayed in brackets. The researcher did this so to enhance the understanding of what the participant had said or to correct a language error made by the participant. As indicated in table 5.1, the findings were reported from two broad perspectives, namely, audit partners and senior inspectors, to further protect the anonymity of the participants.

5.3 PRESENTATION AND DISCUSSION OF EMPIRICAL FINDINGS

As stated, the empirical findings of the study were derived from both the interview transcripts and the field notes. In this section the findings are reported in accordance with the themes that emerged from the data analysis. The themes include assessing a company's ethical leadership, assessing a company's ethical culture, assessing the

governance role of a company's audit committee, assessing a company's compliance with laws and regulations and quality control in 'tone at the top' assessments.

5.3.1 Assessing a company's ethical leadership

The following statements from the participants provided evidence of the importance of ethical leadership as an aspect of 'tone at the top':

> "… your board of directors … I would see the 'tone at the top' at the very top level …" (D8:43).

> "management('s) sort of approach and their view of how they display integrity, their belief in ethics" (D12:1).

> "So, what I say, if the leaders are corrupt, chances are the whole organisation will be corrupt" (D10:60).

The views expressed by Van Vuuren (2016:22), who posits that ethical leadership is central to achieving a positive 'tone at the top', support the views of the AP participants quoted above.

The categories that emerged from the analysis of the data and that related to the theme: auditors' assessment of a company's ethical leadership, are indicated in table 5.2.

TABLE 5.2 Categories relating to the theme: auditors' assessment of a company's ethical leadership

Theme	Categories
Assessing a company's ethical leadership	• Assessing the background of the members of the governing body and management • Assessing the integrity of the members of the governing body and management

Source: Own compilation

5.3.1.1 *Assessing the background of the members of the governing body and management*

According to the majority of the participants, assessing the background of the members of the governing body and management of a company is important because the auditor has to rely on them to provide accurate and true information on the company (D8:21; D9:62; D10:6; D13:3). Sharma et al. (2008:107) confirm that an ethical governing body and management would enhance the auditor's reliability on the financial statements.

As part of assessing a company's ethical leadership, an AP participant mentioned that he/she would obtain information on "Who is on the board of directors? Who is top management who may not be a director?" (D8:11). This AP participant's understanding was in line with ISQC1 (IAASB, 2009k:ISQC1.A19) that mandates an auditor to identify the client's owners, management and those charged with governance as part of his/her understanding and evaluation of the company's integrity. In evaluating the integrity of the company, the AP participants perform background checks on the members of the governing body and management (D8:10; D9:12; D10:15; D11:12; D13:19; D14:14). Kueppers and Sullivan (2010:289) support the participants' use of background checks as an audit procedure and posit that background checks assist with identifying whether management is ethical.

The background checks on the members of the governing body and management will include both third party confirmations from lawyers and bankers of the company (D14:4) and also consultation with internal and externally available databases (D11:12). This could also involve the audit firm's forensic department conducting checks within the confines of the law (D8:10). These procedures are consistent with ISQC1 (IAASB, 2009k:ISQC1.A20) that outlines possible sources to consult when performing background checks. However, an AP participant mentioned that conducting background checks is not always without challenges. For example, auditors may obtain information from the South African Companies and Intellectual Property Commission (CIPC) but the CIPC is not always up to date with directorship information (D11:23). Thus, the auditor faces the risk of obtaining incomplete information regarding the directorships of board members.

When performing background checks, the participants will obtain an understanding of the members of the governing body and management's experience (D10:44; D11:2)

because, if any of the directors served on the board of a company that is perceived as unethical, “it is possible that that director is bringing that conduct to the client company” (D10:44; D11:2). In addition, the auditors will also be able to evaluate the competence of the governing body and management (D10:32). The King IV Report confirms that the members of the governing body should be competent (IoDSA, 2016:principle 1, practice 1(b)). The members’ past experience and competence may be evaluated by inspecting their qualifications and experience as indicated in their curriculum vitae as well as assessing the responsibilities involved in their positions at previous companies (D10:32). Decker et al. (2016:101) are of the view that a curriculum vitae will demonstrate whether management possesses the knowledge and skill required to perform the duties assigned to them.

While performing background checks on the members of the governing body and management, the AP participants also consider their independence (D8:9; D12:15). The independence or non-independence of the members of the governing body and management provide an indication of “what pressures they are under” (D8:9). The independence of the members of the governing body is recommended in the King IV Report (IoDSA, 2016:principle 7). Related to independence, an AP participant will identify, from the background checks, whether any of the directors or other significant personnel at the company is a “PEP (politically exposed person)” (D14:14). This finding is in accordance with the Financial Intelligence Centre (2018) which states that “accountable institutions, such as audit firms, (must) address the issue of PEPs in their risk framework” and that PEPs must be regarded as high-risk clients.

Some of the AP participants also indicated that the background checks would assist in determining whether the members of the board did, in fact, qualify to act as directors or whether they were in contravention of section 69 of the Companies Act (RSA, 2008) (D8:10; D9:11; D13:19). The appointment of people who do not qualify to act as directors amounts to the non-compliance with laws and regulations which auditors must report on in terms of ISA 250 (IAASB, 2016b:ISA 250.11(a)) (refer to section 5.3.4 for the discussion of compliance with laws and regulations). An AP participant added that a review of publicly available articles that relate to the affairs of the company also forms part of the background checks on the members of the governing body and management (D9:15).

5.3.1.2 Assessing the integrity of the members of the governing body and management

According to some of the AP participants, the best indication of the members of the governing body and management's "moral compass" (D9:7) is "how they conduct themselves" (D9:9; D11:27; D14:7) and "whether they're living it (ethical values)" (D8:31). Some of the AP participants stated that the behaviour of the members of the governing body and management provided an indication as to whether they lived according to the values stated in the code of ethics of the company (D9:10; D11:15; D13:6). This view of the AP participants is supported by Bello (2012:229) who asserts that neither a code of ethics nor ethics training should be seen as a representation of the company's values unless the company's leaders practise what they preach. The King IV Report also indicates that the integrity of the governing body is an integral component of ethical leadership (IoDSA, 2016:principle 1, practice 1(a)). Furthermore, Sneathen Jr et al. (2003:17) posit that a higher assessment of management's integrity will decrease the risk of material misstatement while Johnson et al. (2013:213) state that poor management integrity is the biggest fraud risk factor.

When assessing management's integrity, the AP participants would consider management's attitude and behaviour towards the auditor (D8:96, D11:8, D12:13; D14:19). Some of the AP participants also indicated that they would evaluate their own relationship with management (D8:96; D11:8). ISA 240 (IAASB, 2009d:ISA 240:App 3) supports the AP participants' views and further indicates that a problematic or unusual relationship with management may indicate the possibility of the financial statements containing material misstatements resulting from fraud. The AP participants evaluated their relationship with management by considering the manner in which management accepts the auditor's management letter outlining errors and control weaknesses (D8:96; D12:13; D14:19). In other words, whether management actually listens to and takes notes of the findings of the auditor and is keen to fix the errors encountered or whether they are offended and defensive from the outset (D8:96; D12:13; D14:19). Another AP participant indicated that he/she would evaluate the way in which management agreed to the audit fees (D14:13). According to ISQC1 (IAASB, 2009k:ISQC1.A19), management's attitude to aggressively keeping the audit fee as low as possible is a reflection of the integrity of management.

A few of the AP participants indicated that their relationships with management were characterised by both positive and negative aspects (D8:96; D14:34). At the same time an AP participant opined that a management who agreed with the auditor on everything should not be taken lightly (D11:30), especially if what the auditor hears from management differs from what the auditor has observed (D13:14). One AP participant saw a "love/hate relationship" between management and the auditor as healthy (D11:30). Despite the fact that an auditor would prefer a good relationship with his/her clients, ISA 240 (IAASB, 2009d:ISA 240:A8) cautions the auditor to maintain an attitude of professional skepticism during an audit (refer to section 5.3.5.3 for a discussion on professional skepticism).

The participants further indicated that they would consider the governing body and management's relationship with the employees when assessing management's integrity (D8:9; D9:39; D10:57; D11:11; D12:10; D13:24; D14:16). In determining whether the governing body and management live in accordance with the values of the company, some of the AP participants indicated that they would inquire of the employees how ethical they perceived the members of the governing body and management to be (D9:10; D11:15; D13:6). The SI participants agreed that the employee's relationship with the governing body and management is an indication of management's integrity and proposed that auditors consider whether the company employees view the members of the governing body and management as living by example or walking the talk (D10:12). This view is in line with ISA 315R (IAASB, 2013a:ISA 315R.A79) which states that an auditor should inquire of the client personnel whether management behaves in a manner that is consistent with the code of ethics. Payne and Raiborn (2018:479) reiterate the importance of the position of both the governing body and management on ethics as the tone set by the governing body and management has a trickle-down effect to the employees of the company.

When assessing the governing body and management's integrity, the SI participants stated that an auditor must also "consider management's attitude towards (the) control environment" (D13:1). One of the AP participants agreed with the SI participants (D9:6). Another AP participant further stated:

> "… if management is … doing everything …, that's normally the first place that the 'tone at the top' is not right" (D12:15).

> “Who can do what and do you need more than one person? … segregation of duties … would sort of play into that as well, as to who’s got what responsibility … in the organisation and where certain decisions need to be approved” (D12:8).

Understanding and evaluating whether there is sufficient segregation of duties may be indicative of management’s integrity because insufficient segregation of duties increases the “risk of management overriding controls” (D12:10) and “collusion” (D8:4). Other AP participants expressed the same view and pointed out that collusion and management overriding of controls are high-risk fraud factors in terms of ISA 240 (IAASB, 2009d:ISA 240.App 1) (D8:25; D11:41).

In assessing management’s attitude towards the control environment, a few of the AP participants indicated that they would inspect the internal audit function’s reports to understand the findings raised by the internal audit function (D9:6; D13:45). If management does not implement the recommendations included in the reports of the internal audit function or takes a long time to provide feedback on the internal audit functions’ findings, this shows that management is not committed to enhancing internal controls (D11:14; D13:14,25,45). The views of these AP participants were in line with ISA 315R (IAASB, 2013a:ISA 315R.A80) which states that an auditor may consider how management reacts to the findings of the internal audit function regarding deficiencies identified in internal control and whether management has implemented the recommendations of the internal audit function when evaluating the control environment. However, the AP participants stated that, prior to relying on the reports, findings and work of the internal audit function, they would first determine whether the company’s internal audit function was independent from management as, if this was the case, it would be possible to rely upon it (D11:45; D12:5). These views of the AP participants are supported by both ISA 315R (IAASB, 2013a:ISA 315R.A113) and Arel and Beaudoin (2012:357) who stated that the work of an internal audit function is considered to be of a higher quality and more valuable to the auditor if the internal audit function is independent from management.

Some of the participants (D9:6; D12:14; D14:17-18) indicated that they would also consider management’s attitude towards the application of policies and procedures in respect of the accounting of estimates and accruals when obtaining an understanding of

and evaluating management integrity. The AP participants would inquire of management what are the company's accounting processes and policies for the raising of estimates and accruals were (D9:6; D12:14; D14:17,18). This would be in keeping with ISA 315R (IAASB, 2013a:ISA 315R.A27). In addition, the same AP participants stated that they would determine whether the estimates and accruals were either reasonable or aggressive in nature (D9:6; D12:14; D14:17,18). Decker et al. (2016:101) are of the opinion that a review of the accounting policies of a company provides the auditor with an indication as to whether management is either aggressive in applying accounting policies or is committed to the correct interpretation of accounting standards. Furthermore, ISA 240 (IAASB, 2009d:ISA 240.App 1) supports the notion that an auditor must consider the appropriateness of the company's accounting processes and policies because management has an opportunity to manipulate the financial statements when providing for estimates as estimates are based on subjective judgements and uncertainties that may be difficult to corroborate.

As part of assessing management's integrity, the participants indicated that they would also consider related parties and related party transactions (D8:9; D9:39; D10:57; D11:11; D12:10; D13:24; D14:16). Some of the AP participants expressed the view that "related parties are the presumed higher risk areas" (D13:28) in an audit as it is difficult to determine the completeness assertion relating to related parties (D9:51; D11:22). ISA 550 (IAASB, 2009j:ISA 550.18) is in agreement that transactions with related parties outside the normal course of business must be treated as a significant risk. Kohlberg and Mayhew (2017:924) call related party transactions outside the normal course of business as 'tone at the top' related party transactions and agree that auditors should flag these transactions because there is a fraud risk attached to such transactions (Kohlberg & Mayhew, 2017:924).

The participants indicated that they would conduct a number of audit procedures to identify related party relationships and transactions. A few of the AP participants also reviewed the company group structure to identify subsidiaries, associates and joint ventures (D9:49; D10:37; D11:22; D13:29; D14:24) and mentioned that in the event of a complex group structure, it is difficult to determine the completeness of related parties (D9:49). Some of the AP participants also stated that they would inspect the register of directors' interests in contracts as well as the shareholders' register to identify related parties (D9:59; D12:11; D13:29) while other AP participants mentioned verifying related

party relationships and transactions when performing background checks on the directors (D9:49; D10:37; D11:22; D14:24). The SI participants shared that there are many auditors who go as far as selecting a sample of directors and performing an audit on the director and his/her family members in terms of shareholdings and directorships in order to identify related parties (D10:37). The related parties identified would also be screened to determine if any of them may be a *"PEP"* (D12:18). The procedures performed by the AP participants are in line with ISA 550 (IAASB, 2009j:ISA 550.A12, A17) that recommends that an auditor consider the entity's ownership and governance structures as well as disclosures in respect of related party relationships and transactions.

The AP participants highlighted that they would determine whether the company was facing the risk of insolvency (D9:16). According to the SI participants and ISA 240 (IAASB, 2009d:ISA 240.App 1), insolvency often breeds the motivation for management fraud. Callaghan et al. (2007:60) support the notion that if a company runs the risk of financial instability, the directors may be motivated to misstate the financial statements.

In addition, some of the AP participants also focus on how management is remunerated when evaluating management integrity (D8:9; D9:38-39; D13:24). Performance-based remuneration provides an incentive for management fraud (IAASB, 2013a:ISA 315R.A44, A48; IAASB, 2009d:ISA 240.App 1). Ogola et al. (2016:144) agree that the likelihood of management fraud increases if the remuneration of management is linked to performance. If management is under pressure to maintain key ratios and targets the effect thereof on 'tone at the top' assessments is the same as performance-based remuneration (D8:9; D10:37; D7:16). The participants' understanding was in line with ISA 240 (IAASB, 2009d:ISA 240.App 1) that states that performance-based remuneration and exerting pressure on management to maintain key ratios and targets serve as motivation for fraud. However, companies often link the remuneration of the members of management to the performance of the company or to key ratios and targets; for example, performance bonuses may be linked to an increase in profitability, profitability ratio or share price (Kirsten & Du Toit, 2018). Companies implement such remuneration structures in an effort to hold management accountable (Kirsten & Du Toit, 2018). Although the justification for the performance-based remuneration is warranted, it is imperative that management demonstrate it can be trusted in its reporting of the company's profitability or ratios.

According to the majority of the participants, it is imperative that the information presented by the governing body and management is corroborated (D10:6; D11:13; D12:2; D13:14). An AP participant explained the importance of corroborating information supplied by the client as follows:

> "because that's one thing about auditing, if they want to pull the wool over your eyes, management or whoever, they will do it. If there is proper collusion …, they can pull the wool over your eyes fairly easily … if your wits are not there" (D11:41).

Such corroboration of information supplied by the governing body and/or management could be done by inspecting the minutes of the board meetings and ensuring that the minutes correspond to what the governing body and/or management have stated (D8:49; D12:3). The corroboration of management supplied information may also be conducted by confirming the accuracy of such information through both inquiries of other parties such as the internal audit function, the audit committee and employees (D9:33) and the disclosures made by the company in its integrated report (D12:16). These corroboration procedures are in line with ISA 315R (IAASB, 2013a:ISA 315R.A79). Sneathen Jr et al. (2003:49) confirm that corroborated information increases the auditor's trust in management and provides the auditor with confidence that the client-supplied information is credible. It also upholds the notion that both the governing body and management are honest and transparent – two fundamental characteristics of ethical leadership in terms of the definition of an ethical leader suggested by Brown et al. (2005:120) and the King IV Report (IoDSA, 2016:principle 1).

5.3.2 Assessing a company's ethical culture

An AP participant aptly summarised the significance of an ethical culture in relation to a company's 'tone at the top' as follows:

> "But I think the culture at the end of the day tends to be a reflection of the 'tone at the top'. If the 'tone at the top' is right you tend to have a very good culture because whoever doesn't fit with the 'tone at the top' will not fit in with the culture" (D13:10).

The above sentiment of the AP participant was also shared by some of the other AP participants (D8:45; D9:57), including the SI participants (D10:4). The significance of an

ethical culture as an aspect of a company's 'tone at the top' is supported by Lail et al. (2015:26) and affirmed by the IFAC (2007:8) that describes the 'tone at the top' as the culture within which a company operates.

The categories that emerged from the analyses of the empirical data relating to the theme: auditors' assessment of a company's ethical culture, are presented in table 5.3.

TABLE 5.3 Categories relating to the theme: auditors' assessment of a company's ethical culture

Theme	Categories
Assessing a company's ethical culture	• Assessing the existence of a code of ethics • Assessing the implementation of a code of ethics • Assessing the enforcing of a code of ethics

Source: Own compilation

5.3.2.1 Assessing the existence of a code of ethics

The majority of the AP participants indicated that the starting point in assessing a company's ethical culture is to consider whether the company has a code of ethics in place (D8:6; D9:45; D11:18; D12:6; D13:8). The SI participants concurred that the auditor must establish whether a company has a code of ethics as required by the ISAs (D10:30). In order to verify the existence of a code of ethics, most of the AP participants mentioned that they would inquire of management whether the company had a code of ethics in place (D8:31; D9:45; D12:6; D13:8). The AP participants would then corroborate management's response by either requesting a copy of the code of ethics (D9:45; D13:8) or by inspecting the company's website in order to corroborate the existence of the code of ethics (D8:31; D12:6). Another AP participant mentioned that he/she would review the integrated report of the company for reference to the code of ethics (D12:6). The existence of a formal code of ethics is in line with the recommendations of the King IV Report (IoDSA, 2016:principle 2, practice 5). According to Webley and Werner (2008:404), the existence of a code of ethics demonstrates that a company takes ethics seriously. This is important because the ethical values included in the code of ethics portray the ethical behaviour of a company in conducting its business.

5.3.2.2 *Assessing the implementation of a code of ethics*

According to an AP participant, *"It's not good enough … just having a code"* (D12:6). In other words, the code of ethics must also be implemented and demonstrated in the conduct of the company (D12:6). Sauser Jr (2013:17) and Schwartz (2004:340) support this view and posit that having a code of ethics in place alone is insufficient and that the code must be implemented if it is to be effective. Other AP participants (D8:34, D9:29; D11:9, D13:18) shared the same view although they did not express it as explicitly. Their views were expressed through their discussions on how they obtained an understanding and evaluated whether the company effected the values infused in the code of ethics.

One AP participant mentioned that he/she assesses whether the values infused in the code of ethics are effected when he/she considers whether the code of ethics is aligned to the company's vision and mission statements (D8:6). This assessment is performed by reviewing the vision and mission statements of the company and assessing whether the statements incorporate the code of ethics in the goals and objectives outlined by the company (D8:6). Another AP participant mentioned that he/she would review the integrated report of the company for reference to the code of ethics and further evaluate whether the integrated report aligned to the information obtained during the audit about the company's ethical culture (D12:6).

The SI participants agreed that an auditor should evaluate whether the values infused in the code of ethics are implemented by reviewing the ethical policy of the company (D10:30) and establishing whether the code of ethics is being implemented in the company's strategic plans (D10:38). According to the SI participants, non-adherence to the values of the code of ethics when strategising the company's plans is an indication that leadership does not consider the code of ethics important, with this portraying a poor 'tone at the top' (D10:38). This view of the SI participants (D10:38) is supported by Stevens (2008:607) who states that it is vital that the code of ethics is central to the company's strategic decisions.

An AP participant revealed that he/she would inquire, when evaluating the implementation of the code of ethics, whether employees are annually reminded of the code of ethics because there are always people either joining or leaving a company (D12:6). This finding is in line with ISA 315R (IAASB, 2013a:ISA 315R.A79) which states

that an auditor should inquire of the client personnel whether they are aware of the code of ethics. Kaptein (2011:247) furthermore supports the important role of the auditor in determining whether management is communicating the code of ethics effectively to employees because the poorer the quality of communication of the code of ethics, the higher the likelihood of unethical behaviour. According to one of the AP participants, merely communicating the code of ethics is insufficient and he/she would also evaluate how effectively the board is conveying the values embodied in the code of ethics to employees (D8:34). Thus, if the code of ethics is not communicated properly and the governing body and management do not adequately convey the values embodied in the code of ethics, the employees may not be aware of the ethical values of the company or may also not perceive ethics as important.

Another AP participant mentioned that he/she would obtain an understanding of the recruitment policies and processes of a company and evaluate if the code of ethics has been incorporated into those policies and processes (D13:18). The AP participant would obtain an understanding of these policies and processes by inspecting whether the human resources division conducts background checks into potential employees (D13:18). This is in line with Sauser's (2005:353) recommendation that a company should investigate whether potential employees have a high moral standing. In addition, an AP participant indicated that he/she would review a sample of employment letters to determine if reference is made to the company's code of ethics or ethical values when employees are hired (D8:35). Alignment between the ethical values of the company and the ethical values of potential employees would promote the ethical culture of the company. Thus, if the company hires employees who are perceived to be ethical, this implies that management are committed to promoting an ethical culture and the culture of a company is a reflection of the 'tone at the top' of the company (D13:10). In relation to recruitment, some of the participants mentioned that they determined whether the company recruited employees through proper recruitment channels or hired employees because they were related to someone in the company, especially in the case of the recruitment of directors (D9:29; D10:47; D11:9; D13:12). The recruitment of employees who are related to directors provides an example of a related party relationship (refer to section 5.3.1.2).

According to one of the AP participants, the staff turnover ratio is a good indicator of the ethical culture of a company (D8:52). The AP participant stated that he/she would

determine what the staff turnover ratio was and inquire about the reasons for the turnover (D8:52). The same participant further stated that he/she would determine whether there had been any "surprise" resignations by directors and, if so, determine the reason for such resignations (D8:36). In addition to staff turnover, the SI participants indicated that it is necessary for auditors to determine whether the high or low staff turnover is specific to a division in the company, for example, the finance division (D10:45). A high turnover ratio of employees may possibly indicate problems in respect of management's competence (Hamlin, 2017) and, arguably, ethical behaviour.

The SI participants indicated that an auditor should consider if employees are trained on the code of ethics (D10:22). This finding is in keeping with ISA 315R (IAASB, 2013a:ISA 315R.App 1) which recommends that an auditor should inspect the training policies of a company to determine whether they include seminars or practices in relation to the expected ethical behaviour of employees. It must also be pointed out that ethics is subjective to people's understanding of what is morally right or wrong and the application of such understanding at the time of a dilemma (Abdullah & Valentine, 2009:93; Banerji & Krishnan, 2000:405; Lewis, 1985:383). Thus, there are a number of variables, such as culture and religion, that affect people's understanding of ethical values and, therefore, evaluation of what is morally right and wrong is subjective to the person's insight (Velasquez, 2014:8; Raga & Taylor, 2005:22). The employees' subjective understanding of ethical values illustrates how important it is for the auditor to determine whether or not employees have/are being trained on the company's code of ethics and ethical values. If the employees are not trained on the company's ethical values, they may interpret the code of ethics inconsistently and contrary to the ethical values of the company.

5.3.2.3 Assessing the enforcing of a code of ethics

The implementation of a code of ethics, as described in section 5.3.2.2, should not focus on the governing body and management "paying lip service" to a code of ethics (D8:32). All the AP participants stated that they would determine whether the code of ethics was enforced through the operation of a whistleblowing line (D8:32; D9:46; D11:19; D12:7; D13:9; D14:27). The AP participants would inquire from the employees if there is a whistleblowing line in place to report non-compliance with the code of ethics, fraud or other matters anonymously (D8:32; D9:46; D11:16; D12:7; D13:9; D14:27). Some of the AP participants further stated that such an inquiry would include whether the employees

felt comfortable reporting non-compliance without fear of being prejudiced against (D9:10; D11:11; D13:15). The use of a whistleblowing line to report ethical breeches is in line with the recommendations of the King IV Report (IoDSA, 2016:principle 2, practice 9(c)). The SI participants agreed that the auditor should determine if there is a whistleblowing process in place (D10:42). The SI participants added that some auditors also inquire if the company runs an employee engagement survey to obtain employees' views on the code of ethics and the effectiveness of the code of ethics (D10:27). These whistleblowing reports and surveys provide the auditor with an understanding of whether the staff members understand the company's ethical values and support such values (D10:25).

Furthermore, the whistleblowing process must be effective in that management must deal appropriately with the information received from the whistleblowing line (D8:32; D9:3; D11:16; D12:7; D13:13). The SI participants (D10:42) concurred with this opinion and highlighted that tolerance of violations of the company's code of ethics may be an indication of the likelihood of material misstatement due to fraud (IAASB, 2009d:ISA 240.App 3). In an effort to determine the effectiveness of the whistleblowing process, some of the AP participants revealed that they would determine whether the person dealing with the whistleblowing reports had considered the possibility of fraud or theft and whether that person had condoned the actions of the perpetrator or not (D8:32; D9:3; D12:7). For example, an AP participant shared his/her experience where companies have dismissed employees for wrongdoing even if the non-compliance with the code of ethics had a negligible impact on the company (D8:32). The effectiveness of a whistleblowing process demonstrates a company's commitment to an ethical culture. If the governing body and/or management consider any sort of unethical conduct to be unacceptable, even if insignificant, this demonstrates that the company's leadership is committed to enhancing the ethical culture in the company which in turn motivates employees to report unethical behaviour (Zhang & Liao, 2016:1230).

An AP participant added that he/she would also evaluate whether management is consistent in dealing with the issues reported through the whistleblowing line (D9:3). Leaders who treat all unethical matters in a consistent manner may be seen to be indicating that they may be regarded as fair and just (do not show favouritism) (Brown et al., 2005:119) in their dealings. Thus, the actions of the governing body and management, in handling whistleblowing issues, provide evidence of their attitude and behaviour towards maintaining an ethical culture.

Equally important to some AP participants is determining to whom the whistleblowing reports are sent. According to an AP participant, if the whistleblowing reports are correctly handled, *"it's actually a very powerful tool"* (D13:9). Some of the AP participants concurred that, ideally, either the audit committee or someone who is independent of management (D13:13) should receive and deal with the whistleblowing reports (D8:32; D9:47; D11:19). These views of the AP participants are in line with ISA 315R (IAASB, 2013a:ISA 315R.App 1.2(c)) which states that one of the responsibilities of those charged with governance, including the audit committee, is to oversee the design and implementation of an effective whistleblowing line and procedures. If the audit committee or an independent party deals with the reports received from the whistleblowing line, then the risk of the governing body and/or management concealing unethical behaviour is minimised.

An AP participant highlighted that the effectiveness of a whistleblowing process is not the only measure which is assessed to determine whether or not the code of ethics is being enforced (D13:8). The same AP participant reflected that he/she would obtain an understanding of and evaluate the internal controls and processes in place for enforcing an ethical culture, including the code of ethics (D13:8). The AP participant's assessment is in keeping with ISA 315R (IAASB, 2013a:ISA 315R.A79-A80) that states that an auditor may determine whether relevant internal controls have been implemented by the company to enforce the code of ethics, including management's response to the findings of the company's internal audit function regarding identified deficiencies in internal control (refer to section 5.3.1.2 for a detailed discussion on management's response to the findings of the internal audit function.)

5.3.3 Assessing the governance role of a company's audit committee

According to an AP participant:

> "'tone at the top' … it's also how they (the board) interact with the corporate governance side of things … what is their relationship with the audit committee? … that whole corporate governance ethos as well, contributes (to) 'tone at the top'." (D12:5).

The above AP participant's view stems from ISA 315R (IAASB, 2013a:ISA 315R.A81) that states that those charged with governance, including the audit committee, have a significant impact on the entity's control consciousness.

The categories that emerged from the analyses of the empirical data and which related to the theme of auditors' assessment of the governance role of a company's audit committee are presented in table 5.4.

TABLE 5.4 Categories relating to the theme: auditors' assessment of the governance role of a company's audit committee

Theme	Categories
Assessing the governance role of a company's audit committee	• Assessing the governance role of the audit committee • Assessing the interactions between the audit committee and the auditor

Source: Own compilation

5.3.3.1 Assessing the governance role of the audit committee

Some of the AP participants expressed the view that the audit committee is an important governance structure because the audit committee is responsible for the appointment of the auditor and for overseeing financial reporting matters (D8:42; D9:23). The AP participants' understanding of the audit committee's role was in line with the Companies Act (RSA, 2008:s94(7)) and the King IV Report (IoDSA, 2016:principle 8).

Prior to requesting information and assistance from the company's audit committee, a few of the AP participants indicated that they would determine whether the audit committee were independent of management (D8:42; D12:5) and thus could be relied upon. This finding is in line with ISA 315R (IAASB, 2013a:ISA 315R.A78(c), A81). Another AP participant (D9:23) stated that he/she would evaluate the independence of the audit committee by obtaining an understanding of the corporate governance structure of the company:

> "Do they (the audit committee) have the right level of oversight over the financial reporting process?" (D9:23).

The above AP participant's consideration of the level of the audit committee's oversight is in line with ISA 260 (IAASB, 2016a:ISA 260R.A5) which states that an auditor must consider whether those charged with governance, which includes the audit committee, have the authority to take action in relation to matters communicated by the auditor. In addition, the auditor must also establish whether those charged with governance are able to provide the auditor with the information and explanations the auditor may need to conduct the audit (IAASB, 2016a:ISA 260R.A5).

One of the AP participants stated that as part of his/her evaluation of the audit committee's governance role, he/she would evaluate whether the company's "three layers of assurance (internal auditor, audit committee and auditor) are working together" (D11:45). Hermanson et al. (2012:A31; A49) posit that an audit committee is more supportive of an auditor when the audit committee is well informed by the internal audit function on issues relating to the company's whistleblowing programme and when the financial reporting process is in line with the values discussed in the company's code of ethics.

According to one of the participants (D12:20), an auditor evaluates the audit committee's governance role and influence over the financial reporting process during his/her interactions with the audit committee. ISA 315R (IAASB, 2013a:ISA 315R.A78(c)) supports this view.

5.3.3.2 Assessing the interactions between the audit committee and the auditor

A few of the AP participants considered whether they were invited to all the audit committee meetings (D9:64; D12:19; D13:26). If "you're (auditor) not … invited to them, (audit committee meetings) that's a red flag" (D9:64). If they were not invited, the AP participants would determine the reason why they were not invited to the audit committee meetings (D9:64; D13:26). ISA 260R (IAASB, 2016a:ISA 260R.A7) indicates that inviting the auditor to attend all the audit committee meetings may be said to imply good governance.

The AP participants further stated that attending the regular audit committee meetings of the company provides them with an opportunity to engage with the audit committee in the presence of management (D12:5; D13:26). These AP participants found that attending

the meetings with management present provides a clear picture of the relationship between management and the audit committee (D12:5; D13:26). For example, such meetings provide an indication of the respect that the members of management have for the audit committee's oversight role and whether the audit committee is effective (D12:5). According to Sharma et al. (2008:108), the auditor's evaluation of the relationship between management and the audit committee is important because the relationship may indicate the effectiveness of the audit committee in discharging its responsibilities and also reveals whether the audit committee would be able to act as an arbitrator in the event of disagreements between management and the auditor. Moreover, ISA 315R (IAASB, 2013a:ISA 315R.A78(c)) states that as part of the auditor's evaluation of the control environment, an auditor must consider the appropriateness of the actions of those charged with governance (thus, including the audit committee) and whether difficult questions are raised and pursued with management.

In addition to the regular audit committee meetings that take place, all the AP participants indicated that they would want to determine whether the audit committee is willing to hold a private meeting with the auditor (D8:24; D9:60; D11:31; D12:20; D13:26; D14:20). Such a meeting between the auditor and the audit committee without management being present is in accordance with the King IV recommendations (IoDSA, 2016:principle 8, practice 58). During this private meeting with the audit committee, a number of inquiries may be made and matters discussed, such as the competence of the company's management (D12:20) and the audit committee's knowledge of actual or suspected fraud within the company (D8:25; D9:96; D13:27; D14:21). Inquiries as to the audit committee's knowledge of actual or suspected fraud within the company are in line with ISA 240 (IAASB, 2009d:ISA 240.21).

The auditor's findings would also be on the agenda at a private meeting between the audit committee and the auditor while such a meeting would provide the audit committee with an opportunity to ask questions that the audit committee may have (D12:20). ISA 260R (IAASB, 2016a:ISA 260R.16) obliges the auditor to communicate to those charged with governance, including the audit committee, significant findings arising from the audit of the company's financial statements. An AP participant specified that during the private meeting between the auditor and audit committee, he/she would consider whether there was an open relationship between him/her and the audit committee, especially regarding discussions around management (D12:20). An open relationship between the auditor and

the audit committee demonstrates that management has little or no influence over the audit committee and also that the audit committee is willing to engage in a proper audit (ARCA, 2007:37). Moreover, this open relationship signifies a positive ‘tone at the top’.

5.3.4 Assessing a company’s compliance with laws and regulations

The SI participants stated that a company’s compliance with laws and regulations is important because it is an indication of the governing body and management’s attitude and behaviour as illustrated as follow:

> “Investigating breaches … any breaches, anything legal happening, news, anything from earlier investigations, any disciplinary action against these people (members of the governing body and management) (add to) ‘tone at the top’.” (D10:35).

The importance of compliance with laws and regulations as an aspect of a company’s ‘tone at the top’ is supported by ISA 250 (IAASB, 2016b:ISA 250.A3) that indicates that non-compliance with laws and regulations may cast doubt on the integrity of, for example, the members of the governing body and management or employees.

The categories that emerged from the analyses of the empirical data and which related to the theme of auditors’ assessment of a company’s compliance with laws and regulations are presented in table 5.5.

TABLE 5.5 Categories relating to the theme: auditors’ assessment of a company’s compliance with laws and regulations

Theme	Categories
Assessing a company’s compliance with laws and regulations	• Assessing compliance with laws and regulations • Assessing compliance with fiduciary duties

Source: Own compilation

5.3.4.1 Assessing compliance with laws and regulations

The majority of the AP participants revealed that they would obtain an understanding of the laws and regulations applicable to a company and distinguish between those laws that are applicable to all companies and those that are applicable to a specific company based on the sector within which the company operates (D8:50; D9:4 D11:28; D12:22). The laws and regulations applicable to all companies include, for example, the VAT Act, Income Tax Act and Companies Act (D8:50; D9:4; D11:28; D12:22). Other laws and regulations, which are based on the sector in which a company operates, are, for example, the Minerals Act (D11:28). The AP participants' understanding was in line with ISA 250 that states that an auditor has, firstly, a responsibility to consider those laws and regulations that generally have a direct effect on the financial statements (IAASB, 2016b:ISA 250.6(a)). Secondly, the auditor has a responsibility to consider those laws and regulations that do not have a direct effect on the financial statements although compliance with such laws and regulations is fundamental for the business because non-compliance with such laws and regulations may have a material impact on the financial statements (IAASB, 2016b:ISA 250.6(b)).

The AP participants indicated that they identify the laws and regulations applicable to a specific company through requesting from management a list of laws and regulations applicable to the company (D8:50; D9:4; D11:28; D12:22). This list of laws and regulations are then corroborated with inquiries from the company's legal team (D11:28; D12:22; D14:28). These procedures are in accordance with the recommendations of the ISAs that an auditor may obtain an understanding of relevant laws and regulations through inquiries from the management and other personnel (IAASB, 2016b:ISA 250.A11) as well as the in-house legal counsel of the company (IAASB, 2013a:ISA 315R.A7).

In addition to identifying the laws and regulations applicable to the company, the AP participants stated that they also evaluate whether the company has complied with the laws and regulations identified (D11:28; D14:28). The participants' procedures to determine non-compliance with laws and regulations were in accordance with ISA 250 (IAASB, 2016b:ISA 250.11(a)).

Compliance with laws and regulations was evaluated by some AP participants through inquiring of the company's legal team whether the team had any knowledge of any pending litigation and claims, including the financial and non-financial impact of such claims on the company (D11:28; D14:28). Another AP participant indicated that he/she would contact the IRBA to request information as to whether any reportable irregularities had been raised about the company by its previous auditors (D9:21:11). Other AP participants stated that they would inquire of the relevant regulators of the company about any pending investigations and the outcome of completed investigations (if any) (D5:48; D9:21). In support of these findings, ISA 315R recommends that an auditor should consider communications obtained from regulatory agencies when evaluating the company's compliance with laws and regulations (IAASB, 2013a:ISA 315R.App 1.13). The SI participants stated that during their audit file inspections, they also considered whether the auditors had any correspondence with the JSE in relation to non-compliance risks facing the company (D10:25).

In addition, the SI participants stated that auditors should consider the company's policies in respect of compliance with laws and regulations, including who is responsible for the implementation and monitoring of such policies and also how these policies are implemented and monitored (D10:11). The SI participants' recommendation is in keeping with ISA 250 (IAASB, 2016b:ISA 250.A11) that states an auditor may inquire of management the entity's policies and procedures regarding compliance with laws and regulations.

When evaluating 'tone at the top', the SI participants (D10:29; D10:63) also stated that inquiries should be made of the directors to evaluate whether the company has a social and ethics committee in place in compliance with section 72(4) of the Companies Act (RSA, 2008) and recommended practice 68 of the King IV Report (IoDSA, 2016). The SI participants also indicated that auditors should determine what the role of the social and ethics committee is and who chairs the social and ethics committee (D10:29, D10:63). It may be argued that if the social and ethics committee is responsible for the oversight of and reporting on the company's organisational ethics, as recommended by the King IV Report (IoDSA, 2016:29), this signifies not only compliance with laws and regulations but also the company's commitment to an ethical culture.

5.3.4.2 Assessing compliance with fiduciary duties

In addition to assessing the company's compliance with laws and regulations, an AP participant stated that he/she would consider whether the directors had discharged their fiduciary duties in good faith as a breach of fiduciary duties may be said to indicate that a positive 'tone at the top' is lacking (D14:37). Directors have a duty to discharge their fiduciary duties in good faith in line with section 76(2) and section 76(3) of the Companies Act (RSA, 2008). However, the same AP participant expressed concern that "there must be more consequences for (those) managers, chief financial officers, directors (who breach their fiduciary duties) … but that doesn't seem to be the case" (D14:37). Another AP participant shared a similar sentiment (D13:38) by stating that at the time of the study, it appeared that directors resigned from their positions but were not taken to court for not having discharging their fiduciary duties because the public viewed the process as expensive and lengthy (D13:38). Thus, the AP participant suggested a regulatory body to regulate directors, similar to the IRBA which regulates auditors, so that directors will be held accountable (D13:38). Such a regulatory body for directors should require all directors to adhere to the same code of ethics. Currently, in South Africa there is a governing body for the Chartered Director (South Africa) (CD(SA)) designation that registers directors on a voluntary basis (IoDSA, 2018). However, since registration by company directors is not mandatory, there remains the likelihood that directors will not be held accountable for their actions. Thus, this finding identifies a need for future research to determine the viability of a regulator for company directors in South Africa.

5.3.5 Quality control in 'tone at the top' assessments

Audit quality encompasses "the key elements that create an environment which maximises the likelihood that quality audits are performed on a consistent basis" (IAASB, 2014:4). An engagement team achieves a quality audit when the team members demonstrate appropriate values, ethics and attitudes; are sufficiently knowledgeable, skilled, and experienced and had sufficient time allocated to perform the required audit work (IAASB, 2014:4). In addition, the engagement team must have applied a rigorous response to the assessed risk and quality control procedures that complied with laws, regulations and applicable standards; provided useful and timely reports; and interacted appropriately with relevant stakeholders (IAASB, 2014:4).

The categories that emerged from the analysis of the empirical data and which related to the theme of quality control in 'tone at the top' assessments are presented in table 5.6.

TABLE 5.6 Categories relating to the theme: quality control in 'tone at the top' assessments

Theme	Categories
Quality control in 'tone at the top' assessments	• Responsibility of the audit engagement partner • Professional judgement • Professional scepticism • Continuous professional development • Timing of 'tone at the top' assessments

Source: Own compilation

5.3.5.1 Responsibility of the audit engagement partner

As was evident in the following statement by one of the AP participants during an audit, and when assessing a company's 'tone at the top', audit engagement partners are assisted by audit teams:

> "we (audit engagement partners) unfortunately can't audit every single thing as a partner or manager ourselves … and, if a trainee documents something that looks okay and is substantiated, you, as partner, would not necessarily question …" (D11:40).

The other AP participants concurred with this assertion (D8:37; D9:53; D12:26; D13:35; D14:32) but added that they, as audit engagement partners, would conduct inquiries themselves with the audit committee chairperson, head of the internal audit function and key board members (D8:21; D11:35; D12:25; D13:35). However, the audit manager and senior trainees are usually invited to join these meetings in order to take minutes and to allow for skills transfer and on the job training (D11:35; D12:26). Despite being assisted by an audit team, the AP participants agreed that the audit engagement partner is, ultimately, responsible for the sign off on the decisions made by the audit team members on 'tone at the top' assessments (D9:53; D11:35; D12:26; D13:35). As succinctly expressed by an AP participant: "ultimately, the buck stops with me" (D8:38). The requirement for sign off on 'tone at the top' assessments by the audit engagement partner is in line with the IFAC's recommendation (IFAC, 2010:26). The academic literature also

calls for audit engagement partner sign off on risk assessment decisions related to 'tone at the top' because the audit engagement partner is deemed to possess the required level of experience and knowledge of the company being audited (Carpenter & Reimers, 2013:66, Kueppers & Sullivan, 2010:291, Cohen et al., 2002:589; Abdolmohammadi, 1999:60). The ISAs require the audit engagement partner to take responsibility that the audit has been conducted with the required quality (IAASB, 2009c:ISA 220.8) including taking responsibility for the direction, supervision and performance of the audit engagement (IAASB, 2009c:ISA 220.15).

Despite the acknowledgement by the AP participants that they are responsible for the sign off on the 'tone at the top' assessments, the SI participants expressed concern about the fact that there appears to be minimal to no evidence in the audit files of audit engagement partner involvement in 'tone at the top' assessments (D10:53). The SI participants indicated that insufficient evidence of audit engagement partner involvement in 'tone at the top' assessment decisions presents a challenge in relation to determining the audit engagement partner's involvement in assessing management integrity ('tone at the top') (D10:48). This finding, therefore, indicates a need for the International Auditing and Assurance Standards Board (IAASB) to indicate in the auditing standards those areas that require mandatory audit engagement partner sign off to ensure that the audit engagement partner has, in fact, been involved in the 'tone at the top' assessment decisions.

5.3.5.2 Professional judgement

The participants highlighted that 'tone at the top' assessment decisions are subjective in nature (D8:53; D9:54; D10:28; D11:39; D12:57; D13:34; D14:13). They all emphasised that 'tone at the top' assessments and decisions are based on the individual audit engagement partner's professional judgement and that each audit engagement partner would base his/her assessments and decisions on his/her knowledge, experience, understanding and training (D8:53; D9:54; D10:28; D11:39; D12:57; D13:34; D14:13). Moreover, an audit partner with many years of experience is expected to make a more informed assessment of a company's 'tone at the top' as opposed to a newly appointed audit partner (D8:57; D11:27; D14:13). The participants' understanding of professional judgement was in line with ISA 200 (IAASB, 2009a:ISA 200.13(k)) that defines professional judgement as the application of relevant training, knowledge and experience,

within the context provided by auditing, accounting and ethical standards, when making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement.

In addition to exercising professional judgement in performing 'tone at the top' assessments, the SI participants acknowledged that professional judgement is necessary to assess the sufficiency and appropriateness of the audit evidence obtained from performing such assessments and included in the audit files (D10:27). This statement by the SI participants is in line with the ISAs requiring that the auditor should document professional judgement considerations and decisions in respect of significant matters (such as 'tone at the top' assessments) as this serves to explain the auditor's conclusions and reinforce the quality of the judgement applied (IAASB, 2009l:ISA 230.A9). In addition, it is imperative that professional judgement is supported with facts and evidence (Centre for Audit Quality, 2014:5) to enable an informed third party (e.g. the IRBA monitoring inspectors) to conclude that an appropriate assessment of 'tone at the top' was performed. However, the IRBA's 2017 inspections report indicated a decline in audit quality due to auditors' lack of professional judgement (IRBA, 2017c:9). This finding of the IRBA inspections report may be explained by the comment of one of the SI participants who stated that auditors do not document the evidence supporting their professional judgement (D10:56).

5.3.5.3 Professional skepticism

Professional skepticism is an attitude and personal trait – "a sixth sense that you've got with respect to your client's integrity" (D9:7). As part of ensuring a quality audit, the AP participants emphasised that they conduct regular meetings with their audit teams during which they highlight the importance of audit team members maintaining an attitude of professional skepticism when assessing a company's 'tone at the top' (D8:53; D12:28; D13:35). The importance of the audit team members' maintaining their professional skepticism is in line with ISA 200 (IAASB, 2009a:ISA 200.15) which requires that an auditor should remain alert and apply a questioning mind to the information received during the audit.

An AP participant stated that it is important to maintain professional skepticism despite the fact that the "client pays your bills" (D9:55). Auditors should not be afraid to challenge

management on differences that arise during an audit and follow up on those differences (IAASB, 2014:41) because the auditor has a duty to protect the public interest (IAASB, 2014:9). However, the IRBA's 2017 inspections report indicated a decline in audit quality due to a lack of professional skepticism on the part of auditors (IRBA, 2017c:9). The SI participants indicated that this finding may be as a result of a lack of audit evidence supporting the auditor's decisions and conclusions (D10:56).

5.3.5.4 Continuous professional development

In order to ensure that all audit teams are competent to perform their duties, some of the AP participants stated that each year the audit teams at their audit firms undergo training on fraud and professional skepticism and audit updates in the form of workshops, e-learning and on-the-job training and mentoring (D11:37; D12:29; D13:40; D14:13). This finding is in keeping with ISQC1 (IAASB, 2009k:ISQC1.26) that requires auditors to maintain professional competence and due care and also stating that the audit firm has a responsibility to provide audit teams with the resources and assistance required to enable them to develop themselves (IAASB, 2009k:ISQC1.A26). However, in light of the recent alleged unethical conduct on the part of the audit partner(s) at KPMG involved with the Gupta-related companies (Groenewald, 2018) and the alleged breach of the code of ethics by the auditors at Deloitte involved with the Steinhoff-related companies (Cronje, 2018); it may be argued that auditors should receive guidance from the IRBA to ensure that auditors interpret any ethical issues in a consistent manner.

5.3.5.5 Timing of 'tone at the top' assessments

The AP participants specified that they would perform 'tone at the top' assessments for both prospective and current clients before accepting or continuing with an audit engagement (D8:38; D13:39; D14:10). Potentially high-risk clients are escalated to a risk committee within the audit firm for approval in order to avoid the firm being associated with undesirable clients (D8:38; D9:56; D11:3; D13:39; .D14:2). According to one of the AP participants, "if there's a red flag we tend to actually walk away" (D11:5). Another AP participant emphatically stated that:

> "No client is worth your brand or your reputation. Not any client in the world. No matter what they're paying you" (D14:31).

These client acceptance and continuance procedures stem from ISQC1 (IAASB, 2009k:ISQC1.26) that requires an audit firm to show that they have considered a potential or current client's integrity and have no information that may lead the audit firm to conclude that the client lacks integrity before accepting or continuing with the client engagement. Carpenter and Reimers (2013:49-50) posit that an auditor may suffer losses or potential litigation due to their association with a client with a negative reputation. The reputation damage suffered by KPMG (Dicey, 2017) is evidence of the negative effects of being associated with a questionable client.

When assessing 'tone at the top' as part of the auditor's client acceptance and continuance procedures, the AP participants indicated that they would contact the company's previous auditor to determine whether there was a professional reason(s) why the client should not be accepted and also to discuss the company's governing body, management, stakeholders and ethical culture (D8:54; D9.20; D11:32; D12:17; D13:21; D14:30). This procedure is in agreement with ISQC1 (IAASB, 2009k:ISQC1.A20) and ISA 300 (IAASB, 2009e:ISA 300.13(b)) which indicate that the auditor should inquire of the previous auditor whether there are any reasons not to accept the engagement, including the reason behind the change in auditors. According to Decker et al. (2016:101), an auditor should inquire from the previous auditors if they had discussed with the audit committee of the company any incidents of fraud, illegal acts and the internal controls of the company.

Despite the practice of holding discussions with the previous auditor on management's integrity, the company's ethical culture and other related matters some of the AP participants were of the view that such a procedure is a worthless exercise, as illustrated by the following:

> "I don't know how successful that is because I have been on both sides" (D8:54).

> "It's a requirement of the ISA but, to be quite honest with you I don't think you get (much) from it" (D13:21).

This view of the AP participants was based on the fact that their experience has shown that previous auditors are not keen to share information as there may possibly be

resentment on the part of the previous auditors for their not having being reappointed. One of the AP participants aptly stated that “you are not happy, you lost a client” (D8:54). On the other hand, previous auditors may not be keen to share information that may indicate an associational risk. For example, one of the AP participants questioned what information related to Oakbay Limited (a company that is under investigation for alleged state-capture) KPMG provided to SizweNtsalubaGobodo before SizweNtsalubaGobodo’s appointment as auditors of Oakbay Limited (D14:30). The other challenge faced by the new auditors is that they are not provided with unlimited access to the previous auditor’s working papers due to confidentiality agreements between the previous auditor and the client (D14:30). The board of directors and previous auditor may also provide conflicting reasons for not reappointing the previous auditor and these reasons may not necessarily be verifiable (D13:22). The subjectivity inherent in the discussions with the previous auditor highlight the importance of professional skepticism and professional judgement.

According to the SI participants, auditors place greater emphasis on ‘tone at the top’ assessments during the pre-engagement phase of the audit as opposed to during the audit planning phase (D10:53). The SI participants ascribed this to the fact that subsequent to assessing the company’s ‘tone at the top’ as part of their client acceptance and continuance procedures, auditors assume they possess the necessary knowledge of the company’s ‘tone at the top’ (D10:53). Nevertheless, despite this reason, the SI participants emphasised that auditors should re-evaluate the client’s ‘tone at the top’ annually as part of their audit planning, while taking into account their past experience with the client (D10:53). The SI participants’ views are supported by the 2016 IRBA inspection findings report (IRBA, 2016a:29) which indicates that the audit files often do not contain sufficient evidence that auditors considered management’s integrity during the planning phase of the audit. An SI participant stated that “sometimes you would see one sentence…we had discussions (with management) and nothing has come to light” (D10:14). Although the auditor has a duty to assess ‘tone at the top’ as part of the client acceptance and continuance (IAASB, 2009k:ISQC1:26), ISA 315R (IAASB, 2013a:ISA 315R.14) states that an auditor should perform ‘tone at the top’ assessments when the auditor obtains an understanding of and evaluates the control environment of the company during planning. Therefore, the auditor may use the information obtained during the client acceptance and continuance phase when performing detailed audit procedures to understand and evaluate the company’s ‘tone at the top’ during the planning phase of the audit (IAASB, 2013a:ISA 315R.7). The AP participants also indicated that their past

experience with a client is taken into account when assessing the client's 'tone at the top' (D8:19; D12:12; D13:4). However, ISA 240 (IAASB, 2009d: ISA240.A8) cautions that even if management and those charged with governance have been honest and ethical in the past, the auditor should remain alert that circumstances may change that may cast doubt on the company's 'tone at the top'.

Furthermore, some of the AP participants stated that 'tone at the top' is considered throughout the audit but that they do not have a specific document on "evaluation of management integrity or 'tone at the top'" (D8:55; D9:54; D11:34; D12:24; D13:32). The SI participants confirmed that the standards on the documentation on 'tone at the top' assessments are not prescriptive (D10:56). Thus, this finding indicates the need for additional guidance to auditors on how to document their assessment of a company's 'tone at the top'. However, the AP participants reiterated that they perform 'tone at the top' assessments according to their audit firm's audit methodology and that their firm's methodology is aligned to the ISAs (D11:34; D12:24; D13:32), thus implying that their procedures to assess a company's 'tone at the top' are performed according to the ISAs. Nevertheless, despite the AP participants' claim that their firms' methodology is aligned to the ISAs, the 2017 the IRBA inspections findings report criticises auditors for non-compliance with the professional standards (IRBA, 2017c:13).

5.4 SUMMARY OF FINDINGS

Based on an analysis of the empirical data, the majority of the participants indicated that the ethical leadership of a company is central to assessing a company's 'tone at the top'. The participants further stated that they would assess the ethical culture of a company, the governance role of a company's audit committee and the company's compliance with laws and regulations when assessing a company's 'tone at the top'. In addition to assessing these aspects, the participants referred to the quality control principles to which they adhere in assessing a company's 'tone at the top'. Such quality control principles include the responsibility of the audit engagement partner for assessing 'tone at the top', the exercise of professional judgement and professional skepticism, the continued professional development of audit teams and the performance of 'tone at the top' assessments before accepting or continuing with a client engagement and during the planning of the audit. However, despite the AP participants acknowledging that 'tone at the top' assessments are conducted during the pre-engagement and planning of an audit

and that the audit engagement partner is ultimately responsible for 'tone at the top' assessments, there appears to be a lack of evidence in the audit files supporting auditors' 'tone at the top' assessments. Figure 5.2 illustrates how the participants in the study assessed a company's 'tone at the top'.

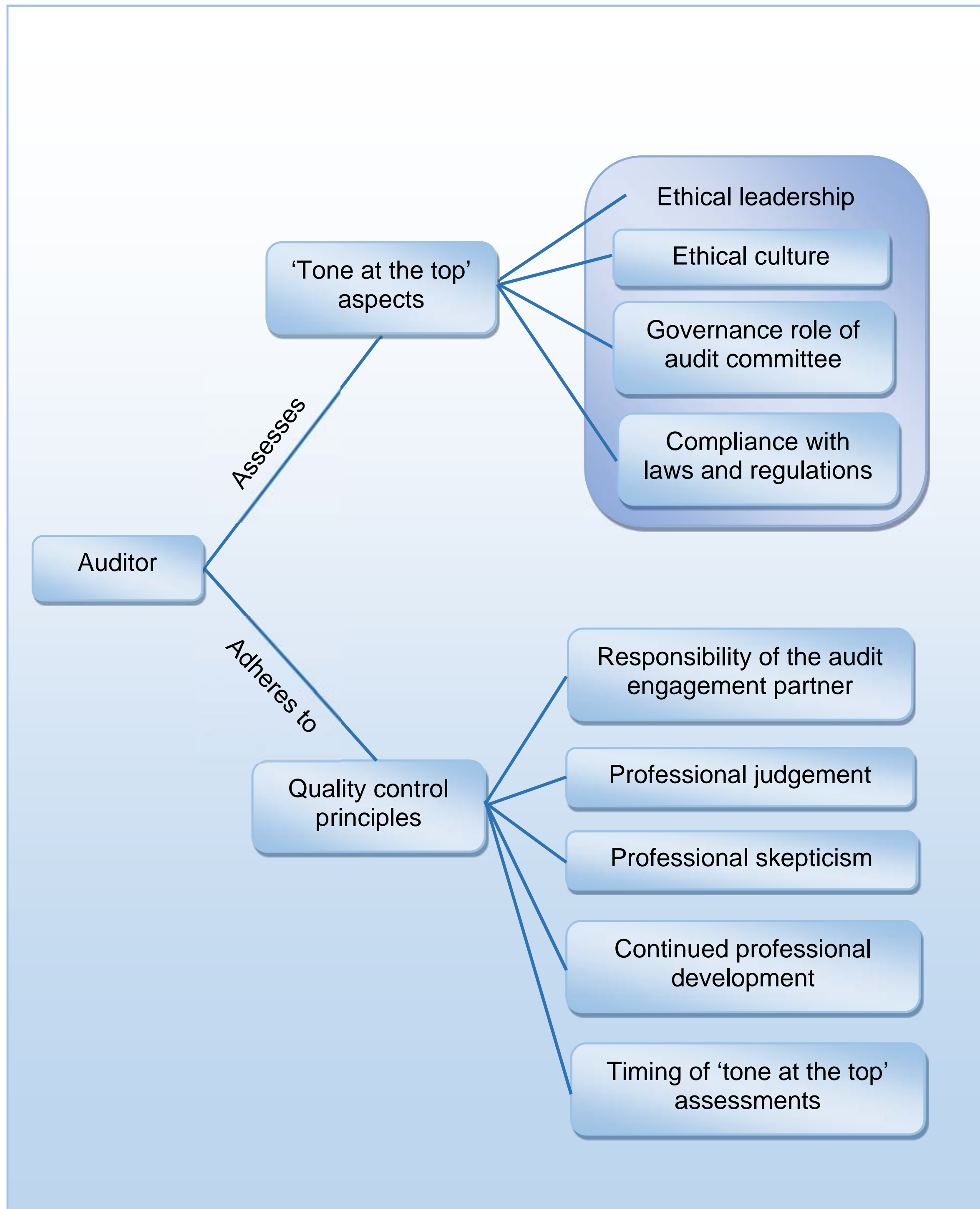

FIGURE 5.2 Participants' assessment of a company's 'tone at the top'

Source: Own compilation

5.5 CONCLUSION

This chapter discussed the empirical findings of the study. The chapter commenced by describing the data analysis as well as the reporting style used by the researcher. The chapter then presented the findings of the study.

The findings were presented according to the five themes that had emerged as relevant to the participants' assessment of a company's 'tone at the top'. These themes included assessing a company's ethical leadership, assessing a company's ethical culture, assessing the governance role of a company's audit committee, assessing compliance with laws and regulations and quality control in 'tone at the top' assessments. The first four themes relate to the auditor's assessment of the aspects of 'tone at the top' (as described in chapter 2 section 2.4) while theme five relates to the quality control principles involved in making 'tone at the top' assessments. These quality control principles include the responsibility of the audit engagement partner for assessing 'tone at the top', the exercise of professional judgement and professional skepticism, the continued professional development of audit teams and the performance of 'tone at the top' assessments before accepting or continuing with a client engagement and during the planning phase of the audit.

Chapter 6 that follows presents an overview of the study, aligns the research objective with the study's findings and then discusses the study's contribution. The limitations of the study and recommendations for further research are also presented.

CHAPTER 6

CONCLUSION

6.1 INTRODUCTION

Chapter 5 outlined the data analysis and reporting style used by the researcher. The chapter also presented and discussed the empirical findings of the study and then concluded with a summary of the study findings.

This chapter provides an overview of the study, the alignment of the research objective with the study findings and the contribution of the study. The limitations of the study are also discussed as are the recommendations for further research. The study is then concluded.

6.2 OVERVIEW OF THE STUDY

Chapter one provided the background to the study and outlined the problem statement as well as the research objective. The discussion on the background to the study highlighted that according to the ISAs, it is incumbent on auditors to assess the 'tone at the top' of a company both prior to accepting a client and when considering continuing with the client engagement. In addition, as part of the audit planning phase, auditors should assess 'tone at the top' as part of their understanding and evaluation of the control environment of the company during their assessment of the risk of material misstatement, due to fraud or error. However, the problem may arise that if auditors were to perform an inappropriate 'tone at the top' assessment, they may become associated with an unethical company. Moreover, such an inappropriate 'tone at the top' assessment may result in an incorrect risk of material misstatement assessment and, consequently, an inappropriate audit opinion on the financial statements of the company. Accordingly, the objective of the study was to understand how auditors assess a company's 'tone at the top'. Chapter 1 also discussed the research methodology used in the study, the importance of the study and the delineations of the study. In addition, the chapter outlined the ethical considerations taken into account, key terms were defined and the structure of the study outlined.

Chapter two presented the first part of the literature review. The chapter discusses corporate governance definitions, approaches to and theories about corporate governance as well as the relationship between corporate governance and ethics. South Africa follows a stakeholder approach to corporate governance with ethics being deemed to constitute the foundation to good corporate governance. In addition, 'tone at the top' was found to be the driver of ethical decision-making and thus chapter two went on to discuss the ethical theories that underpin ethical decision-making. The overall message conveyed by the ethical theories explored was that the interest of the company must be placed before self-interest. In view of the fact this study was concerned with how auditors assess a company's 'tone at the top' a discussion of business ethics then followed. Thereafter 'tone at the top' was described as entailing the implementation and promotion of an ethical culture, ethical conduct on the part of company leaders (ethical leadership), maintaining healthy relationships with all stakeholders and those charged with governance, and management fulfilling their responsibilities in terms of legislation and other applicable governance standards.

Chapter three presented the second part to the literature review and focused on auditors' responsibility for assessing a company's 'tone at the top' in terms of legislation, professional regulations, academic literature and the ISAs. In order to provide context to the notion of the auditors' responsibility for assessing a company's 'tone at the top', the nature of auditing and the audit process were described. In terms of the ISAs, 'tone at the top' assessments are performed primarily during the pre-engagement and planning phases of the audit. During the pre-engagement phase, auditors must assess the integrity of the client's management prior to associating with the client or before deciding to continue with an existing client relationship. During the planning phase auditors must assess the client's 'tone at the top' when obtaining an understanding of and evaluating the company's internal controls, specifically when understanding and evaluating the control environment. The control environment constitutes the foundation of all other components of internal control. The chapter also indicated that three of the aspects of a company's 'tone at the top', namely, ethical culture, ethical leadership and relationships with stakeholders, align to the seven elements of the control environment. The fourth aspect (fulfilment of responsibilities in terms of legislation and other applicable governance standards) is not an element of the control environment although auditors would obtain an understanding of it when they obtain an understanding of the

environment in which the company operates. Finally, the auditors' understanding and evaluation of a company's 'tone at the top' during the planning phase of the audit should take into account both the auditor's business risk assessment decisions and the understanding of the company's 'tone at the top' obtained during the pre-engagement phase of the audit.

Chapter four described the research methodology used in the study. The study fell within the ambit of a constructivism paradigm and followed a qualitative research approach. A multiple-case study design was deemed appropriate for realising the objective of the study. The cases selected for the study included six JSE-accredited audit firms and the IRBA. The participants from each of the six selected JSE-accredited audit firms was an audit partner responsible for the audit of a JSE listed company and who had been with the audit firm for at least five years while, in the case of the IRBA, the team of senior inspectors responsible for the inspections of the audit files of JSE accredited audit firms during the most recent audit quality control cycle. Chapter four explained how the requisite data was gathered and analysed. The data were collected through semi-structured interviews and field notes. The interviews conducted were digitally recorded and transcribed by an independent transcriber. The transcriptions and field notes were initially coded manually, using open coding. Thereafter, the interview transcripts and field notes were imported into ATLAS.ti™ and recoded using the codes derived during the manual coding of the interviews but refining or changing the codes where necessary. The codes were then categorised. The data collected was also coded and categorised by an independent coder after which the researcher and the independent coder reached consensus on any discrepancies in order to enhance the credibility and reliability of the coding. Thereafter, the relationships between the different categories were explored to identify common themes among the categories.

The research findings were presented and discussed in chapter five. These findings are aligned to the research objective in the next section.

6.3 ALIGNMENT OF RESEARCH OBJECTIVE AND FINDINGS

The objective of the study was to understand how auditors assess a company's 'tone at the top'. Central to assessing a company's 'tone at the top', most of the participants indicated that they would firstly assess the ethical leadership of the company. The

participants would, therefore, perform background checks (including obtaining third party confirmations, reviewing publicly available information and obtaining assistance from the audit firm's forensic auditors) to identify the members of the governing body and management and to evaluate their competence, experience, reputation in the market and independence (i.e. if they were free from undue influence or 'pressure' and not deemed to be PEPs). Furthermore, some of the participants indicated that they would evaluate whether the members of the board of directors were not disqualified to act as directors in terms of the Companies Act (RSA, 2008).

Most of the participants also stated that they would obtain an understanding of management's integrity by assessing both management's relationship with themselves (the auditor) and their attitude towards the audit fee. All of the participants indicated that they would also assess the relationship between the governing body and management and the company's employees by inquiring of the employees their perception of the governing body and management. The participants also stated that they would assess management's attitude and behaviour towards the company's control environment by making inquiries of the internal audit function and determining whether the recommendations of the internal audit function were implemented. In addition, one of the AP participant cited the solvency of the company since the risk of insolvency breeds motivation for management fraud.

A few of the participants also stated that they would review management's attitude towards the accounting of estimates and accruals and determine whether the estimates and accruals were reasonable or aggressive in nature. All of the participants would also assess management's attitude towards related party relationships and transactions and management's remuneration structures. The honesty and transparency of the governing body and management may be said to be confirmed when the information presented by them may be corroborated.

Secondly, the participants stated that they would assess the company's ethical culture as part of their assessment of a company's tone at the top. The majority of the participants would establish not only whether the company had a code of ethics in place but also whether the company implemented the code of ethics. In addition, they would determine whether the values embodied within the code of ethics were aligned to the company's vision, mission and strategy and whether those values were included in the company's

integrated report. The participants also cited that they would evaluate the ethical policies and processes of the company to determine the following, namely, the company's communication of the code of ethics to relevant stakeholders, annually reminding of employees about the company's ethical values, recruiting of ethical employees, performing of background checks on potential employees, and providing training in ethics to employees. Equally important when assessing the implementation of the code of ethics some of the participants indicated they would review the staff turnover ratio and the number of directors who had resigned during the year, including the reasons for their resignations. Moreover, all of the participants highlighted that they would establish whether the company's leadership lived by the values infused in the code of ethics.

All of the participants stated that a code of ethics is effective only if it is enforced. Accordingly, the participants would determine whether the company had an anonymous whistleblowing line for the safe reporting of ethical breaches and whether the whistleblowing reports were directed to someone independent of management. In addition, the majority of the participants would consider whether the governing body and management dealt with unethical behaviour in a consistent way and without bias. Another participant indicated that he/she would also assess the internal controls surrounding the code of ethics and the internal audit functions' findings in respect of such internal controls. The SI participants also mentioned that some auditors would determine whether the company had conducted an employee engagement survey and if the results of the survey in relation to ethical issues in the company were reviewed.

Thirdly, the participants indicated that they would assess the governance role of the audit committee as part of their assessment of a company's 'tone at the top'. According to a few of the participants, they would establish whether the audit committee was independent of management by determining the audit committee's level of oversight over the company's financial reporting process. The participants would also gauge the governance role of the audit committee during their interactions with the audit committee members when management is present and during private meetings with the audit committee. When management was present, the participants would evaluate the relationship between management and the audit committee, specifically management's respect for the audit committee. Equally important to one of the participants was determining whether there was harmony between the efforts of the auditor, internal audit function and the audit committee.

Fourthly, when assessing ‘tone at the top’, the participants considered the company’s compliance with laws and regulations. As such, the participants inquired of management and the company’s legal team about laws and regulations that have a financial impact on the financial statements and also those that do not have such an impact but where non-compliance could materially affect the financial statements. In addition, the AP participants determined whether there have been instances of non-compliance with laws and regulations through inquiries from the company’s legal team, the IRBA and relevant regulatory bodies. Furthermore, the SI participants stated that auditors should enquire about the existence and role of a social and ethics committee as the existence of such a committee signifies the company’s commitment to an ethical culture. Some of the AP participants indicated that they evaluated whether the directors had complied with their fiduciary duties by establishing if the directors had acted in good faith during company dealings and whether they were held responsible for their actions. A few of the participants also expressed the need for a regulator for directors in South Africa to address the issue of directors’ breaching their fiduciary duties.

Finally, the participants referred to the importance of quality control in assessing a company’s ‘tone at the top’. Despite the AP participants acknowledging that ‘tone at the top’ assessments are ultimately the audit engagement partner’s responsibility, according to the SI participants, the audit files generally contain limited or no evidence of audit engagement partner involvement in ‘tone at the top’ assessments. All of the participants emphasised that ‘tone at the top’ assessment decisions are impacted upon by the professional judgement of the audit engagement partner making the relevant decisions and that such professional judgement is influenced by the audit engagement partner’s knowledge, experience, understanding and training as well as the circumstances surrounding the audit engagement. However, the IRBA’s findings highlights that the audit files often contain little or no evidence supporting the audit engagement partners’ professional judgement (IRBA, 2017c:12). All the participants also referred to the importance of professional skepticism in assessing a company’s ‘tone at the top’ with the participants explaining that the audit staff is regularly reminded to maintain an attitude of professional skepticism when performing a company’s ‘tone at the top’ assessments. In order to ensure the continued professional development of audit staff, the AP participants disclosed that their audit firms provide resources for training on fraud and professional skepticism, and also audit updates. However, the training provided by the various audit

firms differs and thus it would appear that there is a need for the IRBA to provide guidance on ethical issues encountered during audits of financial statements, thus indicating that training is required.

According to the AP participants, 'tone at the top' assessments are performed before an audit firm either accepts or continues with a client engagement while high-risk clients are escalated to a risk committee for approval. As part of a company's 'tone at the top' assessment, all the participants liaise with the previous auditor although the participants acknowledged that the previous auditor may not be keen to share information about the client and that access to the previous auditors' working papers is usually limited. Although the AP participants stated that they also performed 'tone at the top' assessments during the planning phase of the audit, the SI participants indicated that auditors place greater emphasis on 'tone at the top' assessments during the pre-engagement phase of the audit as compared to the planning phase of the audit. Furthermore, some of the AP participants stated that 'tone at the top' is considered throughout the audit but they did not have a specific document on 'tone at the top' assessments. The SI participants confirmed that the auditing standards on the documentation of 'tone at the top' assessments are not prescriptive. This finding indicates the need for additional guidance to auditors on how to document their assessment of a company's 'tone at the top'.

6.4 CONTRIBUTION OF THE STUDY

It is believed that this study has contributed to the existing body of knowledge on "how" auditors assess a company's 'tone at the top'. The findings of the study on how the auditors who participated in this study assessed a company's 'tone at the top' may be used by audit firms to provide guidance in respect of both their audit methodologies on 'tone at the top' assessments and the documentation of their 'tone at the top' assessments. The IRBA could also use the findings of the study as a point of reference to provide guidance and training to auditors on the assessment of a company's 'tone at the top' in an attempt to reduce the number of audit inspection findings that arise due to auditors' inadequate assessment of 'tone at the top'.

6.5 LIMITATIONS OF THE STUDY

Although the study was conducted with due consideration of the research design best suited to achieve the research objective and the strict adherence to the methodological norms for ensuring quality research, certain limitations were noted.

A qualitative approach and multiple-case study research design were employed to understand how auditors assess a company's 'tone at the top'. It is, however, acknowledged that a quantitative research approach or the use of an alternative research design may have led to findings which would have differed from those of this study.

Only audit firms in the Top 40 JSE listed companies formed part of the study and non-probability sampling was used to select the research participants. Consequently, the findings reported in this study may have been different if other audit firms and/or audit partners had been included in the sample.

The description of 'tone at the top', as derived from previous research on corporate governance and business ethics, played a significant role in the development of the interview guide (Appendix E) used during the data collection stage of the study. It is thus possible that the findings may be different to the findings reported in this study should a different description of 'tone at the top' be used.

This study focused on the risk assessment decisions made by auditors regarding a company's 'tone at the top' only and thus risk assessment decisions other than those related to the 'tone at the top' of a company during the audit were not considered.

6.6 RECOMMENDATIONS FOR FURTHER RESEARCH

The study was confined to 'tone at the top' assessments made by audit firms which audit the Top 40 JSE listed companies. Consequently, only large audit firms were included in the study. It is, therefore, recommended that another study be conducted to explore whether 'tone at the top' assessments conducted by small and medium audit firms and by the Auditor General of South Africa would be similar to those in this study.

The SI participants indicated that auditors place greater emphasis on ‘tone at the top’ assessments during the pre-engagement as compared to during the planning of an audit. Thus, future research could explore why auditors do, indeed, place greater emphasis on ‘tone at the top’ assessments during the pre-engagement as compared to during the planning of an audit.

Despite the AP participants acknowledging that ‘tone at the top’ assessments are conducted during both the pre-engagement and planning of an audit and that the audit engagement partner is, ultimately, responsible for ‘tone at the top’ assessments, it would appear that there is a lack of evidence in audit files supporting auditors’ ‘tone at the top’ assessments. This finding indicates the need for future research on the documentation of ‘tone at the top’ assessments. Future research could also provide guidance on those responsibilities which audit engagement partners may not delegate to other audit team members.

The participants indicated that investigations into director misconduct are often lengthy, resulting in years passing before a director is brought to account for fraud or corruption. It is, therefore, recommended that research be conducted on the feasibility of a regulator for directors in South Africa.

6.7 CONCLUSION

The chapter provided an overview of the study as a whole. The overview highlighted the literature review which was conducted as well as the research methodology followed in the study. The research objective of the study was then aligned to the research findings. The findings outlined how the auditors who participated in this study assessed a company’s ‘tone at the top’. The study found that in assessing a company’s ‘tone at the top’, the auditors assessed the ethical leadership of a company, the ethical culture of a company, the governance role of a company’s audit committee and compliance with laws and regulations. The auditors in this study also indicated that they adhered to quality control principles when assessing a company’s ‘tone at the top’. Finally, the chapter discussed the contribution and limitations of the study and also recommendations for further research. In conclusion, the role of auditors in assessing a company’s ‘tone at the top’ has never been more prominent than it is at present. This was highlighted by the following quote of the chairperson of the Financial Reporting Council:

"Nobody is in a position to develop a better feel for the culture of an organisation than its auditor. I suggest that you are able − more than anyone − to draw the attention of the Chairman or the Board as a whole, or its CEO, to shortcomings and potential failures as you become aware of them. This is not a duty specifically prescribed in any auditing manual but is a responsibility you may well agree you have towards investors. Perhaps even towards what is broadly considered the broader public interest."

(Bischoff, Deloitte's Annual Risk, Regulatory and Public Policy Forum Rome, 2016:5)

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ANNEXURES

ANNEXURE A

REQUEST FOR PERMISSION TO CONDUCT A RESEARCH STUDY

(a similar letter will be sent to IRBA)

Dear XXX

Request for permission to conduct a research study at XXX

I am a registered student at the University of South Africa (UNISA) pursuing a MPhil in Accounting Sciences. My research study is entitled *The auditor's evaluation of 'tone at the top'.* The purpose of this letter is to request XXX participation in the study.

As part of the study, I intend to conduct semi-structured interviews with an audit partner from each of the six JSE-accredited audit firms and with the inspections director and two senior team leaders (responsible for the inspections of the JSE-accredited audit firms) at the Independent Regulatory Board for Auditors. The audit partner should be engaged in auditing a JSE-listed company and have been with the audit firm for at least five years. The interview should take no longer than 60 minutes. The privacy and confidentiality of the audit firm and the participant will be ensured. The output of this study will be a master's dissertation as well as articles in accredited academic journals.

The research intends to address the following questions:

- What is the auditor's understanding of the term 'tone at the top'?
- How does the auditor obtain an understanding of and evaluate a company's 'tone at the top' as part of the identification and assessment of the risk of material misstatement, due to fraud or error?
- Who, within the audit firm, obtains an understanding of and evaluates a company's 'tone at the top' as part of the identification and assessment of the risk of material misstatement, due to fraud or error?

The study has received ethical approval from the Research Ethics Review Committee of the College of Accounting Sciences, UNISA. Ethics clearance reference number: 2017_CAS_039.

Your audit firm's participation will enable the researcher to complete her research project. Should you require more information you may contact my supervisors:

Prof EM Odendaal, e-mail: odendem@unisa.ac.za, Tel: +27 12 429 4363 or
Prof HJ Theron, e-mail: Therohj@unisa.ac.za Tel: +27 12 429 4364

Your approval and support to conduct the interviews will be highly appreciated.

Regards

Mrs Faeeza Jaffer (CA) (SA)
Senior Lecturer: Department of Financial Accounting
Tel: 082 464 0179
Email: jaffeff@unisa.a.c.za

ANNEXURE B

PARTICIPANT INFORMATION SHEET

Ethics clearance reference number: 2017_CAS_039

Date

The auditor's evaluation of 'tone at the top'

Dear prospective participant

My name is Faeeza Jaffer and I am conducting research with Prof EM Odendaal and Prof HJ Theron in the College of Accounting Sciences (CAS) towards a Masters degree in Accounting Sciences at the University of South Africa (Unisa). I invite you to participate in a study entitled: The auditor's evaluation of 'tone at the top'.

WHAT IS THE OBJECTIVE OF THE STUDY?

The purpose of this study is to explore the process whereby the auditor obtains an understanding of and evaluates a company's 'tone at the top' as part of the risk of material misstatement identification and assessment, due to fraud or error.

WHY AM I INVITED TO PARTICIPATE?

As your firm is one of the six JSE-accredited audit firms it has been selected to participate in the study. Interviews will be conducted with an audit partner from each of the audit firms who has been engaged in auditing a JSE-listed company and who has been with the audit firm for at least five years. You have met the criteria.

WHAT IS THE NATURE OF MY PARTICIPATION IN THIS STUDY?

This study involves a single, 60 minutes individual interview. The following questions will be posed:

- What is your firm's understanding of the term 'tone at the top'?
- How does your firm obtain an understanding of and evaluate a company's 'tone at the top' as part of the identification and assessment of the risk of material misstatement, due to fraud or error?
- Who, within your firm, obtains an understanding of and evaluates a company's 'tone at the top' as part of the identification and assessment of the risk of material misstatement, due to fraud or error?

The interview will be a semi-structured interview and, therefore, the questions listed above will form a basic guideline for the interview. Other questions may be asked as the discussion evolves. Then interviews will be recorded through digital voice recording after written agreement to do so had been obtained from you, with the proviso that you may request for the voice recorder to be switched off at any time.

MAY I WITHDRAW FROM THIS STUDY EVEN AFTER HAVING AGREED TO PARTICIPATE?

You may choose not to participate in the study or you may also withdraw from the study without any adverse consequences or providing any reasons for your withdrawal. I kindly request you to sign the consent form below before participating in the interview.

WHAT ARE THE POTENTIAL BENEFITS OF TAKING PART IN THIS STUDY?

There is limited academic research on how an auditor obtains an understanding of and evaluates a company's 'tone at the top' as part of the identification and assessment of the risk of material misstatement, due to fraud or error, during both the pre-engagement activities and the planning phases of an audit. Thus, this research study aimed to supplement existing literature by, firstly, determining what 'tone at the top' means to auditors and, secondly, exploring how auditors go about obtaining an understanding of and evaluating a company's 'tone at the top'.

ARE THEIR ANY NEGATIVE CONSEQUENCES FOR ME IF I PARTICIPATE IN THE RESEARCH PROJECT?

Your participation in this study is important and will be appreciated. In view of the non-sensitive and non-personal nature of the study, I do not foresee that you will suffer any harm as a result of your participation in the study.

WILL THE INFORMATION THAT I CONVEY TO THE RESEARCHER AND MY IDENTITY BE KEPT CONFIDENTIAL?

Your name will not be recorded anywhere and neither will anyone be able to link you to the answers you give. You will be given a fictitious participant number and you will be referred to in this way in the data, any publications, or other academic research reporting methods, such as journal articles and conference proceedings. The persons transcribing and cocoding the interviews will sign a confidentiality agreement to ensure that the data remains strictly confidential.

HOW WILL THE RESEARCHER PROTECT THE SECURITY OF THE DATA?

Hard copies of the transcribed interviews will be stored for a period of five years in a locked cupboard in the researcher's office at Unisa for future research or academic purposes while any electronic information will be stored on a password protected computer. Hard copies of the information will be shredded and electronic copies will be permanently deleted from the hard drive of the computer through the use of relevant software. The transcriber will be required to immediately destroy the digital recordings once the transcription has been completed.

WILL I RECEIVE PAYMENT OR ANY INCENTIVES FOR PARTICIPATING IN THIS STUDY?

No financial or other compensation or incentives will be given for participation in the study.

HAS THE STUDY RECEIVED ETHICS APPROVAL?

This study has received written approval from the Research Ethics Review Committee of the CAS, Unisa. A copy of the approval letter may be obtained from the researcher if you so wish.

HOW WILL I BE INFORMED OF THE FINDINGS/RESULTS OF THE RESEARCH?

The output of this study will be a master's dissertation as well as articles in accredited academic journals. If you would like a copy of the dissertation or the articles published, please contact Faeeza Jaffer on 012 429 4873 or jaffeff@unisa.ac.za. Should you require any further information or you wish to contact the researcher about any aspect of this study, please use the same contact details.

Should you have concerns about the way in which the research has been conducted, you may contact my supervisors: Prof EM Odendaal (odendem@unisa.ac.za) or Prof HJ Theron (Therohj@unisa.ac.za). In addition, you may contact the research ethics chairperson of the CAS Research Ethics Review Committee, Lindie Grebe, on grebel@unisa.ac.za if you have any ethical concerns.

Thank you for taking the time to read this information sheet and for participating in this study.

Yours faithfully

…………………………………….

Mrs Faeeza Jaffer

CONSENT TO PARTICIPATE IN THIS STUDY

I, __________________ (participant name), confirm that the person asking my consent to take part in this research has told me about the nature, procedure, potential benefits and anticipated inconvenience of my participation in the study.

I have read (or had explained to me) and understood the study as explained in the information sheet.

I have had sufficient opportunity to ask questions and am prepared to participate in the study.

I understand that my participation is voluntary and that I am free to withdraw at any time without penalty.

I am aware that the findings of this study will be processed in a research report, journal publications and conference proceedings but that my participation will be kept confidential.

I agree to a face-to-face interview with Faeeza Jaffer.

I have received a signed copy of the informed consent agreement.

Participant's Name and Surname ……………………………………… (please print)

Participant's Signature…………………………………   Date…………………

Researcher's Name and Surname……………………………………… (please print)

Researcher's Signature…………………………………   Date…………………

ANNEXURE C

TRANSCRIBER CONFIDENTIALITY AGREEMENT

I ……………………………………………….. (name and surname), hereby agree to the following regarding the transcription of the digital recordings:

- The contents of the digital recordings as well as the identities of the participants, their organisations and any other individuals or organisations mentioned in the recordings will be treated with the utmost confidentiality.
- The digital recordings, the transcriptions and the content thereof will not be discussed with or made available to any person other than the researcher, Faeeza Jaffer.

  All digital recordings and transcriptions, whether in electronic or hard copy format, will be kept securely for the entire period afterb it has been received and until it is returned/given to the researcher.
- All hard copies of the transcriptions will be shredded once the transcription thereof is complete.
- All copies of the digital recordings will be returned to the researcher and all electronic copies of the transcriptions will be destroyed after copies thereof have been given to the researcher.

Full Name and Surname: ______________________________________
(Transcriber)

Signature: ______________________________________

Date: ________________________

ANNEXURE D

CO-CODER CONFIDENTIALITY AGREEMENT

I ……………………………………………….. (name and surname), hereby agree to the following regarding the coding of the transcriptions:

- The contents of the transcriptions as well as the identities of the participants, their organisations and any other individuals or organisations mentioned in the recordings will be treated with the utmost confidentiality.
- The content of the transcriptions and the results of the coding will not be discussed with or made available to any person other than the researcher, Faeeza Jaffer.
- All copies of the transcriptions and the coding, whether in electronic or hard copy format, will be kept securely for the entire period after it has been received and until it is returned/given to the researcher.
- All hard copies of the transcriptions and coding will be shredded once the coding thereof is complete.
- All electronic copies of the coding will be destroyed after copies thereof have been given to the researcher.

Full Name and Surname: ______________________________________
(Co-coder)

Signature: ______________________________________

Date: _______________________

ANNEXURE E
INTERVIEW GUIDE

Good day. My name is Faeeza Jaffer. As discussed telephonically, I am going to conduct a semi-structured interview with you to specifically discuss how the auditor obtains and understanding and evaluates a company's 'tone at the top' as part of the risk of material misstatement identification and assessment, due to fraud or error.

Please note that you are not obliged to answer any of the questions. If you so choose you may withdraw from the interview at any stage. I confirm again that your personal details will remain confidential. The interview should take approximately 60 minutes. We are now going to start the interview process.

1. What is your understanding of the term 'tone at the top'?

   - The board conducting themselves ethically (ethical leadership)
   - Implementation and promotion of an ethical culture by the board
   - Healthy relationships between the board and stakeholders
   - The board fulfilling its responsibilities in terms of legislation and other applicable governance standards

2. How do you obtain an understanding of and evaluate a company's 'tone at the top'?

   Ethical leadership

   - How does the firm evaluate the ethical leadership of a company (eg, the board's reputation, qualifications and background)?
   - Does the audit firm consider the board's attitude towards the auditor, internal audit function and audit committee?
   - Does the audit firm evaluate the board's attitude towards the financial reporting process and accounting policies?
   - Does the audit firm deliberate on the company structure to determine whether suitable employees support the structure?
   - What measures does the audit firm take to evaluate the board's involvement/non-involvement in fraudulent activities of any kind?

Implementing and promoting an ethical culture

- Does the audit firm consider whether the company has a code of conduct in place (communication and training of the code, monitoring of adherence, disciplinary measures for non-adherence to the code)?
- Does the audit firm evaluate the staff recruitment and promotion criteria of the company (eg, if the employees hired or promoted are ethical)?

Maintaining healthy relationships with stakeholders

- How does the audit firm identify the company's stakeholders and evaluate the relationships between the stakeholders and the board?
- How does the audit firm evaluate the relationship between the board and the internal audit function?
- Do the audit firm and internal audit function meet with the audit committee on an annual basis, without management being present?
- Does the audit firm discuss the board's tone and make inquiries of the audit committee and internal audit function whether any fraud may be taking place (specifically, fraud involving the board)?

Compliance with laws and regulations

- How does the audit firm evaluate whether the company has adhered to all the relevant laws and regulations?

3. Who, within the audit engagement team, obtains an understanding of and evaluates a company's 'tone at the top' (audit partner, audit manager or senior audit trainee)?

    - Who collects the information needed to evaluate a company's tone at the top?

    - What is the role of the rest of the audit engagement team members in the evaluation of a company's 'tone at the top' (team discussions or included on a need to know basis)?

Is there any additional information that you could contribute which, although important, was not considered during this interview?