

# **THE AUDIT EXPECTATION GAP: A PRIVATE COMPANY PERSPECTIVE**

by

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# TABLE OF CONTENTS

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<b>TABLE OF CONTENTS</b> .....	<b>i</b>
<b>DECLARATION</b> .....	<b>vi</b>
<b>LANGUAGE EDITING CERTIFICATE</b> .....	<b>vii</b>
<b>ACKNOWLEDGEMENTS</b> .....	<b>viii</b>
<b>ABSTRACT</b> .....	<b>x</b>
<b>LIST OF FIGURES</b> .....	<b>xii</b>
<b>LIST OF TABLES</b> .....	<b>xiii</b>
<b>LIST OF ABBREVIATIONS USED</b> .....	<b>xiv</b>
<b>DEFINITIONS AND CONCEPT CLARIFICATION</b> .....	<b>xv</b>
<b>CHAPTER 1: INTRODUCTION AND BACKGROUND</b> .....	<b>1</b>
<b>1.1. Introduction and Background to the Study</b> .....	<b>1</b>
1.1.1.    What is the audit expectation gap.....	2
1.1.2.    The perceptions/expectations of financial statement users of auditor’s reports..	4
1.1.3.    Recent scandals and the relevance of the study .....	5
<b>1.2. Problem Statement and Research Question</b> .....	<b>7</b>
1.2.1.    Primary Objective .....	8
1.2.2.    Secondary Objectives.....	8
<b>1.3. Scope and Delimitations of this Study</b> .....	<b>8</b>
<b>1.4. Research Design and Methodology</b> .....	<b>12</b>
<b>1.5. The Significance of this Study</b> .....	<b>14</b>
<b>1.6. Chapter Outline and Reference Style</b> .....	<b>16</b>
<b>1.7. Summary and Concluding Remarks</b> .....	<b>18</b>

<b>2. CHAPTER 2: LITERATURE REVIEW.....</b>	<b>19</b>
<b>2.1. Introduction .....</b>	<b>19</b>
<b>2.2. The Audit Expectation Gap and its Evolution.....</b>	<b>19</b>
2.2.1. The Evolution of the Purpose of an Audit .....	19
2.2.2. Historical Overview of the Audit Expectation Gap .....	22
2.2.3. Typical Areas where Differences in Expectations Arise.....	24
<b>2.3. Key differences between a Public and Private Company from an audit expectation gap perspective .....</b>	<b>28</b>
2.3.1. The Nature of Agency Conflict in Private Companies.....	30
2.3.2. The Quality of Financial Statements.....	32
2.3.3. Audit Firms and Audit Quality .....	33
2.3.4. Voluntary and Mandatory Audits.....	35
<b>2.4. Users of Financial Statements and Auditor Reports .....</b>	<b>38</b>
2.4.1. Executive Management.....	41
2.4.2. Shareholders .....	42
2.4.3. Third Party Providers of Finance .....	43
2.4.4. South African Revenue Service.....	44
<b>2.5. Conclusion: Literature Review.....</b>	<b>44</b>
<b>CHAPTER 3: RESEARCH METHODOLOGY .....</b>	<b>46</b>
<b>3.1. Introduction .....</b>	<b>46</b>
<b>3.2. Research Philosophy and Paradigm .....</b>	<b>47</b>
<b>3.3. Approach to Theory Development.....</b>	<b>50</b>
<b>3.4. Research Design and Strategy .....</b>	<b>51</b>
<b>3.5. Research Method .....</b>	<b>53</b>
3.5.1. Data collection methods .....	54
3.5.1.1. Secondary Data Collection: Literature Review .....	54
3.5.1.2. Primary Data Collection: Interviews.....	54

3.5.1.3.	Secondary Data Collection: Comparison to applicable audit requirements.....	60
3.5.2.	Population of users.....	61
3.5.3.	Sampling methods.....	63
3.5.3.1.	Sampling Method: Executive Management and Shareholders .....	64
3.5.3.2.	Sampling Method: Banking Institutions.....	71
3.5.3.3.	Sampling Method: SARS.....	73
3.5.4.	Data analysis and coding methods.....	75
3.5.4.1.	Organising .....	77
3.5.4.2.	Perusal .....	77
3.5.4.3.	Classification .....	78
3.5.4.4.	Synthesis.....	79
3.5.5.	Trustworthiness of the study.....	81
<b>3.6.</b>	<b>Ethical Considerations .....</b>	<b>85</b>
<b>3.7.</b>	<b>Summary.....</b>	<b>92</b>
<b>CHAPTER 4:</b>	<b>RESULTS AND DISCUSSION .....</b>	<b>93</b>
<b>4.1.</b>	<b>Introduction .....</b>	<b>93</b>
<b>4.2.</b>	<b>Description of participants in each group .....</b>	<b>96</b>
4.2.1.	Group 1: Management and Shareholders .....	96
4.2.2.	Group 2: External Stakeholders .....	98
<b>4.3.</b>	<b>Users of audited financial statements.....</b>	<b>100</b>
4.3.1.	Influence of background on user perceptions.....	101
4.3.2.	Shareholders .....	105
4.3.3.	Banks/Providers of Finance.....	106
4.3.4.	SARS.....	113
4.3.5.	Management .....	117

<b>4.4. Audit purpose expectations .....</b>	<b>122</b>
4.4.1. Fraud .....	123
4.4.2. Errors.....	128
4.4.3. Going Concern .....	133
4.4.4. Good Investment .....	136
4.4.5. Systems of Internal Control .....	139
4.4.6. Compliance with Laws and Regulations .....	142
4.4.7. Summary: Audit Purpose Expectations .....	146
<b>4.5. Audit value expectation.....</b>	<b>150</b>
4.5.1. Primary/Direct Value.....	151
4.5.2. Secondary/Indirect Value .....	156
<b>4.6. Auditor independence .....</b>	<b>165</b>
4.6.1. Relationships.....	166
4.6.2. Other services .....	171
<b>4.7. Conclusion.....</b>	<b>175</b>
<b>CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS .....</b>	<b>176</b>
<b>5.1. Introduction .....</b>	<b>176</b>
<b>5.2. Conclusions – answering the research questions.....</b>	<b>176</b>
5.2.1. The users of audited private company financial statements.....	178
5.2.2. The expectations of users of audited private company financial statements and how these expectations align with the applicable audit requirements.....	179
5.2.3. A comparison between public and private companies.....	185
<b>5.3. Implications – recommendations for practice .....</b>	<b>189</b>
5.3.1. Independence (including advisory services and resolving agency conflict).....	190
5.3.2. Laws and regulations, Internal Control and Detection of Errors .....	191
5.3.3. General.....	192

<b>5.4. Recommendations for future research .....</b>	<b>193</b>
<b>5.5. Limitations of the study.....</b>	<b>194</b>
<b>5.6. Value of the study .....</b>	<b>195</b>
<b>LIST OF REFERENCES .....</b>	<b>198</b>
<b>APPENDIX A .....</b>	<b>216</b>
<b>APPENDIX B .....</b>	<b>218</b>
<b>APPENDIX C .....</b>	<b>239</b>
<b>APPENDIX D .....</b>	<b>250</b>
<b>APPENDIX E .....</b>	<b>278</b>
<b>APPENDIX F .....</b>	<b>293</b>
1.    Audit Team .....	293
2.    Approach to Audit.....	296
3.    Auditor’s Report.....	299
4.    Summary .....	302

## DECLARATION

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I declare that the dissertation hereby handed in for the qualification Master of Accounting at the University of the Free State is my own independent work and that I have not previously submitted the same work for a qualification at/in another university/faculty.



**Ané Church**

13 November 2023

**DATE**

I hereby cede copyright of this product in favour of the University of the Free State.



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# LANGUAGE EDITING CERTIFICATE

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To whom it may concern

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This serves to confirm that the Master's thesis submitted to Star Language Services in October 2023 by Ms Ané Church was indeed subject to language editing, and that the accompanying feedback regarding recommended revisions was sent to the client thereafter.

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Yours faithfully,

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*Dedicated to my loving husband and three beautiful boys, without whom this dissertation would have been completed two years earlier.*

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When I embarked on this journey a couple of years ago, I had no idea what would lie ahead. Three months into my first year of study, Covid-19 shocked the world and brought my study to a standstill for an extended period. Mixed with maternity leave and a couple of other challenges, this ended up being the longest project that I have ever undertaken. It certainly taught me patience, persistence and a lot of humility. My accounting teacher at school, the late Mr Otto Neethling, gave me a poster (which I still have in my office) with the following quote that I still cherish:

***“I know the price of success: Dedication, hard work and an unremitting devotion to the things you want to see happen.”***

***– Frank Lloyd Wright***

## ABSTRACT

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Differences between what financial statement users expect from external auditors and what the external audit actually delivers, give rise to the widely researched phenomenon of 'the audit expectation gap'. Most extant research focuses on public, listed companies, the findings of which are not necessarily generalisable to private companies which are subject to audit.

By focusing on the 'evolution gap' component of the audit expectation gap, this study aimed to determine to what extent the expectations of the users of audited private company financial statements differ from what is delivered by the audit engagement undertaken in accordance with applicable audit requirements, which includes International Standards on Auditing, International Standards on Quality Management, the International Code of Ethics for Professional Accountants by the International Ethics Standards Board for Accountants and relevant legislation, such as the Companies Act of South Africa 2008 and the Auditing Profession Act, 2005..

This qualitative, phenomenological study is positioned in the interpretive, constructivist paradigm, and uses induction as the approach to theory development. In-depth interviews were conducted with 20 participants in two financial statement user groups: Management and Shareholders (n=12) and External Stakeholders (n=8), which included participants from banking institutions and the South African Revenue Service (SARS). Data was analysed by using inductive coding to identify codes, which were categorised and synthesised into themes. Four themes emerged from the data.

The theme 'Users of audited financial statements' identified the users of private company financial statements as members of executive management, shareholders, providers of finance and SARS. The theme of 'Audit purpose perceptions' considered those areas typically identified as contributors to the audit expectation gap in public, listed companies. Private company financial statement users shared the expectations that auditors should verify compliance with all laws and regulations applicable to the company and should verify the effectiveness of all internal controls implemented by the company. Participants also expected auditors to detect all errors when underlying company financial records are transferred to the formal set of financial statements, although they did not expect auditors to detect all errors in the financial records itself.

Participants, furthermore, expected auditors to play an advisory role where doubt exists over the company's ability to continue as a going concern. Participants, however, did not expect auditors to detect all fraud, which is the most common expectation in the context of public, listed companies.

'Audit value perceptions' addressed factors that participants did not necessarily view as the primary role of the auditor, but which they expected to receive as a consequence of the audit as a value-adding service. This included various forms of advisory services and agency conflict resolution, amongst others. It was also evident from the responses of participants in the Management and Shareholders group that they either misunderstand or have a lower requirement for 'Auditor independence' than set by applicable audit requirements.

This study underlined the differences between public, listed companies and private companies, emphasising that findings in research on public, listed companies cannot be generalised to private companies. Various factors known to contribute to the audit expectation gap in public, listed companies, were confirmed as not being present in private companies, while additional contributors in the private company context were identified.

The findings in this study enable registered auditors, professional accountancy bodies and audit regulators to respond appropriately to the contributors to the audit expectation gap in private companies, which could lead to the improved relevance of private company audits.

**Word count:** 566

**Key terms:** audit expectation gap; private companies; audit; auditing; financial statement audit

# LIST OF FIGURES

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Figure 1: Structure of the audit expectation-performance gap (Porter, 1993) ..... 2

Figure 2: The Audit Expectation Gap (ACCA, 2019) ..... 3

Figure 3: The audit expectation gap (compiled by the researcher, informed by Porter (1993) and ACCA (2019)). ..... 3

Figure 4: The 'research onion' ..... 47

Figure 5: Creswell Data Analysis Spiral ..... 76

Figure 6: Alignment between the findings of the study and the research sub-questions ..... 177

Figure 7: Comparison of contributors to the audit expectation gap in public, listed companies versus private companies ..... 186

## LIST OF TABLES

---

Table 1: Summary of users of financial statements.....	10
Table 2: Summary of participants, sampling methods and number of interviews.....	13
Table 3: Overview of the evolution of the objective of the external audit.....	20
Table 4: Typical areas where differences in expectations from an audit arise .....	26
Table 5: Public and Private Company Differentiation .....	30
Table 6: Uses of financial statements by different user groups .....	39
Table 7: Philosophical positions when conducting research .....	48
Table 8: Approaches to theory development.....	50
Table 9: Non-probability sampling techniques.....	64
Table 10: Sample selection indicating the number and distribution of interview participants.....	68
Table 11: Interview Groups and Sub-groups.....	75
Table 12: Characteristics of Trustworthiness Applied to the Study .....	82
Table 13: Ethical Considerations applied to the study.....	86
Table 14: Themes, categories and codes emerging from data analysis.....	94
Table 15: Interview Participant Demographic and Other Relevant Information – Management and Shareholders .....	97
Table 16: Interview Participant Demographic and Other Information – External Stakeholders .....	99
Table 17: The impact of an audit on interest rates and facilities.....	110
Table 18: Summary of Audit Purpose Expectations .....	147

## LIST OF ABBREVIATIONS USED

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ACCA	-	Association of Chartered Certified Accountants
CEO	-	Chief Executive Officer
CIPC	-	Companies and Intellectual Property Commission
EU	-	European Union
FMCG	-	Fast Moving Consumer Goods
GDP	-	Gross Domestic Product
IAASB	-	International Audit and Assurance Standards Board
IFAC	-	International Federation of Accountants
IFRS	-	International Financial Reporting Standards
IFRS for SMEs	-	International Financial Reporting Standard for Small and Medium-sized Entities
IRBA	-	Independent Regulatory Board of Auditors
IRS	-	Internal Revenue Service
ISA	-	International Standards on Auditing
JSE	-	Johannesburg Stock Exchange
MOI	-	Memorandum of Incorporation
PI-Score	-	Public Interest Score
SAICA	-	South African Institute of Chartered Accountants
SARS	-	South African Revenue Service
UK	-	United Kingdom
USA	-	United States of America

## DEFINITIONS AND CONCEPT CLARIFICATION

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*Applicable Audit Requirements* International Standards on Auditing (ISAs), International Standards on Quality Management (ISQM), the International Code of Ethics for Professional Accountants by the International Ethics Standards Board for Accountants (IESBA Code of Ethics) and relevant legislation, such as the Companies Act of South Africa 2008 and the Auditing Profession Act, 2005.

*Audit / Audit Engagement* The independent, external examination of financial statements, in accordance with the ISAs, with the objective of expressing an opinion as to their fairness or compliance with the identified financial reporting framework and applicable statutory requirements (South Africa, 2005; The International Auditing and Assurance Standards Board (IAASB), 2018b).

*Private Company* A profit company that is not a public company, personal liability company or state-owned company, whose Memorandum of Incorporation prohibits it from offering any of its securities to the public and restricts the transferability of its securities (South Africa, 2008).

*Public Interest Score (PI-Score)* The sum of the following:

- a number of points equal to the average number of employees of the company during the financial year;
- one point for every R 1 million (or portion thereof) in third-party liability of the company, at the financial year end;
- one point for every R 1 million (or portion thereof) in turnover during the financial year; and
- one point for every individual who, at the end of the financial year, is known by the company to directly or indirectly have a beneficial interest in any of the company's issued securities. (South Africa, 2011a).

# CHAPTER 1: INTRODUCTION AND BACKGROUND

---

## 1.1. Introduction and Background to the Study

“Where were the auditors?” – these were the words uttered by nearly every asset manager following the Steinhoff-scandal that shook not only South Africa, but the world (Khumalo, 2019). These words are not new to the auditing profession, considering well-known international scandals such as Enron, WorldCom and Lehman-Brothers, to name but a few. South-Africa has, however, added to this list of scandals in the past decade, with not only Steinhoff, but also those involving VBS Bank, EOH and Tongaat Hulett, and this in a context of an already struggling South African economy (Matsangou, 2019; Mkentane, 2019; Daily Investor, 2022). Naturally, the public wants someone to pay, or at least a target to blame. This gives rise to the question of whether the target should always be the auditors, or whether there is a difference between what auditors are thought to do and what they are required to do. This is commonly referred to as the audit expectation gap.

Public, listed entities are, however, not the only companies which are audited, and while it is understandable that these large corporate scandals are so well known due to their public interest, private companies should not be underestimated. Internationally, small and medium-sized companies contribute more than 50 percent to employment and represent more than 90 percent of all businesses; even more so in emerging economies like South Africa (World Bank, 2023). Still, the audit expectation gap in the context of private companies remains unexplored.

The background to this study will:

- address what is meant by the audit expectation gap;
- provide an overview of the financial statement user perceptions widely identified as contributors to the audit expectation gap; and
- briefly describe recent South African scandals and emphasise the relevance of this study.

### 1.1.1. What is the audit expectation gap?

The audit expectation gap is referred to in the financial press as “the difference between what the public and the financial statement users believe auditors are responsible for and what auditors themselves believe their responsibilities are” (Financial Times, 2018). The first academic study on the audit expectation gap, as defined here, was done by Liggio (1974) who interpreted the audit expectation gap as the difference between the actual performance and expected performance of auditors. The reason for the audit expectation gap ranges from poor performance of auditors and/or deficient auditing standards, to the unreasonable expectations of users of audit reports and the larger public. This is presented in Figure 1, recognising the various causes of the audit expectation gap (Porter, 1993; Hassink, Bollen, Meuwissen and De Vries, 2009).

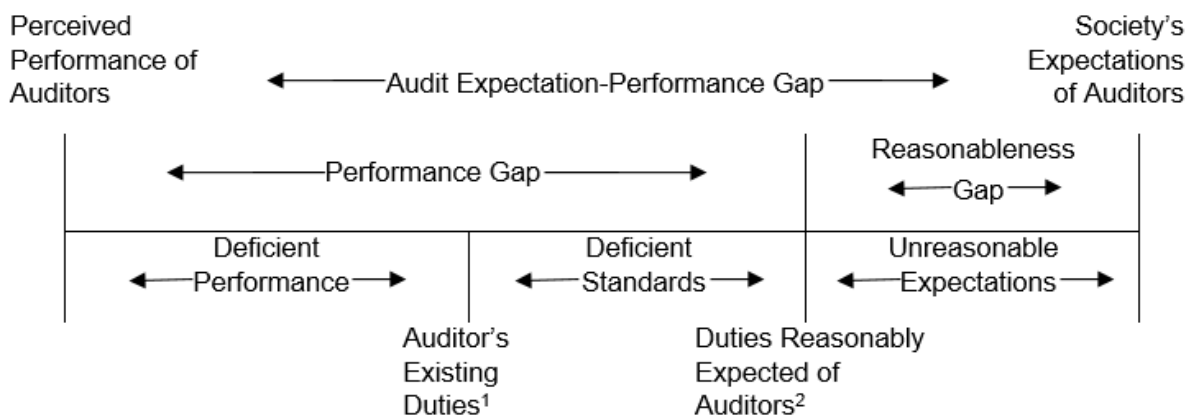


Figure 1: Structure of the audit expectation-performance gap (Porter, 1993)

<sup>1</sup>Duties defined by the law and professional standards

<sup>2</sup>Duties which are cost-beneficial for auditors to perform

Figure 1 divides the audit expectation gap between a performance gap and a reasonableness gap, the latter being the expectation from society which is deemed unreasonably high and outside of the scope of an auditor's duties. Further studies have questioned whether the reasonableness gap is in fact 'unreasonable' and a 'failure of the public' (Ruhnke and Schmidt, 2014) or whether auditors are not merely protecting themselves in order to avoid legal liability from claims (Humphrey, Moizer and Turley, 1993; Hassink *et al.*, 2009). While many auditors feel the audit expectation gap should be addressed by better informing the greater society (Independent Regulatory Board for Auditors (IRBA), 2018), the question should be asked whether the audit expectation gap should not be narrowed from both sides, namely those of the auditor and those of society.

Research conducted by the Association of Chartered Certified Accountants (ACCA) (2019) added an additional dimension to Porter's so-called 'performance gap'. This dimension stems from ACCA's argument that 'deficient performance', according to Porter's study, may be attributable to either perceived deficient performance or actual deficient performance; an argument that results in the breakdown of Porter's performance gap into two components: the 'knowledge gap' and the 'performance gap'. The former refers to the gap between what the public thinks auditors do and what they actually do and the latter refer to the gap between what auditors are required to do according to auditing standards and what they actually do. As the public's perception of what auditors do opposes what the public wants auditors to do (opposite sides of the gap), the knowledge gap as defined by ACCA implies that the public thinks that auditors generally do less than what they actually do, which is also less than what they are required to do according to the auditing standards, i.e. the performance gap. ACCA also identifies an additional element, which addresses what would ideally be expected of auditors, described as the evolution gap. This is illustrated in Figure 2 below.

Knowledge Gap	Performance Gap	Evolution Gap
What the public thinks auditors do	What auditors actually do	What auditors are supposed to do
		What the public wants auditors to do

Figure 2: The Audit Expectation Gap (ACCA, 2019)

Figure 1 and 2 break down the elements of the audit expectation gap in varying detail. When combining the illustrations and elements of Porter (1993) and ACCA (2019), the following illustration is submitted:

Audit Expectation Gap				
Knowledge-Performance Gap		Evolution Gap		
Knowledge Gap	Performance Gap	Standards Gap	Reasonableness Gap	
What the users think auditors do	What auditors actually do	What auditors are supposed to do	What is reasonably expected from auditors by the users	What is unreasonably expected from auditors by the users

Figure 3: The audit expectation gap (compiled by the researcher, informed by Porter (1993) and ACCA (2019)).

While all elements of the audit expectation gap warrant further study, this study will focus on the 'Evolution Gap', therefore evaluating the gap between what auditors are supposed to do, according to applicable audit requirements, and what is expected from auditors by the financial statement users. This study will not divide the expectations from auditors between reasonable and unreasonable expectations, and therefore does not address the breakdown between the 'Standards Gap' and the 'Reasonableness Gap'.

### **1.1.2. The perceptions/expectations of financial statement users of auditors' reports**

Various studies on public, listed companies have identified perceptions and/or expectations of users of financial statements and auditors' reports. These perceptions and/or expectations are often not aligned with, and sometimes exceed, the requirements of auditors prescribed by auditing standard setters. While not all studies agree on these perceptions, the common themes of perceptions beyond what is required of an auditor in terms of the auditing standards include:

- Absolute assurance, rather than reasonable assurance (Epstein and Geiger, 1994; Ruhnke and Schmidt, 2014).
- Assurance on the detection of fraud in all circumstances (Epstein and Geiger, 1994; McEnroe and Martens, 2001; Gray, Turner, Coram and Mock, 2011).
- Assurance on the entity's ability to continue as a going concern (Campbell and Mutchler, 1988; Gray *et al.*, 2011).
- Assurance on the effectiveness of the entity's system of internal control (auditinghelp.com, 2015).
- Assurance on compliance with all relevant laws and regulations (McEnroe and Martens, 2001).
- Assurance on the detection of all misstatements due to error (Epstein and Geiger, 1994; Coram, Mock, Turner and Gray, 2011; Gray *et al.*, 2011).
- Assurance on every item that might be of importance to stakeholders (McEnroe and Martens, 2001).

This study will test these perceptions and expectations, while also investigating other contributors or factors impacting the audit expectation gap in relation to private companies.

### **1.1.3. Recent scandals and the relevance of the study**

Recent corporate scandals in South Africa have once again placed the spotlight on the audit expectation gap (IRBA, 2019b). Some of these scandals include:

- One of the Big-4 audit firms, KPMG South Africa, has been involved in multiple scandals since 2017. These scandals started with the firm's alleged ties to the politically-linked Gupta family, involving accounting irregularities and tax evasion. Sub-standard consulting and the withdrawal of an investigation report for the South African Revenue Service (SARS) also surfaced, (fin24, 2017; Verschoor, 2018). This was followed by KPMG's clear lack of independence in the VBS Bank scandal, which entailed a R2billion fraud scandal and the ultimate collapse of the bank (Khumalo, 2018). Auditor independence has long been considered the most important attribute of audit quality (Mautz and Sharaf, 1961) and a lack thereof would surely impact the 'performance gap'.
- At the end of 2017, one of South Africa's most well-known companies, Steinhoff International Holdings N.V., collapsed after the resignation of its then Chief Executive Officer, Markus Jooste (Rose, 2018). This came after its external auditors of more than 20 years, Deloitte, refused to sign off the 2017 financial statements of the JSE-listed entity. Its share price reached an all-time low of less than R1 in 2019, compared to R96.85 in 2016 (Bowker, 2019) and accounting irregularities of billions were confirmed by the PwC Forensic Report (Steinhoff, 2019). The audit partner assigned to the audit of the Steinhoff Group was found guilty of not acting with professional competence and due care by not obtaining sufficient, appropriate audit evidence and not being sufficiently professionally sceptical (Financial Mail, 2021).
- Bosasa Operations, a private company, was implicated in alleged tender fraud, bribery and corruption, involving many political leaders, the company's management and the auditors (Hunter, 2019; Rose, 2019). While the

investigation is still ongoing, questions regarding the role of the auditor once again arise.

- Executive directors of Tongaat Hulett were found to be involved in a multi-billion Rand reporting scandal, which included misstated financial statements, declaring incorrect profits, and awarding substantial bonuses (Daily Investor, 2022). Its auditor was arrested on accounts of breaching the Auditing Profession Act (Tongaatt Hulett, 2022).

The golden thread question in all of the above cases was “Where were the auditors?” It would seem that the general public places blame on the audit profession for many accountancy irregularities that occur, which then poses the follow-up questions:

- Are the public’s expectations too high (failure of the public)?
- Are auditors complying with relevant acts and professional standards (failure of the auditor)?
- Are the acts and professional standards sufficient to respond to the growing financial challenges and fraud opportunities (failure of the standard-setter)? (Ruhnke and Schmidt, 2014).

As a result of all these scandals, South Africa's ranking in Audit and Assurance Standards by the World Economic Forum has suffered a decline. The country was ranked as number one (1) in the world for seven (7) consecutive years, but dropped to number 30 in the 2017-2018 Global Competitiveness Report. Corruption is also stated as the number one problematic factor for doing business in South Africa (World Economic Forum, 2018), with 77% of South African organisations having experienced economic crime in 2018 (PwC, 2018). As private companies are seldom of high public interest, few of their financial and auditing scandals are covered in the media, but smaller enterprises in South Africa contribute approximately 35 percent to the country’s GDP and constitute over 90 percent of all formalised businesses, also employing between 50 and 60 percent of the country’s workforce (International Finance Corporation, 2021). This emphasises the importance of private companies in the South African economy.

Limited academic research has been conducted on the recent scandals. Prior research has focused mainly on the audit expectation gap in the context of public, listed companies, with very limited research having been undertaken on private

companies. It is submitted that the audit expectation gap in the context of the type of auditee may differ, therefore supporting the need for this study particularly focussing on private companies (Langli and Svanström, 2014).

## **1.2. Problem Statement and Research Question**

The existence of the audit expectation gap has been defined, proven and investigated in numerous studies (Toumeh, Yahya and Siam, 2018). The vast majority of these studies focus on public, listed companies, while others do not specify the range of companies investigated. No evidence of research on the audit expectation gap regarding private companies has been found in the literature. As many private companies are required to be audited in terms of the Companies Act (South Africa, 2011a), it is surprising and of concern that the audit expectation gap in this area remains unexplored.

**The research question considered in this study is:**

*To what extent do the expectations of the users of audited private company financial statements differ from what is delivered by the audit engagement undertaken in accordance with the applicable audit requirements?*

In order to answer the research question, the following sub-questions need to be addressed:

- a. Who are the external users of audited private company financial statements?*
- b. What are the expectations of the users of audited private company financial statements?*
- c. To what extent do the expectations of users differ from what is prescribed by applicable audit requirements?*

In this study, applicable audit requirements include, but are not limited to, International Standards on Auditing (ISAs), International Standards on Quality Management (ISQMs), the International Code of Ethics for Professional Accountants by the International Ethics Standards Board for Accountants (IESBA Code of Ethics), the

IRBA Code of Professional Conduct for Registered Auditors and subsequent amendments (IRBA Code) and relevant legislation, such as the Companies Act of South Africa (2008) and the Auditing Profession Act (2005).

### **1.2.1. Primary Objective**

The primary objective of this study is to determine the existence and cause(s) of the audit expectation gap within the context of audited private companies and to determine what the users of audited financial statements would want auditors to do additionally to assist in reducing the audit expectation gap.

### **1.2.2. Secondary Objectives**

From the above primary objective, the following secondary objectives can be derived:

- SO<sub>1</sub>: Conducting a literature review on the audit expectation gap, the users of audited financial statements, and the expectations of these users (Chapter 2);
- SO<sub>2</sub>: Identifying and presenting the chosen research methodology to follow in order to address the set research objectives (Chapter 3);
- SO<sub>3</sub>: Identifying the expectations that users of audited private company financial statements have from auditors by means of an empirical study (Chapter 4);
- SO<sub>4</sub>: Comparing the identified audit expectations to the outcomes of the audit in terms of the applicable audit requirements (Chapter 4); and
- SO<sub>5</sub>: Summarising the findings of the study and making the relevant recommendations (Chapter 5).

## **1.3. Scope and Delimitations of this Study**

Delimitations of research should be clear in order to inform readers of the extent of the study, as well as its restrictions (Leedy and Ormrod, 2015). While the problem statement describes what the intention of the study is, the delimitation (scope) and limitations of the study aim to define what is *not* intended (Leedy and Ormrod, 2015). The following section describes the scope and limitations of this particular study.

## *Entities*

As noted earlier, the majority of studies performed on the audit expectation gap focus on public, listed entities. Some studies also test perceptions of the general public, without reference to a particular range of companies (Okafor and Otalor, 2013; Otalor and Okafor, 2013). Studies with private companies as their focus are an unexplored area, which supports the need for this study. This study is limited to private companies that are audited, whether voluntarily or mandatorily. According to South African legislation, companies with a Public Interest (PI) Score of 350 and above, and companies with a PI-Score of between 100 and 350 whose financial statements are compiled internally are mandated to be audited. All other companies may voluntarily opt for an audit to be undertaken. (South Africa, 2011a and Crous, Lamprecht, Eilifsen, Messier, Glover and Prawitt, 2012).

Private companies that form part of a group of companies of which the holding company is listed on a stock exchange, are specifically excluded from consideration as the group auditor would typically be appointed by the holding company and the relationship with the auditor would usually be administered by the holding company. Responses received in relation to private companies that are subsidiaries of listed companies, would therefore likely coincide more with studies on public, listed companies than with other responses in this study.

South Africa also has other company types, such as state-owned companies, personal liability companies and non-profit companies, but these companies make up approximately 8% of all companies in South Africa (Companies and Intellectual Property Commission, 2020) and are therefore not of significance in this study. Since May 2011, no new close corporations could be registered and companies can no longer be converted to close corporations (Portfolio Property Investments, 2021), and therefore close corporations also do not form part of this study.

This study is limited to the province of the Free State, in South Africa. This geographical area is particularly relevant due to the nature of its user base. The Free State has very limited listed companies and most audited businesses in the province are incorporated as private companies (Companies and Intellectual Property Commission, 2020). It is also practical to perform the study in this area as this is where the researcher and University where the study was conducted are based. It is

acknowledged that the conclusions reached in this study may differ from a similar study undertaken in a different geographical area, and this represents a limitation of the study.

### *Users/Participants*

When taking into account the nature of the companies within the scope of the study, measuring the audit expectations of the general public would not be relevant, as the general public do not have access to the financial statements of private companies. This study will focus on the gap between what the users of audited private company financial statements expect from auditors and what is delivered by the audit in terms of applicable audit requirements as described, rather than according to the expectations of the society at large.

The users of financial statements are summarised below, indicating which users will be regarded as within the scope of this study. Detail on how these users were determined can be found in 2.4.

**Table 1: Summary of users of financial statements**

<b>Users of financial statements</b>	<b>In or out of scope of the study</b>	<b>Motivation</b>
Shareholders / Investors	In scope	This group is the primary user of financial statements and is required to have access to the financial statements according to the Companies Act (South Africa, 2008). Where a private company is a subsidiary or associate of a parent company and consequently, the shareholder(s) is a company rather than natural persons, the board of directors of the parent company will be regarded as the users of the subsidiary's or associate's financial statements, as the board of directors manages the company, thereby becoming its proxy (South Africa, 2008).

Management	In scope	Executive management uses financial statements for decision-making (Van Auken and Yang, 2014; Van Auken, Ascigil and Carraher, 2014; Akhtar and Liu, 2018). While management might not use the auditor's report as such, the audit service rendered assists the management of private companies with a range of activities as described in section 2.4.1.
Lenders	In scope	Banks require audited financial statements (Minnis, 2011) for the companies who are regarded in scope of this study. The information is therefore available to and used by them.
Creditors and trade unions	Out of scope	Trade unions may only gain access to financial statements of an entity in the case of business rescue, while certain creditors may gain access thereto where a court judgement has determined that access should be granted as the company has insufficient disposable property to cover its debt (South Africa, 2008).  Therefore, access to a company's financial statements is only granted to these groups in exceptional circumstances. This study will only focus on companies in the normal course of business.
SARS	In Scope	According to South African tax law, SARS may obtain access to financial statements upon request (South Africa, 2011b). Typically, SARS requests financial statements along with the companies' submission of their tax return (Jordaan 2019, pers.comm., 22 August). It is therefore clear that SARS is a key user of the financial statements of companies liable for tax.

Source: Compiled by the researcher as informed by the sources mentioned in the table.

The limitations of the study are addressed comprehensively in Chapter 5.

#### **1.4. Research Design and Methodology**

This study is positioned in the constructivist paradigm as it involves the social construction of knowledge through a transactional process (Creswell and Creswell, 2018), but it is also informed by interpretivism as it seeks understanding in the world in which people work and live, developing subjective meaning of their experiences of certain objects or things; in this case, the audit expectation gap (Denzin and Lincoln, 2008; Creswell and Poth, 2018) (cf. 3.2). Induction is employed as the approach to theory development (Saunders, Lewis and Thornhill (2019) (cf. 3.3), while the study is of a qualitative nature as it aims to achieve a deeper understanding of the existence and causes of the audit expectation gap, particularly pertaining to audited private companies. The aim of qualitative research is to achieve depth of understanding (Palinkas, Horwitz, Green, Duan and Hoagwood, 2015) and it is often employed to understand complex phenomena. The main purpose of this study is not to generalise findings (Koerber and McMichael, 2008), but to construct a deep and meaningful picture of the audit expectation gap as a complex phenomenon (Leedy and Ormrod, 2015) (cf. 3.4).

Qualitative research has a number of designs. Leedy and Ormrod (2015) identify a phenomenological study as a design commonly used to understand people's perceptions and perspectives. This is echoed by De Vos, Strydom, Fouché and Delport (2005), who add that the final result of a phenomenological study should portray the phenomenon as seen through the eyes of those who have experienced it personally. Phenomenological studies, therefore, report the experiences of those directly affected by the phenomenon, reducing individual experiences to a holistic understanding (Creswell and Poth, 2018). As this study investigates the perceptions of users of private company audited financial statements, and compare these perceptions/expectations to the applicable audit requirements, it is classified as a phenomenological study (cf. 3.4).

Before commencing with data collection in this study, ethics approval was obtained from the University's Research Ethics Committee. A copy of the ethics approval can be viewed under APPENDIX A. Primary data was collected through in-depth

interviews with the relevant participants in this study (cf. 3.5.1), while secondary data was collected through a review of literature and applicable audit requirements (cf. Chapter 2 and 3.5.1).

Interview participants in this study were categorised in four financial statement user groups and Table 2 sets out the population and sampling techniques used to identify the appropriate participants:

**Table 2: Summary of participants, sampling methods and number of interviews**

<b>Financial Statement User Group</b>	<b>Number of usable interviews</b>	<b>Population</b>	<b>Sampling Technique employed</b>
<b>Executive Management: Finance</b>	5	The executive managers and shareholders of all audited private companies with a registered office in the Free State province, South Africa	Convenience Sampling
<b>Executive Management: Non-finance</b>	5		
<b>Shareholders</b>	2		
<b>Banking Institutions</b>	5	Senior employees in the credit divisions of all locally-controlled South African banking institutions that operate in the Free State Province, South Africa	Intensity Sampling as a form of Purposive Sampling
<b>SARS</b>	3	Employees of the South African Revenue Service (SARS) who undertake tax compliance audits in the Free State Province, South Africa	Purposive Sampling
	<b>20</b>	<b>Total number of interviews rendering usable data</b>	

Source: Compiled by the researcher

Refer to 3.5.3 for more detail regarding the interview participants, the populations and the sampling techniques employed. While a total of 25 interviews were conducted,

only 20 were found to render usable data. During the interviews, the researcher made use of open-ended, in-depth questions as the aim was to obtain a deep understanding of interview participants' expectations and experience (De Vos *et al.*, 2005; Leedy and Ormrod, 2015; Creswell and Poth, 2018). Before interviews were conducted, the appropriate gatekeepers' permission was obtained.

Interviews were transcribed by a professional service provider, after which the transcriptions were de-identified by replacing the names of participants and companies with [PERSON] or [INSTITUTION] where applicable. A co-coder was used to enhance the credibility of the study and achieve investigator triangulation. The researcher and co-coder followed a descriptive coding approach by reading the transcripts independently to identify codes, which were later analysed to identify appropriate categories and themes (Saldaña, 2016) (cf. 3.5.4). At this stage of the research process, its interpretive nature was especially evident. After analysing the data, findings were reported using verbatim quotations and rich descriptions, triangulated with applicable audit requirements. This contributed to the overall trustworthiness of the study.

The research philosophy and paradigm, approach to theory development, research design and strategy, data collection, data analysis and the strategies employed to enhance the trustworthiness of the study, as well as ethical considerations are discussed in further detail in Chapter 3.

## **1.5. The Significance of this Study**

Research on listed companies is widely documented and available, which includes research on the audit expectation gap, while topics such as the quality of audits, audit fees and the effect of internal audit functions and audit committees on external audits are also covered (McEnroe and Martens, 2001; Gray *et al.*, 2011; Asare and Wright, 2012; Brydon, 2019b). It is understandable that listed companies are subject to extensive and frequent research, not only because of their major public interest, but also due to the availability and accessibility of information.

The economic importance of private companies should, however, not be underestimated. 99% of all companies in the USA are private, unlisted companies, contributing more than 50% to its private sector's gross domestic product (GDP) (Langli and Svanström, 2014). In the United Kingdom, more than 50% of audit fees received by auditors come from private companies (Chaney, Jeter and Shivakumar, 2004). The World Bank (2023) reports that small and medium-sized companies contribute more than 50 percent to employment and represent more than 90 percent of all businesses globally. In emerging economies, like South Africa, these companies often contribute more than 40 percent to the country's gross domestic product. While not all small and medium-sized entities are audited, a large number of private companies in South Africa are mandated to be audited in terms of the Companies Act (South Africa, 2008). Many audited private companies also exceed the criteria for small and medium-sized entities (Connect Space, 2023), arguing that the impact of private companies on the economy is likely to exceed the statistics on small and medium-sized companies. In response to the Brydon review's call for views, the IFAC urges attention to small and medium enterprises, emphasising this sector as an important part of the economy (IFAC, 2019), and further supporting the need for research in this area.

Given the differences between public, listed companies and private companies, which include the nature of their financial statement users and the quality of the audit service (cf. 2.3), research findings on private companies are likely to differ from those on public, listed companies. The study will, therefore, contribute to understanding the differences between public, listed companies and private companies in the context of the audit expectation gap.

The state of the auditing profession in South Africa has reached a long-time low and audit quality and independence has become a global concern (Kassem and Higson, 2016). Auditors cannot continue to ignore the demand from users of financial statements for them to do more. Many studies focus on the auditor's perspective of the audit expectation gap, primarily attributing its existence to unreasonable expectations from the users of financial statements (Toumeh, Yahya and Siam, 2018). Studies focus largely on the views of the auditor, without challenging whether auditors are acting with the required expertise or whether auditing standards are sufficient in addressing the possibility of fraud, amongst other expectations.

The aim of this study is to identify the existence and causes of the audit expectation gap, specifically pertaining to private companies in the province of the Free State. While this study does not primarily focus on the solution to narrowing the gap going forward, it aims to indicate what the main causes of the audit expectation gap are and what users of financial statements would ideally want auditors to achieve, therefore opening the opportunity to future studies addressing possible solutions.

The first step in restoring the reputation of the auditing profession is acknowledging that there is a problem to be solved. The audit expectation gap is but one of the problems and may have widened as a result of the recent scandals in South Africa. This study recognises the renewed relevance of the audit expectation gap, as well as the need to explore audits of private companies.

***“Only through combined efforts will we be able to restore the reputation of the profession.”***

**Bernard Agulhas, former CEO of the IRBA**

## **1.6. Chapter Outline and Reference Style**

The outline of this dissertation is as follows:

**Chapter 1** contextualises the study by providing a high-level background of the audit expectation gap and the relevance thereof after recent developments in the auditing profession. Gaps in the existing literature are also identified as context in formulating the problem statement. The research objectives are outlined, followed by a description of the scope and delimitation of the study. A brief outline of the research methods employed is also provided, and finally, the significance of the study is argued.

In **Chapter 2**, a detailed review of literature related to the study is presented. Literature sources pertaining to the audit expectations gap, the evolution of the audit, users of audited financial statements and key differences between public and private companies were scrutinised. Electronic literature sources were identified by making use of *Google Scholar*® and *EBSCOhost*®, while the library staff of the University

where the research was conducted were also approached to locate literature from reputable journals and publications.

Chapter 2, therefore, addresses the first secondary objective of the study, which is to conduct a literature review on the audit expectation gap, the users of audited financial statements, and the expectations of these users (SO<sub>1</sub>).

**Chapter 3** sets out the research methodology employed in this study. The research paradigm which informs the research methodology is addressed, after which the approach to theory development and research design and strategy are discussed. Thereafter, the data collection methods, population and sampling techniques employed are set out, followed by the approach followed to analyse and code data. The chapter is concluded by discussing the trustworthiness of the study and ethical considerations.

The second secondary objective, to identify and present the chosen research methodology to follow in order to address the set research objectives (SO<sub>2</sub>), is therefore addressed in Chapter 3.

In **Chapter 4** the empirical findings of this study are presented and discussed for two participant groups: *Management and Shareholders* and *External Stakeholders*. Codes, categories and themes identified through the data analysis and coding process are presented alongside prominent links to prior literature, where applicable. Findings are also supported by verbatim quotations with rich descriptions from participants. This approach addresses the third secondary objective: Identifying the expectations that users of audited private company financial statements have from auditors by means of an empirical study (SO<sub>3</sub>).

The fourth secondary objective, to compare the identified audit expectations to the outcomes of the audit in terms of the applicable audit requirements (SO<sub>4</sub>), is also addressed in Chapter 4, by discussing the applicable audit requirements related to each finding, which triangulates the findings. Preliminary conclusions are drawn at the end of each finding by indicating the ways in which the main research question and sub-questions are answered.

**Chapter 5** concludes the study by briefly summarising the literature review and research methodology employed. The final conclusions drawn from the study are

presented by plotting the findings against theoretical underpinnings which inform this study. Findings are summarised according to their impact on the audit expectation gap. The differences between public and private companies are again revisited, but this time in the context of the audit expectation gap. The limitations of the study are acknowledged and areas for future research are presented before concluding the study with final reflections.

Throughout the dissertation, the 'Harvard Reference format 1 (deprecated)' style of reference, as automated by the *Mendeley Cite-O-Matic* plug in on the *Microsoft Word* program, was used. Page numbers of sources cited are presented in the Reference List at the end of the dissertation, where applicable, to give due recognition to sources.

## **1.7. Summary and Concluding Remarks**

An orientation to this study was presented in this chapter by providing a background to the study and detailed description of the problem statement, research questions and objectives. A synopsis of the research method employed was also presented. Lastly, the significance of the study was argued, followed by an outline of the dissertation.

In order to truly understand the phenomenon of the audit expectation gap and related concepts, a comprehensive literature review is essential. Chapter 2 provides a review of literature on the evolution of the external audit service, the history of the audit expectation gap, and typical areas contributing to the audit expectation gap. It further delves into the key differences between public and private companies and the users of financial statements.

## **CHAPTER 2: LITERATURE REVIEW**

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### **2.1. Introduction**

Chapter 1 set out the problem statement and research question for this study. It also included a brief overview of the elements of the audit expectation gap and identified what some of the expectations of users of financial statements and auditor reports may be. The relevance of this study was also addressed, particularly in the light of recent occurrences and scandals surrounding the audit profession.

The literature in this chapter provides a deeper understanding of the audit expectation gap and its evolution in response to the changing auditing environment. Although many studies address the audit expectation gap, they often do not differentiate between private and public, listed companies, or many focus only on public, listed companies. This chapter provides literature supporting why findings in the public company sphere may not be generalisable to private companies, while also detailing the differences between private and public, listed companies. These differences will also emphasise the relevance of this study, given that not much has been done to investigate the audit expectation gap in private companies.

### **2.2. The Audit Expectation Gap and its Evolution**

#### **2.2.1. The Evolution of the Purpose of an Audit**

External audits play a vital role in maintaining the well-being and stability of society, but the practice of auditing has evolved over years and will probably continue to do so in future (Teck-Heang and Ali, 2008).

In the book, 'Principles of External Auditing', Porter, Simon and Hatherly (2003) describe the development of the objective of the audit function. This is echoed and elaborated on by Teck-Heang and Ali (2008) in their article on 'The Evolution of Auditing: An analysis of the historical development'. The history of the establishment of the International Auditing and Assurance Standards Board (IAASB) and the growing

number of ISAs, as well as their significance and influence, are dealt with by Humphrey, Loft and Samsonova-Taddei, (2014). A synthesis of their findings is summarised in Table 3, while also incorporating the developments within South Africa as reported on by the South African Institute of Chartered Accountants (2022) and the Public Accountants' and Auditors' Board (2006).

**Table 3: Overview of the evolution of the objective of the external audit**

<b>Time Frame</b>	<b>Evolution of Auditing</b>
Prior to 1840	The practice of auditing was not formalised prior to 1840, but some forms of verifying financial information existed, with the primary purpose of preventing or detecting fraud. Sampling was not part of audit procedures at this stage, and auditing comprised detailed verification of every transaction.
1840 – 1920	With the industrial revolution, auditing became an established function. Large commercial and industrial undertakings developed, while the share market was unregulated. This resulted in numerous financial failures, and it became evident that investors needed protection. During this time, auditors' duties mainly comprised the detection of fraud and ensuring the appropriate representation of a company's solvency/insolvency in the balance sheet.  The Institute of Accountants and Auditors in the South African Republic (IAASAR) was established in 1894 and the South African Committee of the Society of Accountants (SAC) in 1896.
1920 – 1960	During this period the purpose of an audit shifted from the detection of fraud and errors to assessing the reliability of financial statements. It was also in this period that the use of sampling and reliance on management's implementation of controls arose.  In South Africa, the Public Accountants' and Auditors' Bill (Bill 51 of 1951) was introduced, which prompted the establishment of the Public Accountants' and Auditors' Board (PAAB).
1960 – 1990	During this period the economy grew substantially, and auditors played an important role in furthering the operations of an effective capital market through enhancing the credibility of financial

	<p>statements. This is also the era wherein advisory services were seen as a secondary audit objective.</p> <p>An international body for the development of international auditing guidance was established in London in 1977, with a secretariat in New York. The first International Auditing Guidelines (IAGs) were issued in 1980 and a number of IAGs followed, although these standards were not yet adopted by South Africa.</p> <p>The South African Institute of Chartered Accountants was established in 1980 and had, amongst others, the duty to set audit standards in South Africa.</p>
1990 – 2000	<p>The primary objectives of an audit – to enhance credibility of financial statements – remained the same after 1990, but a business risk approach, rather than an audit risk approach was adopted. This was done to improve the effectiveness and efficiency of the audit, as well as to ‘add value’ to the audit. The auditing profession also became more rule-based, especially to strengthen independence and audit quality. 28 IAGs were issued by 1991, after which these pronouncements were renamed to ISAs to reflect the appropriate authority. All existing ISAs were updated and codified for ease of understanding and use in 1994.</p>
2001 - 2007	<p>The Enron scandal broke in 2001 and after the collapse of Enron’s audit firm, Arthur Anderson, regulators pushed for greater independent oversight. A ‘Clarity Project’ was launched by the IAASB in 2004, which led to the update, clarification and substantive changing of the 36 existing ISAs.</p> <p>In South Africa, the audit standard-setting role was transferred from SAICA to the PAAB in 2001, who became responsible for issuing all auditing pronouncements. The Auditing Profession Act (Act 26 of 2005) was passed in late 2005 and in 2006 the PAAB became the Independent Regulatory Board for Auditors (IRBA) as a consequence thereof. From January 2005, South Africa adopted the ISAs as set by the IAASB.</p>

After 2008	While the 'Clarity Project' concluded in 2009, another global financial crisis hit, which caused the role of the auditor to be questioned. Significant changes were made to the format of the auditor's report in order for it to be more relevant and informative to users. As of 2023, there are 37 ISAs, which are supplemented by other pronouncements and practice notes.
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*Source: Porter, Simon and Hatherly, 2003; Teck-Heang and Ali, 2008; Humphrey, Loft and Samsonova-Taddei, 2014*

From the above it is evident that, over time, there has been an evolution in the nature of the audit engagement and, specifically, the purpose of a financial statement audit. Fraser (2010) describes this evolution by pointing out that auditing in recent years has become far more complex than it was in its early days. He attributes the complexity to the significant increase in auditing standards, the complicated transactions and accounting due to the globalisation of the business world, consolidated accounts (which were not always required) and the sophisticated integration of information technology.

Taking all of this into account, the question naturally arises of whether the objective of an audit in its current form does not fall short of what can reasonably be expected by the users of financial statements (IRBA, 2018).

### **2.2.2. Historical Overview of the Audit Expectation Gap**

The audit expectation gap is regarded as one of the most debated phenomena in the accountancy field and has been defined as a state of incompatibility between the auditor and the users of financial statements on the procedures and results of an audit (Toumeh, Yahya and Siam, 2018). While Liggio (1974) was the first to introduce the concept of the 'Audit Expectation Gap', a number of studies elaborated thereon and investigated different components thereof. The major studies and findings are addressed in this section.

Porter (1993) was the first to introduce a formal definition, providing structure and components to the concept and suggesting the broadened term 'audit expectation-performance gap'. This was addressed in section 1.1.1, which included a schematic

presentation (cf. Figure 1). She further argues that the causes of the audit expectation gap can be attributed to either deficient performance of auditors or deficient auditing standards (grouped as the 'performance gap') or unreasonable expectations from society (indicated as the 'reasonableness gap'). Other studies have defined the audit expectation gap as follows:

- The difference between the perception of the public and financial statement users of auditors' responsibilities versus what auditors believe their responsibilities are (McEnroe and Martens, 2001).
- The public's expectations of an audit exceeding auditors' perceived performance (what the public thinks auditors do) (Ruhnke and Schmidt, 2014).
- The difference between what the public expects from the auditing profession and what the auditing profession actually provides (ACCA, 2019).
- The expectations of beneficiaries of audited financial statements exceed what can be reasonably expected from auditors to achieve (Quick, 2020).

The audit expectation gap has been studied in many countries, focusing mainly on whether a gap exists and what the contributing factors are. While various countries have judicial and cultural differences, it was universally established that the audit expectation gap does exist and that the public often expects more from auditors than what can be reasonably expected from them, mainly due to the public's lack of understanding of auditors' roles and responsibilities (Porter, 2014). In South Africa, the regulator, the IRBA, is also of the opinion that the public lacks understanding of the work and purpose of auditors (IRBA, 2018), which also links to society's 'unreasonable expectations'. However, some studies that investigated the auditors' perceptions of the audit expectation gap and its causes, recognise that auditors may be biased in their analysis, not only because of their knowledge of and familiarity with the subject, but also due to self-interest (Ruhnke and Schmidt, 2014; Toumeh, Yahya and Siam, 2018).

The quality and effectiveness of an audit was recently the subject of a high-profile study, commonly referred to as the 'Brydon Review'. In April 2019, the United Kingdom's Department for Business, Energy and Industrial Strategy contracted Sir Donald Brydon, chairman of the London Stock Exchange Group, to perform an independent review into the quality and effectiveness of an audit (United Kingdom,

2019). This review addresses not only the audit expectation gap, but also the scope of an audit, changes that may be required and how an audit can better serve the public interest. The terms of reference limit the scope of this review to ‘public interest entities’, which includes companies with equities or debt admitted to trading on a regulatory market and credit and insurance firms (United Kingdom, 2019).

The final report, entitled “Assess, assure and inform: Improving audit quality and effectiveness” was released in December 2019 and contains over 30 recommendations to improve audit quality and effectiveness; many of these suggestions aimed at role players other than auditors. Brydon makes specific reference to the audit expectation gap, as well as other gaps, in his report. He mentions the view that the audit expectation gap was created by the accountancy profession in order to blame users who misunderstand the role of auditors. Brydon himself, however, views the concept of the audit expectation gap as a “distraction” and adds that “audit is either helping to reinforce deserved confidence in business or it is not. What is required is better audit delivered by professionals in a more understandable framework.” (Brydon, 2019a). Brydon therefore does not specifically link the suggestions in his report to the audit expectation gap, but many of his recommendations address the typical areas where differences in expectations arise, which are discussed in the following section.

### **2.2.3. Typical Areas where Differences in Expectations Arise**

In order to understand the audit expectation gap, an important step is identifying what the expectations of users of financial statements, and ultimately users of auditors’ reports, are. The most common expectation of users of financial statements from auditors is that of fraud detection (Quick, 2020). Numerous studies have indicated that users assume or expect that auditors will detect all fraud, or at least all material fraud (Epstein and Geiger, 1994; McEnroe and Martens, 2001; Gray *et al.*, 2011). The Brydon Review’s initial draft report echoed this by specifically including “an expectation that the auditor will have actively sought out any evidence of fraud” as a contributing factor to the audit expectation gap (Brydon, 2019). Similarly, the detection of all misstatements due to error in the financial statements has also been identified as a

common expectation amongst users (Epstein and Geiger, 1994; Coram *et al.*, 2011; Gray *et al.*, 2011).

The level of assurance provided by an audit is closely linked to the likelihood that all fraud and errors have been detected. Due to the inherent limitations of an audit, such as the use of sampling and judgement, an audit can only provide reasonable assurance, rather than absolute assurance (IAASB, 2022b). Users of auditors' reports are, however, unfamiliar with the concept of 'reasonable assurance' and commonly have inflated expectations thereof (Ruhnke and Schmidt, 2014). Misunderstandings regarding the level of assurance provided by auditors may therefore contribute to the audit expectation gap. In Brydon's final report, he pushes for better communication and transparency from auditors, a change in the definition of an audit and a change to the language used in the auditors' opinions (Brydon, 2019a), all of which aim at providing users with a better understanding of the audit. A study by ACCA involving 11 countries also indicated that the overall understanding of what an external audit entails is poor. This conclusion was reached after more than 50% of participants in the ACCA study were unable to identify the definition/purpose of an audit, highlighting the knowledge gap (ACCA, 2019).

Assurance on the entity's ability to continue as a going concern or, similarly, preventing company failure, also ranks high as an audit expectation on the one end (Campbell and Mutchler, 1988; Gray *et al.*, 2011; Ruhnke and Schmidt, 2014; ACCA, 2019; Brydon, 2019). On the other side, investors often consider the auditor's report in decision-making and would naturally want to invest in companies with sound and sustainable business practices. Investors therefore often falsely believe that when a company is issued with an unmodified audit report, it can be regarded as a good investment (McEnroe and Martens, 2001; Quick, 2020).

Following the Enron-scandal, the United States of America (USA) introduced the Sarbanes Oxley Act (Rockness and Rockness, 2005). In addition to the standard auditor's report, Section 404 of this Act also requires auditors of public, listed companies to issue joint reports on their clients' internal control over financial reporting (Asare and Wright, 2012). This in itself indicates that the users of financial statements are interested in a company's internal control. Being USA legislation, these provisions of the Sarbanes Oxley Act are only applicable to publicly traded companies, wholly

owned subsidiaries of those companies, and foreign companies who are publicly traded and do business in the USA (Sarbanes-Oxley-101.com, 2021). Indicators are, however, clear that some users are under the false impression that good internal control is certified with an unmodified auditor's report. Others have also called for auditors to explicitly express an opinion on audit clients' internal control over financial reporting (Fadzly and Ahmad, 2004; Pourheydari and Abousaiedi, 2011; auditinghelp.com, 2015).

While some laws and regulations, such as tax laws, have a direct impact on a company's financial statements, not all laws and regulations are of audit importance (IAASB, 2022b). It does seem, however, that users are also of the opinion that an audit should ensure that a company is not involved in any illegal operations (McEnroe and Martens, 2001; Ruhnke and Schmidt, 2014). This potentially contributes to the audit expectation gap as well, as International Standards on Auditing 250 states that auditors cannot be expected to detect non-compliance with all laws and regulations, as many laws and regulations relate to the operational aspects of an entity and do not have a direct effect on the financial statements (IAASB, 2022b).

Table 4 sets out a summary of the typical areas above where a difference in audit expectations arises:

**Table 4: Typical areas where differences in expectations from an audit arise**

<b>Expectation</b>	<b>Description</b>	<b>Source</b>
<b>Fraud detection</b>	Users expect that an external audit will detect all fraud.	Epstein and Geiger, 1994; McEnroe and Martens, 2001; Gray <i>et al.</i> , 2011; ACCA, 2019; Brydon, 2019b; SAICA, 2019; Quick, 2020
<b>Error detection</b>	Users expect that an external audit will detect all errors in the financial statements.	Epstein and Geiger, 1994; Coram <i>et al.</i> , 2011; Gray <i>et al.</i> , 2011
<b>Going concern (preventing company failures)</b>	Users expect that an unmodified auditor's report confirms that the	Campbell and Mutchler, 1988; Gray <i>et al.</i> , 2011; Brydon,

	company is financially strong and therefore a going concern.	2019b; ACCA, 2019; Quick, 2020
<b>Investment decision</b>	Users expect that an unmodified auditor's report confirms that it is a good financial decision to invest in the company.	McEnroe and Martens, 2001
<b>Level of assurance</b>	The concept of reasonable assurance is misunderstood by users and they often perceive 'reasonable assurance' as 'absolute assurance'. This also links to the language barrier in auditor reports, making it difficult for users to understand and interpret.	Epstein and Geiger, 1994; Ruhnke and Schmidt, 2014; Brydon, 2019a
<b>Assurance on internal control</b>	Users expect that an unmodified auditor's report confirms that all internal controls are implemented effectively and that the auditee has a good control environment.	Fadzly and Ahmad, 2004; Pourheydari and Abousaiedi, 2011; auditinghelp.com, 2015
<b>Assurance on compliance with all laws and regulations</b>	Users expect that an external audit tests compliance with all laws and regulations and that an unmodified auditor's report confirms compliance thereto.	McEnroe and Martens, 2001; Ruhnke and Schmidt, 2014

Source: Compiled by the researcher

### **2.3. Key differences between a Public and Private Company from an audit expectation gap perspective**

While the audit expectation gap has been researched extensively, studies either do not differentiate between public, listed and/or private companies (i.e. results are not presented in a manner to enable comparison) or the focus of the study is primarily on public and/or listed companies. The terminology used in countries around the world to describe the various types of companies and their legal status, also differs to some extent. To accurately interpret the results and findings of prior studies on the audit expectation gap, the country-specific nuances regarding public, listed companies and private companies need to be understood. To illustrate this point, these concepts as applied in the world's two largest economies, the USA and the European Union (Trading Economics, 2024) are detailed below, followed by an explanation of the situation in South Africa.

In the USA, companies are considered 'public companies' when they have public reporting responsibilities – which arises when securities are sold in a public offering, when the number of investors reach a certain size, or when they voluntarily register with the US Securities and Exchange Commission. For these US public companies, their shares may but do not have to be traded on a securities exchange and their financial reports are available in the public domain (United States Securities and Exchange Commission, 2021). Companies not considered 'public companies' are not required to make their financial reports available to the public and therefore the user group would differ.

In the European Union, there are four types of companies: Private Companies Limited by Shares, Private Companies Limited by Guarantees, Private Unlimited Companies and Public Limited Companies. For the first two, members' liability is limited, while for the third, there is no limit to members' liability. For all three 'private' companies, shares are not publicly traded. In the case of public limited companies, members' liability is limited to the amount unpaid on their shares. A public limited company may offer its shares to the public and may or may not be quoted on a stock exchange. These companies are also required to publish their financial reports in the public domain (United Kingdom Companies House, 2021).

In South Africa, all companies are regulated by the Companies Act 71 of 2008. This Act defines a private company as a profit company, which prohibits the offering of its securities to the public and restricts transferability of its securities. It also excludes public, state-owned or personal liability companies (South Africa, 2008). Similar to the international perspective, in South Africa the most noticeable differentiator between a public and a private company is the fact that the former's shares are traded in the public domain and easily transferable, while the latter's shares are not. South Africa has approximately 330 companies listed on the Johannesburg Stock Exchange (JSE) and therefore the public has access to their financial statements and other information (Johannesburg Stock Exchange, 2020; CEIC Data, 2021). With private companies' shares not being traded, the public does not have access to their financial statements and other information. It is acknowledged that not all public companies are listed. The legal status of public companies and public, listed companies is, however, the same and the nature of their users is comparable.

The legal status of South African companies is similar to that of other countries, and it seems that, overall, private companies restrict public share trade, while public companies allow public share trade and may, but do not always, list on a stock exchange. Most noticeable is the fact that public companies are required to make their financial reports available in the public domain, while this is not a requirement for private or non-public companies. The implication is therefore that the users of the financial statements for public and private companies will differ.

In addition to the obvious differences between public and private companies, the nature of these companies, how they operate, their governance structures and often, their auditors, differ from those of public, listed companies. Details of these differences are discussed by Langli and Svanström (2014) and summarised in Table 5.

**Table 5: Key differences between Public and Private Companies**

<b>Category</b>	<b>Brief description of how a private company differs from a public, listed company</b>	<b>Reference to further discussion</b>
<b>The nature of agency conflict</b>	Due to its often more concentrated ownership, conflict arises between shareholders and management of private companies, as these are limited to a smaller number of individuals, often including family ties.	2.3.1
<b>Quality of financial statements</b>	There are weaker incentives to provide high quality financial statements for private companies as these are analysed less by market participants.	2.3.2
<b>Quality of auditors</b>	Due to the lower risk of litigation and reputational damage for private companies, there is reduced pressure to hire high quality auditors.	2.3.3
<b>Voluntary audits for some</b>	Many private companies are not mandated to be audited, but choose to be audited for various reasons, such as reduced finance costs from banking institutions or to compensate for loss of control upon expansion.	2.3.4

*Source: Compiled by the researcher based on the findings by Langli and Svanström (2014).*

These differences will be discussed more comprehensively in the sub-sections that follow.

### **2.3.1. The Nature of Agency Conflict in Private Companies**

The relationship between shareholders, directors and management often creates agency conflict. Agency conflict in the context of companies is explained as the shareholder(s) (principal) mandating management and/or directors (agents) to make

decisions regarding the daily operations of the company, consistent with predetermined agreements, contracts and restrictions (Safrihana, Subroto, Subekti and Rahman, 2019). Information asymmetry arises when there is a conflict of interest between the principal and the agent, which often necessitates independent assurance by means of an audit (Safrihana *et al.*, 2019).

Elements of agency conflict are present in any company, but the nature thereof differs for private companies compared to public, listed companies. Public, listed companies' shareholding is usually wide spread, with ownership commonly lying with members of the general public. Private companies' shareholding, however, often includes owner-management as well as family ties between owners and management (Hope, Langli and Thomas, 2012; Langli and Svanström, 2014; Corten, Steijvers and Lybaert, 2017).

Hiring an auditor to mitigate high intra-family agency conflict, is not necessarily an economical decision, but often one driven by emotions (Corten, Steijvers and Lybaert, 2017). This can be due to conflict between parents and children, sibling rivalry or jealousy, which could lead to opportunistic behaviour (Sharma *et al.*, 2001; Nicholson, 2008b, 2008a). Conflict may also arise between family and non-family members due to differences of opinion, different goals or even employment of other family members (Schulze, Lubatkin, Dino and Buchholtz, 2001; Schulze, Lubatkin and Dino, 2003).

Esplin, Jamal and Sunder (2018) argue that both accounting and auditing have different purposes for private companies compared to public, listed companies. They support this by stating that private companies usually have dominant shareholders, something which carries the risk that corporate control can be misused and minority shareholders be abused. For public, listed companies, auditors may focus more on monitoring management with the intention of protecting shareholders, while in private companies, it is often the majority shareholder that needs to be monitored. In addition, private company stakeholders are also less dependent on financial statements in order to gain information about the company as they typically have access to internal information as well as direct access to the auditor himself.

Auditors also respond differently to the nature of agency conflict in private companies. Auditors' efforts are often increased where the private company auditee's Chief Executive Officer (CEO) has family ties with majority shareholders, possibly due to the lack of independence of shareholders. The auditor's efforts are decreased when fewer

shareholders are present and when all the shareholders are also directors, as involvement and monitoring by shareholders in these cases are increased (Hope, Langli and Thomas, 2012; Corten, Steijvers and Lybaert, 2017). Auditors therefore respond differently to the auditing of public and private companies. Due to auditors' varying response to auditees, financial statement users may experience audits differently, thereby possibly having different perceptions about and expectations of an audit.

### **2.3.2. The Quality of Financial Statements**

In smaller companies, access to in-house expertise is often limited, and therefore these companies may opt for an audit purely to gain access to financial expertise (Langli and Svanström, 2014). (A discussion on voluntary audits is presented in 2.3.4.) Owners' inability to interpret financial statements may also point to their inability to prepare quality financial statements. However, owners' ability to prepare quality financial statements is not the only consideration, as Langli and Svanström (2014) also found that the incentive to produce high quality financial statements is weaker for private companies, as these financial statements are not scrutinised and analysed as much as those of public, listed companies.

Ball and Shivakumar (2005) found that the quality of private companies' financial reporting is lower than that of public companies. Although they are subject to the same accounting standards, private companies often substitute financial reporting for private communication, as demanded by the market in which they operate. Beuselinck and Manigart (2007), in addition, argue that where private equity investors have a high equity stake, financial statements produced are also of lower quality.

It is therefore clear from the above that financial statements for private companies differ from those of public, listed companies when considering the quality thereof and, to some extent, how these financial statements are used, or not used, in decision-making. The difference in the quality of audited financial statements may, therefore, contribute to the possible audit expectation gap in private companies.

### **2.3.3. Audit Firms and Audit Quality**

Another matter which differentiates auditing for public and private companies, is the auditor itself. In the European Union (EU), 90% of public companies are audited by the so-called “Big-4” audit firms – Deloitte, Ernst & Young, KPMG and PwC (Big 4) (Langli and Svanström, 2014). This is mirrored by South Africa with 90% of JSE-listed companies also being audited by one of the Big-4 firms, even though 23 audit firms / firm networks are approved by the JSE to audit JSE-listed companies (IRBA, 2015; JSE, 2020). It is therefore safe to say that the Big 4 firms dominate listed company audits in South Africa.

When viewing all companies – public and private combined – the Big 4’s market share in the EU is only 26% of audit fee revenue in 19 of its member states and 44% in four of its member states (ESCP Europe, 2013), clearly indicating that the Big-4’s involvement in the private company audit market is less than that of non-Big 4 firms. In South Africa, similar statistics are not readily and reliably available, but according to the website of the IRBA, 1 996 registered audit firms can be found (IRBA, 2020). Few of these firms have involvement in the audit of listed companies, given the Big 4’s dominance of the JSE market (IRBA, 2017). While Big 4 firms have various listed and private company clients, non-big 4 firms have limited (if any) listed clients and therefore mostly service private companies.

As all auditors in South Africa are required to conduct audits in terms of the ISAs (IRBA, 2019a), one would expect that audit quality and audit offerings would be similar for Big 4 and non-Big 4 firms. Other factors may, however, contribute to differences in audit quality and audit offerings for private companies. Most ISAs contain sections with specific considerations for smaller entities, which are those entities with concentrated ownership and management, complemented by some other characteristics, such as few internal controls, straightforward and uncomplicated transactions, and so forth (Bagshaw, 2013). It is also acknowledged internationally that audits for smaller entities do differ from those for larger entities. For example, when determining materiality, the amount in the financial statements that would influence users’ decision-making is influenced by the financial statement user profile, which is likely to differ between public, listed companies and private companies (cf. 2.4). Furthermore, the

Independence Standards have various stricter requirements for audits of public interest entities, such as public, listed companies.

The IAASB noted that more than 90% of businesses worldwide are small and medium-sized entities, which led to a proposed new standard (exposure draft for comments) that was released by the IAASB in 2021 to guide audits for smaller, less complex entities. This standard proposes a proportionate application of the ISAs to the nature and circumstances of the entity and is more clear, concise, understandable and simplified (IAASB, 2021a).

Private companies are also associated with lower reputational risk for auditors due to their information not being publicly available, as well as decreased risk of litigation, seeing that the users of audit reports are also fewer in comparison to public, listed companies (Rodríguez and Alegría, 2012; Langli and Svanström, 2014). The lower risk may lead to auditors being less diligent, possibly reducing audit quality. While Big-4 firms are able to consult with a network of specialists within the firm (Carson, 2009) and have access to audit guidelines, tools and training (Lenz and James, 2007), smaller firms do not necessarily have access to these resources and often operate alone. It has also been found that Big 4 firms charge a premium compared to smaller firms, given their firm-specific characteristics and higher quality audits (Chaney, Jeter and Shivakumar, 2004; Choi, Kim, Kim and Zang, 2010).

In contrast, studies have also found evidence of improved audit quality in smaller firms, due to synergies achieved with non-audit service offerings (Beardsley, Lassila and Omer, 2019). This would contribute to the auditor having a better understanding of the company and its environment, but could be at the cost of auditor independence. Langli and Svanström (2014) remark that private company audit quality may be more dependent on the individual auditor and his/her specific experience, competence, integrity and judgement, in comparison to Big-4 firms.

Esplin, Jamal and Sunder (2018) investigated audit quality for private companies, wherein they noted that, for private companies, management desired the following from auditors: General business, accounting and tax advice; identifying control deficiencies and suggestions on how to improve internal control; exposure to business networks; the offer of other non-assurance services; and sometimes even personal tax advice. They further noted that within private companies, CFOs often dictate where

auditors must focus their testing, requiring audit risks to align with business risks in order to 'get value from the audit' (Esplin, Jamal and Sunder, 2018). As the aforementioned factors are all likely to compromise independence, the quality of the audit may also be compromised. Auditor independence has long been considered the most important attribute of audit quality (Mautz and Sharaf, 1961).

As discussed at the start of this section, it is recognised that some private companies are also audited by Big-4 firms, but that this is far from the majority. Given the differences in audit firms and the quality of the audit delivered when comparing public, listed companies and private companies, it is submitted that the users of private company audit reports may experience audits differently to those of public, listed companies.

#### **2.3.4. Voluntary and Mandatory Audits**

While all public, listed companies are mandated to be audited, this is not the case with all private companies. Which South African private companies are mandated to be audited, is largely determined by two factors: the company's PI-Score and whether the company has its financial statements compiled internally or independently. Private companies are only required to undergo an audit in one of the following cases (South Africa, 2011a; Crous *et al.*, 2012):

- The company's PI-Score exceeds 350 points;
- The company's PI-Score is between 100 and 350 points and its financial statements are internally compiled; or
- The company holds assets exceeding R5 million in a fiduciary capacity for anyone not related to the company.

In some instances, the legal form of the company requires it to be audited (Weik, Eierle and Ojala, 2018), which, in South Africa, may be that a company's Memorandum of Incorporation requires it to be audited, although its PI-Score may be below the threshold mandating an audit. In this case, however, the audit becomes a statutory audit (South Africa, 2008; SAICA, 2018). Some holding companies who are mandated to be audited, also require their subsidiaries, who may not be required to be audited

by law, to undergo an audit for the purpose of consolidated reports (Weik, Eierle and Ojala, 2018). ISA 600 determines that a subsidiary that is financially significant to the group of companies or that is likely to include significant risks of material misstatement of the group financial statements due to its nature, must be audited (IAASB, 2022b). In these instances, the companies are mandated to be audited by some form of authority, although not specifically the Companies Act. (It should be noted that a new standard, *ISA 600 Revised*, has replaced ISA 600 which was effective at the time that the field study was conducted.)

For those companies mandated to be audited, having an audit done may either be a mere compliance exercise or a value-adding exercise in addition to the legal requirement. It is reasonable to assume that those companies that are not mandated to be audited, but that opt to do so voluntarily, believe that the benefit of an audit outweighs the cost thereof (Esplin, Jamal and Sunder, 2018). This section delves deeper into why companies opt for a voluntary audit, as this may indicate further expectations from auditors, which may not necessarily be present in public, listed companies.

The most common drivers for undergoing a voluntary audit, are agency conflict and conflicts of interest between shareholders, directors and management (Mustapha and Yaen, 2013; Dedman, Kausar and Lennox, 2014; Langli and Svanström, 2014; Ojala, Collis, Kinnunen, Niemi and Troberg, 2016; Weik, Eierle and Ojala, 2018). As discussed under section/paragraph 2.3.1, agency conflict is not unique to private companies that undergo voluntary audits, but rather applies to all companies in varying degrees. This has, however, been investigated further for voluntarily audited private companies in particular (Ojala *et al.*, 2016; Weik, Eierle and Ojala, 2018). Evidence in this area supports that companies specifically appoint auditors to address / mitigate this conflict. Studies on these companies also find that where ownership is more dispersed, more agency conflict is expected, and companies are more likely to opt for an audit should owners (shareholders) be unable to verify numbers and results themselves (Ojala *et al.*, 2016; Weik, Eierle and Ojala, 2018). The audit therefore compensates for the loss of control where a longer chain of command is present (Langli and Svanström, 2014). This is also consistent with the agency theory and research suggesting that companies are less likely to have a voluntary audit when

management and owners are more involved in all levels of the company (Mustapha and Yaen, 2013).

Companies undergoing growth and expansion are also more likely to voluntarily opt for an audit (Ojala *et al.*, 2016), possibly due to the increased risk associated with expansion (Dedman, Kausar and Lennox, 2014), and additional funding requirements (Hope, Thomas and Vyas, 2011). As noted under 2.4.3, it is also reported that having audited financial statements is likely to aid in securing finance and in reducing finance cost (Hope, Thomas and Vyas, 2011; Minnis, 2011; Dedman, Kausar and Lennox, 2014; Langli and Svanström, 2014) and could aid in securing supply from creditors in certain instances (Ojala *et al.*, 2016). Some evidence, however, suggests that audited financial statements will not directly reduce borrowing costs, but that the companies seeking finance and that are thereby required to have audited financial statements, will become valued clients of lenders over time, contributing to lower cost of debt, thereby showing a correlation between being audited and a lower cost of debt (Esplin, Jamal and Sunder, 2018). An additional benefit, again, includes tax reporting credibility, especially for those voluntarily undergoing an audit (Ojala *et al.*, 2016). This could all contribute to the cost-benefit of an audit.

Being audited further allows access to expertise, which would not always be available internally (Langli and Svanström, 2014). Companies who obtain other non-audit services from an audit firm are also more likely to have an audit done (Dedman, Kausar and Lennox, 2014). Evidence includes seeking expertise from auditors on internal control (Abdel-Khalik, 1993), accounting and taxation matters (Seow, 2001), as well as general business advice (Ojala *et al.*, 2016). All of these 'additional services' would pose a threat to auditor independence, which would need to be managed (SAICA, 2020). This suggests that smaller companies – those who are not required by law to be audited – may be somewhat dependent on their auditors for financial expertise. This is, however, contradicted to some extent by Weik, Eierle and Ojala (2018), who reported that companies whose financial statements are compiled externally, often do not opt for an audit as they regard the expertise of the financial statement compiler to be sufficient in ensuring accuracy of financial statements.

In summary, some of the reasons why companies would voluntarily opt for an audit include:

- Addressing agency conflict and dispersed ownership;
- Enhanced credibility of financial statements;
- Tax credibility and fewer tax adjustments;
- Easier access to finance and lower finance costs; and
- Access to expertise.

Although these are all realistic benefits obtained as a result of having audited financial statements, it does not provide a clear indication of the meaning that users derive from auditors' reports, i.e. what users think auditors do and/or what their expectations from auditors are. It may be that, for example, users believe that the credibility of their financial statements is enhanced due to auditors detecting all fraud. It is therefore important to explore what users think an audit offering entails, as well as what they would like an audit to achieve in order to answer the research questions in this study.

## **2.4. Users of Financial Statements and Auditor Reports**

The Conceptual Framework of the International Financial Reporting Standards (IFRS), describes the primary users of financial statements as existing and potential investors, lenders and other creditors who rely on financial statements for the financial information they need (International Accounting Standards Board, 2020). When investigating the uses of financial statements, a common theme in literature is that financial statements are used "to improve financial management, decision-making and control" (Van Auken and Yang, 2014; Van Auken, Ascigil and Carraher, 2014; Akhtar and Liu, 2018). Previous studies have investigated the needs of users of financial statements, identifying the following users and the purpose for which they use financial statements as set out in Table 6 (Mihaela, 2008; Medintu, Manache and Domnisor, 2016; Esplin, Jamal and Sunder, 2018):

**Table 6: Uses of financial statements by different user groups**

<b>Users</b>	<b>What Financial Statements are Used For</b>
<b>Managers (often also the preparers of financial statements)</b>	To enable the effective running of the business, proper control and improved decision-making.
<b>Shareholders</b>	To gather information about profitability, how much profit can be withdrawn, the value of shares (whether the company is still a good investment).
<b>Suppliers</b>	To determine whether obligations can be honoured.
<b>Customers</b>	To determine whether the company is a reliable supplier of products and not in danger of liquidation.
<b>Providers of finance (e.g. Banks)</b>	To determine whether capital and interest can be paid.
<b>Tax authorities</b>	To easily determine the taxes that are payable.
<b>Employees</b>	To determine whether their future employment is secure, whether salary and pension increases are possible, etc.
<b>Financial analysts (e.g. brokers) and spokespersons</b>	To obtain information of relevance to investors and the public in order to communicate this.
<b>Government</b>	Financial information may influence resource allocation. Information is needed for statistical institutions.
<b>Public</b>	Various uses, such as using the financial statements to assess the company's impact on the environment, the contribution to the local economy (e.g. through job creation, etc.).

*Source: Mihaela, 2008; Medintu, Manache and Domnisor, 2016; Esplin, Jamal and Sunder, 2018*

The user groups identified and evaluated in Table 6 are very general and the envisaged use would naturally depend on whether these individuals have access to the financial statements or not. Apart from the uses of financial statements also indicated in Table 6, the literature does not delve into much detail as to exactly how these financial statements are used (Shields, 2010). A study by Esplin, Jamal and Sunder (2018) indicates that users of financial statements of private companies are generally interested in the cost structure and profitability of the company, cash flows

generated from operations and capital requirements or leverage of the business. They expanded on these factors by identifying the following uses for private company financial statements:

- To project cash flow and calculate cash flow measures, such as EBITDA;
- To test operating assumptions influencing the cash flow projections;
- To enable verification of cash flows and other important assets necessary to evaluate whether contractual requirements are being met;
- To assess management quality;
- To assist with internal governance and control;
- To review related party transactions;
- To obtain information on management compensation;
- To adjust the capital structure; and
- To review proposed capital expenditure.

The level of competence of the user in using the reported financial statements also cannot be ignored, as this too would impact how they use financial statements. Ample literature is available that supports the existence of relationships between small and medium-sized companies' financial position and their owners' ability to analyse and interpret the financial statements (Dahmen and Rodríguez, 2014; Van Auken and Yang, 2014; Akhtar and Liu, 2018). Van Auken, Ascigil and Carraher (2014) found that experience, confidence and knowledge of business owners in using and interpreting financial statements are the key factors impacting the use of financial statements in significant financial decisions. This is elaborated on by Akhtar and Liu (2018) who, similarly found that experience, knowledge and ability are the key factors. Where management is unable to interpret and use financial statements effectively, these companies often face financial difficulty (Dahmen and Rodríguez, 2014; Van Auken, Ascigil and Carraher, 2014).

ISA 200, the purpose of an audit - and consequently the auditor's report - is to enhance the confidence that users of auditors' reports have in financial statements (IAASB, 2022b). Studies have found that users of financial statements, specifically investors, place more confidence in audited financial statements compared to unaudited financial statements (Chow, 1982; Watts and Zimmerman, 1983; Abdel-Khalik, 1993; Coram *et al.*, 2011). In order to be a user of auditors' reports, it is submitted that one needs to

be a user of the financial statements. For the purposes of this study, the users of auditors' reports at most would be regarded as the users of the audited financial statements (it is possible to use financial statements without an auditor's report, but not to use an auditor's report without the financial statements).

The users of financial statements for private companies are, however, more restricted and do not include all the users listed above. According to the Companies Act of South Africa, when a company is financially sound, the only persons who have a statutory right to access the accounting records, including the audited financial statements, are the shareholders of the company (South Africa, 2008). Some other users demand audited financial statements for reasons other than legislative requirements, such as banking institutions requiring audited financial statements as a prerequisite for funding (Esplin, Jamal and Sunder, 2018; Calitz 2020, pers.comm., 4 March). It is only in particular circumstances, when a company is facing financial difficulty and/or when determined by a court of law, that certain judgement creditors and trade unions must be provided with copies of audited financial statements in terms of South African law (South Africa, 2008). The common users of financial statements of audited private companies, in particular, are discussed in the following sections, also further explaining how these users utilise financial statements.

#### **2.4.1. Executive Management**

One could argue that those in management are the preparers of financial statements, rather than its users, however, executive management uses financial statements for decision-making (Van Auken and Yang, 2014; Van Auken, Ascigil and Carraher, 2014; Akhtar and Liu, 2018), which would include them as users of financial statements and consequently auditors' reports. Even more so, while management might not use the auditor's report as such, the audit service rendered assists the management of private companies with a range of activities. These include business advice, advice on taxation matters, identifying and communicating internal control deficiencies, and more (Abdel-Khalik, 1993; Seow, 2001; Ojala *et al.*, 2016). Also see 2.3.4 where these elements are elaborated on as the reasons for opting for a voluntary audit.

Executive managers of private companies, in many cases, are also the owners of these companies (Schulze *et al.*, 2001), but even when this is not the case, it is clear that those in executive management are also regarded as users of financial statements and auditors' reports. If they do not use the specific auditors report, they at least make use of or value the audit service as a whole (Mihaela, 2008; Esplin, Jamal and Sunder, 2018).

#### **2.4.2. Shareholders**

For listed companies, financial statements and other records are published online, making them available to any person to use for whatever reason they deem fit (Johannesburg Stock Exchange, 2020).

In the case of private companies, their shareholders also have access to their financial statements and other records, but the nature of the shareholders differs fundamentally from public, listed companies in that the private company's shares may not be offered to the public (South Africa, 2008). This gives rise to ownership being more concentrated and often includes ties between directors and shareholders (Hope, Langli and Thomas, 2012; Langli and Svanström, 2014).

As mentioned in 2.3.1, private companies' shareholding is more heterogeneous compared to public, listed companies, as it often includes owner-management and family ties. Public, listed companies' shareholding is wide-spread and mostly consists of the general public (Hope, Langli and Thomas, 2012; Langli and Svanström, 2014; Corten, Steijvers and Lybaert, 2017).

While in principle, shareholders are undoubtedly users of financial statements and auditor reports, it should again be emphasised that the nature of shareholders in private companies differs fundamentally from those in public, listed companies.

### 2.4.3. Third-Party Providers of Finance

Studies have shown that companies who have their financial statements audited, have easier access to financing and enjoy more favourable interest rates compared to companies with unaudited financial statements (Blackwell, Noland and Winters, 1998; Allee and Yohn, 2009; Hope, Thomas and Vyas, 2011; Minnis, 2011). This supports the findings by Coram *et al.* (2011) that more confidence is placed in financial statements that are audited compared to those that are not. Third-party providers of finance are therefore undoubtedly regarded as a user of auditors' reports for all companies.

Third-party providers of finance can vary widely, but banking institutions are by far the most common source of finance (Ho, 2019). Internationally, other finance companies include captive financing subsidiaries of non-financial corporations, general consumer and business finance companies, leasing companies and non-depository financial institutions extending credit to businesses and consumers (Carey, Post and Sharpe, 1998).

It is common for banks to have divisions, departments or entities for the different types or sizes of customers (Calitz 2020, email to Ané Church, 4 March). It may therefore be that auditor reports are not used in the same way by all divisions and the way in which auditor reports are used or interpreted for private companies may therefore be different to those of public, listed companies.

A number of studies examined the usefulness of qualified auditor reports to lenders in particular. The findings were not unanimous, with some suggesting that such reports are useful in determining loan ratings (LaSalle and Anandarajan, 1997; Guiral-Contreras, Gonzalo-Angulo and Rodgers, 2007), while others were unable to establish a correlation between qualified auditor reports and credit decisions (Abdel-Khalik, Graul and Newton, 1986; Lin, Tang and Xiao, 2003). This raises questions as to whether banking institutions really use the content of the audit report or merely value the process of an audit, if at all.

#### **2.4.4. South African Revenue Service**

The Tax Administration Act of South Africa does not specifically mention the right of SARS to access a company's financial statements, but it does mention its right to inspect 'relevant material', which includes any information or document deemed relevant for a tax risk assessment (South Africa, 2011b). Academic research on the use of financial statements by SARS is, at best, limited, and at worst, non-existent. Some evidence in the USA suggests that financial statements are reviewed by the Internal Revenue Service (IRS) (Schickel, 2019), but it is limiting in describing how this review is done.

When consulting the website of SARS, it is, however, evident from its *Frequently Asked Questions*, that companies are required to submit financial statements along with their tax returns (SARS, 2014), consequently meaning that SARS is a user of company financial statements. It is not clear from the website of SARS whether these financial statements should be audited. Taxation academics and practitioners, however, confirm that audited financial statements are indeed required by SARS (Jordaan, 2008; Jordaan 2019, email to Ané Church, 22 August) presumably when an audit is required by law.

Internationally, taxation authorities have a higher regard for audited financial statements supporting taxation returns, which leads to fewer adjustments from these authorities (Ojala *et al.*, 2016). Audited financial statements could consequently aid in tax credibility for companies.

There is currently no literature on whether SARS is concerned with the content of the auditor's report or what SARS expects or assumes from an auditor's report when present.

#### **2.5. Conclusion: Literature Review**

This chapter dealt with the audit expectation gap overall, including typical areas where differences in expectations arise. It further set out the areas in which audits for public and private companies differ, contextualising the relevance of this study. In exploring

these differences, agency conflict, the uses of financial statements, audit quality and voluntary audits were investigated. Lastly, it was determined who the users of financial statements, and consequently auditor reports are, as these are the users whose expectations from auditors will be relevant.

In the following chapter, the research methodology adopted for this study is documented, explaining why this study is classified as a qualitative, phenomenological study and setting out how this study will be conducted.

## CHAPTER 3: RESEARCH METHODOLOGY

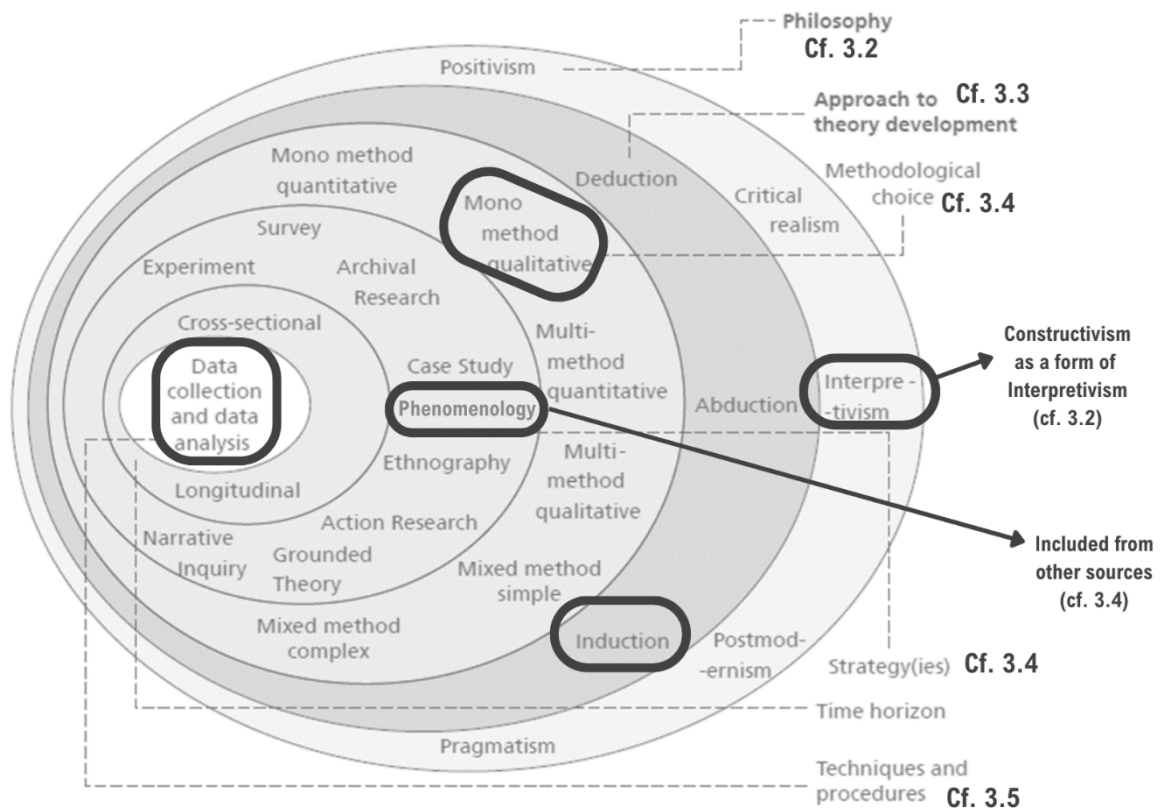
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### 3.1. Introduction

Chapter 2 offered a review of the current literature on the key concepts related to this study. This included literature on how the audit service and the audit expectation gap have evolved over time, as well as the typical areas that contribute to the audit expectation gap in public, listed companies. The key differences between public, listed companies and private companies were further detailed, by discussing the nature of agency conflict, the quality of financial statements, audit firms and audit quality, and the requirements determining which companies are mandated to be audited (mandatory versus voluntary). Lastly, the users of private company financial statements were presented. Executive management, shareholders, third-party providers of finance, and tax authorities were identified as key users and the way in which they use these financial statements was also detailed.

In this chapter, the research philosophy, design and methodology for this study will be discussed. Within research, the difference between research philosophy, research paradigm and theoretical orientation is somewhat disputed; however, it is evident that it is important to distinguish one's assumptions at a broad philosophical level from the practical, interpretive frameworks (Creswell and Poth, 2018). Saunders, Lewis and Thornhill (2019) created the *Research Onion* model which addresses the different stages of writing a dissertation and which was developed as a guide for students to develop a sound methodology (15writers.com, 2023). This model will be used to guide the structuring of this chapter. An adapted version of the *Research Onion* figure is presented as Figure 4. In this figure, the option in each dimension that is relevant to this study is encircled, with references to the sections in the chapter where each dimension is addressed. Furthermore, phenomenology was included as a strategy in the adapted *Research Onion* figure, as recognised by other credible sources, such as Leedy and Ormrod (2015) and Creswell and Creswell (2018).

**Figure 4: The 'research onion'**



Source: Saunders, Lewis and Thornhill, 2019; adapted by the researcher

### 3.2. Research Philosophy and Paradigm

There are five research philosophical positions when conducting research in the business/management field, i.e. Positivism, Critical Realism, Interpretivism, Post-Modernism and Pragmatism (Saunders, Lewis and Thornhill, 2019). Table 7 sets out a short explanation of each of these philosophies:

**Table 7: Philosophical positions when conducting research**

Philosophy	Explanation
Positivism	Entails working with a noticeable social reality, to produce law-like generalisations, facts and pure data, none of which are influenced by human interpretation or bias (Saunders, Lewis and Thornhill, 2019).
Critical Realism	Highlights how senses can deceive us and argues that things are not necessarily how we see them (Saunders, Lewis and Thornhill, 2019).
Interpretivism	Seeks understanding in the world in which people work and live, developing subjective meaning of their experiences of certain objects or things (Creswell and Poth, 2018).
Post-Modernism	Provides truth and knowledge about dominant ideologies and discourses, revealing hidden meanings (Ghauri, Grønhaug and Strange, 2020).
Pragmatism	Research that focuses on the outcome of the study – its actions, consequences and situations. It seeks change and solutions (Creswell and Poth, 2018).

Source: Compiled by the researcher

The research paradigm refers to the fundamental set of beliefs that inform practice, which helps to define research philosophy. The research paradigm should be stated clearly as it influences decisions throughout the research process (Creswell and Creswell, 2018; Žukauskas, Vveinhardt and Andriukaitienė, 2018).

In 1.4, this nature of this study was identified as qualitative, as it aims to achieve a deeper understanding of the existence and causes of the audit expectation gap, particularly pertaining to audited private companies. Through analysing literature, differences and contradictions were identified in the various qualitative research paradigms. Denzin and Lincoln (2008) argue that *all* qualitative research is interpretive and note that there are various forms of interpretive paradigms, including constructivism. In contrast, others differentiate between interpretive and constructivist paradigms as two separate epitomes (De Vos *et al.*, 2005). According to Creswell and Creswell (2018) constructivism is often used in combination with the interpretivist paradigm, while Saunders, Lewis and Thornhill (2019) mention that they are the same.

Having considered all these resources, this study is positioned in the **constructivist paradigm** as it involves the social construction of knowledge through a transactional process, while it also **acknowledges interpretivism** to inform the analysis of data (Denzin and Lincoln, 2008). Consequently, the researcher's interpretation of the ontology, epistemology and axiology for the **constructivist paradigm** as a form of interpretivism, are discussed next.

**Ontology** refers to the nature of being or how we view reality (Denzin and Lincoln, 2008; Ghauri, Grønhaug and Strange, 2020). Within the constructivist paradigm, reality is regarded as social actors producing social phenomena through interaction, and reality is therefore constantly changing, with various realities co-existing (Bryman and Bell, 2011). Reality is thus relative and not absolute (Denzin and Lincoln, 2008). The purpose of this study was to investigate these 'various realities' as they are perceived by users of auditor reports, by determining the expectations that these users have of auditors and, consequently, how they compare to auditing standards.

**Epistemology** refers to what is regarded as the acceptable source, limit and nature of knowledge (Ghauri, Grønhaug and Strange, 2020). According to Guba and Lincoln (2008), constructivists create knowledge through their findings from interaction with research participants. The researcher is therefore not objective as their own background shapes their interpretation of others' experiences (Creswell and Poth, 2018). In this study, it is acknowledged that interpretations of the knowledge created through interviews are influenced by the researcher's own perceptions and interpretations. The researcher, therefore, does not claim to be objective, but rather strives to achieve trustworthiness as depicted in 3.5.5.

**Axiology** refers to the role that values play in the research process (Saunders, Lewis and Thornhill, 2019). Obtaining propositional, transactional knowledge is a valuable means to creating social rights, or as described by Guba and Lincoln (2008), social emancipation. Therefore, exploring the experiences and perceptions of users of auditor reports and what their expectations are of auditors, creates intrinsic value and a positive contribution to the auditing profession.

The paradigm and beliefs described above set the foundation for this study and informed the approach and methodological choices that were followed. The knowledge created from the realities of users of auditor reports about their expectations of

auditors therefore provides the background for the following sections described in this chapter.

### 3.3. Approach to Theory Development

The second layer of the *Research Onion* (Figure 4) addresses the approach to theory development within the chosen philosophy (and paradigm). Saunders, Lewis and Thornhill (2019) assert that choosing a theory development approach is an important part of research, as it enables a more informed research design and enables changes to that design where necessary. They describe three approaches to theory development: deduction, induction and abduction. Ghauri, Grønhaug and Strange (2020) state that induction and deduction are ways to determine what is true or false. Although some believe that abduction is a combination of deduction and induction, there is more to this approach. These three approaches are briefly contrasted in Table 8:

**Table 8: Approaches to theory development**

Approach to theory development	Explanation
<b>Deduction</b>	Development of a theory or hypothesis, whereafter a research strategy is designed to test the hypothesis. Conclusions are drawn from a known premise or cases/matters known as true.
<b>Induction</b>	Collection of data takes place, whereafter a theory is developed from the data analysis. Facts acquired therefore lead to theories or hypotheses.
<b>Abduction</b>	A phenomenon is explored by making use of data, identifying themes and patterns to generate a new theory or change an existing one. It is a theoretical interpretation of a research problem, which may lead to developing a new or an amended theory. This theory is subsequently tested through the collection of additional data.

Source: Saunders, Lewis and Thornhill, 2019; Ghauri, Grønhaug and Strange, 2020

In this study, the expectations of users of private company auditor reports are explored to determine to what extent these differ from what is required by auditing standards. This data will be used to establish whether an audit expectation gap exists in the private company sphere and, if so, what the causes of this expectation gap are. In order to answer the research question, data needs to be gathered from research participants, i.e. users of auditor reports of private companies, whereafter a theory or hypothesis can be formed when comparing the data collected to the international auditing standards. The approach to theory development is therefore one of induction, which is consistent with the view of Saunders, Lewis and Thornhill (2019) that interpretivists (of which constructivists from part) tend to utilise induction.

### **3.4. Research Design and Strategy**

Research design is explained as the general strategy used in solving the research problem (Leedy and Ormrod, 2015). Research design entails numerous steps to collect, analyse, interpret and report on data that is collected whilst conducting the research process (Lombard, 2018). The methodological choice in research can be either quantitative or qualitative (Rajasekar, Philominathan and Chinnathambi, 2013). The aim of qualitative research is to achieve depth of understanding, while quantitative research aims to achieve breadth of understanding (Palinkas, Horwitz, Green, Duan and Hoagwood, 2015). In other words, the main purpose of a qualitative study is not to generalise (Koerber and McMichael, 2008), but to construct a deep and meaningful picture of a complex phenomenon (Leedy and Ormrod, 2015).

According to Creswell and Creswell (2018), when working in the constructivist paradigm, a qualitative research design is typically applied. The purpose of this study – to determine to what extent the expectations of users of auditor reports for private companies differ from the requirements of the ISAs – allows these users to voice their opinions and experiences related to the phenomena. When considering both the purpose and the paradigm of this study, it lends itself to a **qualitative nature** as it aims to achieve a deeper understanding of the existence, nature and causes of the audit expectation gap, particularly pertaining to audited private companies.

Qualitative research has a number of strategies, such as Case Study Research, Ethnography, Phenomenological Studies, Grounded Theory Studies (Bryman and Bell, 2011; Leedy and Ormrod, 2015; Creswell and Creswell, 2018), Content Analysis (Leedy and Ormrod, 2015) and Narrative Research (Creswell and Creswell, 2018). A description of each of these strategies follows:

**Case Study Research:** This strategy is described as an in-depth study of individuals in their particular context (Bryman and Bell, 2011). Creswell and Creswell (2018) assert that it does not necessarily need to be the study of individuals, but that it could be a process, programme, event or activity. The cases are, however, bound by time and the data is collected over a sustained time period. Case studies are often employed when it is difficult to perform the study outside of its natural setting and where there are many variables (Ghauri, Grønhaug and Strange, 2020).

**Ethnography:** With this strategy, human interaction and communities are studied and appreciated. The researcher directly participates and observes the community in which the study takes place (Bryman and Bell, 2011). Patterns of behaviour, actions or language are studied over lengthy periods (Creswell and Creswell, 2018).

**Phenomenology:** Leedy and Ormrod (2015) identify a phenomenological study as a strategy which attempts to understand people's perceptions and perspectives. This is echoed by De Vos, Strydom, Fouché and Delpont (2005), who add that the outcome of a phenomenological study should portray the phenomenon as seen through the eyes of those who have experienced it personally. Phenomenological studies therefore report the experiences of those directly affected by the phenomenon, reducing these individual experiences to a "description of the universal essence" (Creswell and Poth, 2018).

**Grounded Theory:** According to Ghauri, Grønhaug and Strange (2020), in Grounded Theory, concepts are developed initially without necessarily having pre-assumed understandings. Measurable constructs are subsequently developed and concepts, through data collection, therefore precede theory development (Bryman and Bell, 2011; Ghauri, Grønhaug and Strange, 2020). In other words, Grounded Theory aims to build theory from data, while Phenomenology seeks to describe and understand the essence of lived experiences.

**Content Analysis:** This is also known as Historical Review. A description is provided of what happened in the past in order to better understand or plan for the future (Ghauri, Grønhaug and Strange, 2020). Specific content is systematically analysed to identify patterns or themes (Leedy and Ormrod, 2015). It should be noted that Content Analysis is often employed with other strategies and might form an integral part of these other strategies (Leedy and Ormrod, 2015).

**Narrative Research:** This strategy is employed when studying the lives of individuals and the researcher creates a narrative to retell the participants' stories (Creswell and Creswell, 2018).

This study investigates the experiences and perceptions of users of auditor reports resulting from external audits undertaken for private companies. It aims to understand these users' expectations of auditors when these auditors undertake financial statement audits and then evaluate how these expectations compare to the requirements of the applicable audit requirements. Therefore, this study is classified as a **Phenomenological Study**.

### **3.5. Research Method**

The exact techniques used to collect and analyse data, are referred to as the research methodology, which is regarded as a systematic approach to problem-solving (Rajasekar, Philominathan and Chinnathambi, 2013; Leedy and Ormrod, 2015). As informed by Tabuena, Hilariso and Buenaflor (2021), the systematic approach to answer the research question of this study will be explained by addressing the data collection methods, sampling methods and data analysis and coding methods, as well as how the trustworthiness of the research will be assured.

### **3.5.1. Data collection methods**

Data collection falls within two categories, namely the collection of secondary or primary data. Secondary data refers to data that has previously been collected or produced by others, while primary data refers to the original real-time data that is collected by the researcher (Ajayi, 2017).

#### **3.5.1.1. Secondary Data Collection: Literature Review**

In this study, secondary data was collected through a literature review of concepts relevant to the study, including users of financial statements and the differences between public and private companies. Similar studies done on the audit expectation gap in public, listed companies, both locally and internationally, were also investigated to identify areas typically contributing to the audit expectation gap. This data is primarily recorded in Chapter 2 of this study. Sources consulted included the library of the University of the Free State, as well as electronic resources such as *EBSCOhost*®, *Google Scholar*®, and *SABINET*. Cognisance was taken of the reliability of all information and efforts were made to locate the original source of information.

Further secondary data was collected through an investigation of the applicable audit requirements in order to compare the expectations of participants in this study with what is required of auditors in terms of these requirements. This data is primarily recorded in Chapter 4 of this study.

#### **3.5.1.2. Primary Data Collection: Interviews**

An interview is an organised conversation with one person asking and another person answering structured questions (Vogt, Gardner and Haeffele, 2012). A recommended method of data collection for phenomenological studies is the use of in-depth interviews with relevant stakeholders who experienced the phenomenon, in this case the audit expectation gap, to understand perceptions and perspectives (Leedy and

Ormrod, 2015; Creswell and Poth, 2018). While other data collection methods, such as questionnaires, may also provide useful information, they do not lend themselves to obtaining a deeper understanding of the particular phenomenon as such methods do not allow discussion and follow-up questions.

Babbie (2016) describes a qualitative interview as in-depth discussions on certain topics rather than using standardised questions. When information is required about a certain topic and the interview questions can be formulated, but answers cannot be predicted, open-ended or guided questions are recommended for the interview (De Vos *et al.*, 2005). Considering the aforementioned literature, it was deemed appropriate to employ in-depth interviews as the primary data collection tool in this phenomenological study, by making use of open-ended questions, as a deeper understanding of participants' experience of the audit expectation gap and related factors was sought.

#### ***a. Interview questions: Formulation and rationale***

Mertens (2015) found that participants who reply to open-ended questions, provide insight into their experiences, concerns and feelings. As this study aimed to obtain a deep understanding of the audit expectation gap phenomenon, unstructured questions were mostly utilised during the actual interview to determine how participants experience the audit service and how they interpret the auditor's report.

As informed by the literature review performed in 2.4, participants were divided into the following four interview groups: Executive management, Shareholders, Banking institutions and SARS. When designing the questions for the interview, it was determined that not all the questions would be relevant to all interview groups, given the diversity of these participants. This led to the design of four different interview guides, taking into account their role as users of the auditor's report that forms part of the audited financial statements of private companies. Copies of these interview guides can be viewed in APPENDIX B.

For the first part of the interview with each participant, free-response questions or open-ended questions were formulated to obtain relevant data. This included questions such as "Would you like your auditors to do more or less work than what they are currently doing? Or are you satisfied with the nature of the work that they currently perform?" and "Do you read the company's auditor's report, or do you just

take comfort in the fact that an audit is done for the company?” The completeness of the financial statement user groups was also tested by asking relevant participants who the users of their companies’ financial statements are and how these financial statements are used. All participants in a particular stakeholder group were asked the same initial questions in order to ensure consistency and to enable similarities to be identified. Follow-up questions to these questions were asked, when necessary, to obtain a better, deeper understanding (cf. 3.5.4).

For the second part of the interview, the questions were informed by the literature and related to areas that have specifically been identified as contributors to the audit expectation gap in general. Here, structured/closed questions were asked, and participants were required to respond to most of these questions using a four (4)-point Likert scale (*Completely Disagree, Somewhat Disagree, Somewhat Agree, Completely Agree*). This was done to initiate discussions with participants on the particular topics/themes. The use of a Likert scale is appropriate when the researcher seeks to understand whether an interview participant’s attitude towards a certain object of interest is favourable or unfavourable (Bryman and Bell, 2011; Cooper and Schindler, 2014). By understanding the participant’s attitude towards a specific area (i.e. each possible contributor to the audit expectation gap), this provided the context to ask follow-up questions and obtain a deeper understanding of each participant’s viewpoint. A four (4)-point Likert scale was used (rather than the more common five (5)-point scale), as this is essentially a ‘forced’ Likert scale which does not allow for participants to have a neutral or undecided viewpoint. Krosnick (2002) found that where participants are allowed to have a neutral/undecided stance, it is often not because they do not have an opinion, but rather because they are unwilling to do the cognitive work that is needed to report their attitude/opinion. In this particular study, it was necessary to determine a participant’s viewpoint to enable follow-up questions to gain a deeper understanding of the audit expectation gap phenomenon.

During the interviews, the Likert scale questions were used as a probing mechanism to explore interview participants’ perceptions. The purpose of these questions was therefore not to quantify responses, but to use the rating given by the interview participant as a starting point for discussions on audit expectation gap-related matters. Once a response to a particular question was obtained, participants were asked to

elaborate on their rating, to enable the researcher to obtain a deeper understanding of the given rating for the question.

Using the guidance provided by Cooper and Schindler (2014), the interview questions were constructed and refined by considering the structure and categories of questions, content of questions, wording of questions and the response strategy. Three categories of questions were included in the interview schedule:

- *Administrative questions:* These questions were asked to determine the conditions and circumstances of the interview and the interview participant, e.g. the name and role of the interview participant, whether the interview will take place online or face-to-face, etc.
- *Classification questions:* These questions were asked to enable grouping or patterns of participants, e.g. is the audit of the company mandatory or voluntary?
- *Target questions:* These questions addressed the specific matter under investigation and were semi-structured to provide a frame of reference to the participant, without limiting the response, e.g. what are the benefits of being audited?

When formulating the content for interview questions, the following considerations were taken into account (Bryman and Bell, 2011; Cooper and Schindler, 2014):

- Is the question necessary?
- Is the scope and coverage of the question appropriate and does it contribute towards answering the research question?
- Is the participant able/does he or she have the knowledge to answer the question?
- Will the participant be willing to answer the question?

Interview questions were prepared by the researcher and then reviewed by the supervisor of the study. Care was taken to ensure that questions were phrased in a shared vocabulary, in other words, concepts and language that all participants would understand, and that the following pitfalls were avoided (Bryman and Bell, 2011; Cooper and Schindler, 2014; Ghauri, Grønhaug and Strange, 2020):

- The use of ambiguous terms
- Making assumptions in questions that are misleading
- The use of questions that are too long and difficult to follow
- The use of questions that contain evidence of bias
- The use of questions that are double-barrelled
- The use of questions that are leading or suggestive
- Using questions that can irritate, provoke or offend participants.

### ***b. Interview process***

Approximately a week before the interview took place, participants were provided with an *Information Leaflet and Informed Consent* document via email. This document provided a broad explanation of what the participants could expect during the interview, including an identification of the themes that would be explored during the interview – to provide the participant with the opportunity to reflect on the themes before the interview took place. Detailed research questions were, however, not provided to participants in the *Information Leaflet and Informed Consent* document, as a key aim of the interview questions was to test the interviewee's perceptions. If all the questions had been provided in advance, this may have led to interview participants obtaining inputs from others beyond what they would normally know or perceive. Further information, such as the purpose of the study, that participation is voluntary, as well as detailing what participants should consent to before the interview can be conducted (cf. APPENDIX D) were also included.

In the same email, participants also received a link to an *Evasys System Survey*, which they had to complete before the interview. The survey, firstly, requested participants' consent to take part in the study (with reference to the *Information Leaflet and Informed Consent* document) as well as their consent to record the interviews. All interview participants provided their consent to take part in the study and agreed to the recording of the interviews. Further survey questions were aimed at eliciting personal/biographical and company/institution information. This enabled the researcher to prepare appropriately for the interview, to understand the frame of reference of the participant, and to categorise the responses received during the

interview. Copies of the *Evasys System Survey* results can be viewed in APPENDIX E.

Interview participants were given a choice as to whether they prefer an online or in-person interview. The use of virtual interviews was often more convenient for participants where they were, for example, out of town or unwell. While virtual meetings are often shorter in length compared to face-to-face meetings due to fewer informal, introductory conversations, it was not perceived by the researcher to compromise the quality of the interview responses. All participants engaged well during the interviews, regardless of the platform used to conduct the interview.

Recordings of all interviews were transcribed by making use of the services of a reputable professional company. This company was contractually bound to ensure that recordings and transcripts remain confidential and to delete digital copies of all data once the researcher had downloaded the transcripts. No interviews were conducted without first obtaining the approval from the appropriate authority or without the ethical clearance from the University of the Free State.

### ***c. Pilot Interview***

Before the first interview for the purposes of data collection took place, a pre-test or pilot interview was undertaken in the presence of the supervisor of this study to determine the length of the interview and to test the data collection instrument, allowing for improvements and refinements to be made. This approach is recommended by, among others, Ghauri, Grønhaug and Strange (2020). The participant for the pilot interview was a member of the executive management of a private company with a non-finance role (his qualifications were also not finance-related). This enabled the researcher to determine whether the interview questions were also understandable to participants from a non-audit/finance background. The employing company of the pilot interview participant met all the criteria as stated in step 2 of section 3.5.3.1 except that the company does not have a registered office in the Free State Province, although the company has a physical office in the Free State Province. Data collected from the pilot interview was not included in the results obtained in this study. The following changes and refinements were made as a result of the pilot interview:

- The online survey that the pilot interview participant had to complete before the interview, was initially prepared in *Google Forms*. The pilot interview participant reported that he did not have a Google account and was therefore not easily able to complete the *Google Forms* survey. The *Evasys Survey System* was therefore chosen to replace *Google Forms* as it is accessible to any person with an internet connection.
- The initial online survey required interview participants to include the name of their employing organisation. The pilot interview participant indicated that, although gatekeeper's permission had been obtained from his employer, he was still uncomfortable with this question and did not want his responses to be linked to his or his company's name in writing. Subsequently, an interview participant number was assigned to each interview participant and a separate record was kept by the researcher about the companies/institutions linked to each interview participant number.
- The pilot interview participant was required to sign and upload documents to the online survey, which indicated his consent to participate in the study, as well as his consent to record the interview. The pilot interview participant indicated that the documents that he needed to sign were protected in such a way that it made the digital signing of the documents difficult. Subsequently, questions were added to the online survey, whereby interview participants could indicate their consent by the click of a button rather than signing and uploading documents.

### **3.5.1.3. Secondary Data Collection: Comparison to applicable audit requirements**

Once the primary data from interview participants had been collected, analysed and coded (cf. section 3.5.4) the audit expectations as identified were compared to the outcomes and applicable audit requirements. These audit requirements, as defined in 1.2, are used by South African auditors when performing external audits on companies in terms of the regulations of the IRBA in South Africa (IRBA, 2019a), and include, but are not limited to:

- International Standards on Auditing (ISAs);
- International Standards on Quality Management (ISQMs);
- The IRBA Code of Professional Conduct for Registered Auditors and subsequent amendments (IRBA Code), which derives from the International Code of Ethics for Professional Accountants by the International Ethics Standards Board for Accountants (IESBA Code of Ethics);
- The Companies Act of South Africa, 2008; and
- The Auditing Profession Act, 2005.

In section 2.2.3, the expectations of users according to the literature were described, but it was also noted that the literature focusses mostly on users' expectations in respect of auditors' reports for listed companies. Comparing these expectations to the outcomes and requirements of an audit would not necessarily be relevant to this study, focusing solely on audited private companies. The evolution gap (cf. Figure 3 in 1.1.1) for private companies is therefore investigated by comparing the expectations of users of audited private company financial statements, to the applicable audit requirements.

### **3.5.2. Population of users**

“A population is the total collection of elements about which we wish to make some inferences” (Cooper and Schindler, 2014). As there are various users of auditor reports, the populations for this study from which samples were selected, were defined as comprising the following:

- The executive managements and shareholders of all private companies with a registered office in the Free State Province, South Africa, that have their annual financial statements subjected to an external audit.
  - ‘Executive management’ refers to the individuals forming part of the private company’s executive team and who are responsible for the day-to-day management of the company;
  - Where the private company is owned by a legal entity (such as a trust or holding company), rather than natural persons, the natural persons who are responsible for the governance of that legal entity (such as trustees

of the trust or holding company directors) were regarded as appropriate interview participants for the 'Shareholders' group. No instances were identified where another company was a minority shareholder;

- Senior employees in the credit divisions of all locally-controlled South African banking institutions who deal with credit approvals of private companies operating in the Free State Province, South Africa; and
- Employees of the South African Revenue Service (SARS) who undertake tax compliance audits in the Free State Province, South Africa.

The executive managements and shareholders of private companies that form part of a group of companies of which the holding company is listed on a stock exchange were specifically excluded from the population. This is because the group auditor would typically be appointed by the holding company and the relationship with the auditor would typically be administered by the holding company. Responses from listed companies' subsidiaries that are private companies would therefore likely coincide more with studies on public or listed companies than with other responses in this study, focusing solely on private companies.

Providers of credit finance, other than banking institutions, not included in the population could include captive financing subsidiaries of non-financial corporations, general consumer and business finance companies, leasing companies and non-depository financial institutions extending credit to businesses and consumers (Carey, Post and Sharpe, 1998). This exclusion was due to the following:

- It is not possible to define a complete population for third-party providers of credit finance for companies incorporated in the Province of the Free State; and
- Banking institutions are by far the most common source of finance (Ho, 2019).

Furthermore, to be regarded as a user of financial statements and consequently of auditor reports, a person should at least have access thereto. Judgement creditors and trade unions must be provided with copies of audited financial statements only in particular circumstances, and not in the normal course of business (South Africa, 2008). As a consequence, these potential users were also excluded from the population.

### **3.5.3. Sampling methods**

Sampling methods usually fall within two categories: probability and non-probability sampling. With probability sampling (also known as random sampling), all members of a population have an equal chance of being selected (Leedy and Ormrod, 2015). While probability sampling is technically superior to non-probability sampling, it is not always practical or desirable. With probability sampling, findings can be generalised and are regarded to be unbiased.

In this study the aim, however, is not to generalise findings, but rather to obtain a deep understanding of the audit expectation gap phenomenon in respect of private company audits (which has been the subject of very limited research to date). The interview participants in this study were, therefore, not selected because their opinions are representative of the perceived dominant opinion, but rather because their attitudes and experiences reflected the full spectrum of user perceptions related to the research question (Cooper and Schindler, 2014). They were therefore regarded as 'relevant stakeholders' in this study.

Koerber and McMichael (2008) recognise that with qualitative studies, the sampling methods utilised will differ from those used in quantitative studies. Furthermore, probability sampling may not be practical or possible, as was the case with this study (cf. section 3.5.3.1 where this is elaborated on) (Cooper and Schindler, 2014).

Non-probability sampling is often associated with qualitative studies, and commonly includes the following techniques: Purposive sampling, Convenience sampling, Quota Sampling and Snowball sampling (Vogt, Gardner and Haeffele, 2012; Cooper and Schindler, 2014). These techniques are briefly described in Table 9.

**Table 9: Non-probability sampling techniques**

<b>Sampling Technique</b>	<b>Description</b>
<b>Judgement/ Purposive sampling (often also referred to as purposeful sampling)</b>	Judgement is used to select participants who will be best suited to answer the research question by meeting certain criteria (Cooper and Schindler, 2014; Saunders, Lewis and Thornhill, 2019).
<b>Convenience/ Opportunity sampling</b>	Participants that are readily available and willing to partake in the study are selected (Ghauri, Grønhaug and Strange, 2020).
<b>Quota sampling</b>	This “stratified convenience sampling” where the researcher decides on the number/quota required in each category. Participants are then identified to fill the quota (Vogt, Gardner and Haeffele, 2012). The sample seeks to represent the total population (Saunders, Lewis and Thornhill, 2019).
<b>Snowball sampling</b>	Participants are identified through referral networks. Initial individuals may be selected through random sampling, but will then be asked to refer the researcher to other possible participants with similar characteristics or traits (Cooper and Schindler, 2014).

Source: Compiled by the researcher

### **3.5.3.1. Sampling Method: Executive Management and Shareholders**

In order to identify executive management and shareholders as interview participants, all companies that fall within the scope of this study first needed to be identified. Next, a sample of companies was selected, after which one or more of the members of their executive management and/or shareholders of the selected companies were selected to be interviewed.

As the study evolved and data collection took place, it was decided to divide the *Executive Management* group into two sub-groups: Executive Management employed in a finance role and Executive Management employed in a non-finance role. This was because, based on the early interviews conducted, a clear difference was identified in

the responses obtained from these two groups. This decision led to the selection of additional interview participants in each of these sub-groups.

Initially, purposive sampling was considered as a technique to identify the sample of companies, and consequently the members of executive management and shareholders to be included in the sample. This, however, required the total population of audited private companies registered within the Free State province to be accurately identified, through appropriate sources. As all registered auditors need to declare the audits that they perform to the IRBA on an annual basis, the IRBA should have a list that would include the total population as defined. As companies need to submit audited financial statements to the CIPC on an annual basis, the CIPC should also be able to provide data on the population as defined. Despite the best efforts of the researcher to obtain a complete and reliable list of these companies from these regulators, this was not possible and, consequently, purposive sampling could not be employed. This is recognised as a limitation to this study.

As the data on which private companies are audited is also not publicly available, it was necessary to make use of convenience sampling in selecting suitable companies, which is described by Higginbottom (2004) as making use of participants who are readily available and easy to contact. Although convenience sampling may still provide rich information, it is recognised that care must be taken not to overgeneralise the findings (Koerber and McMichael, 2008).

The recruitment strategy utilised to identify and select an appropriate sample is set out in the following steps:

- Step 1: By making use of convenience sampling, suitable companies that met the criteria for inclusion in the study were identified using the researcher's personal and business networks, such as the members of the SAICA Central Region Council and colleagues at the University of the Free State. These contacts also provided the names and/or contact details of possible suitable interview participants at these companies. An effort was made to identify and include companies operating in different sectors/industries within the sample to contribute towards the 'richness' of the data gathered.

Step 2: It was confirmed, either through the business contact (if knowledgeable) or by contacting the company itself, that the company identified meets the following criteria and therefore falls within the scope of this study:

- The company is a private company as defined by the Companies Act of South Africa, 2008;
- The company has a registered office in the Free State province, South Africa;
- The company is not a subsidiary of a listed company; and
- The company is audited (either mandatorily or voluntarily).

Step 3: By making use of the contacts explained in Step 1, potential interview participants were identified and approached informally by telephone call or email to test their interest/willingness to participate in the study in principle. Where applicable, the potential interview participant was asked who the appropriate gatekeeper is and to share his/her contact details.

Step 4: For members of executive management, gatekeepers were contacted to request permission to conduct research at the company and to interview the specific participant. The purpose of the study was explained, and the gatekeeper was provided with the *'Request for permission to conduct research from Gatekeepers'* form included in APPENDIX C in order to obtain permission to conduct the interview. Scanned copies of signed gatekeepers' permission documents were obtained, where relevant, before conducting any interviews at the company. No gatekeepers' permission was obtained for shareholders, as this is not required or relevant.

Step 5: Gatekeepers (where applicable) or the first potential interview participant identified for the company were asked for suggestions for additional suitable interview participants, specifically also for shareholders who are not involved in the day-to-day management of the company. Steps 3 to 5 were repeated for additional interview participants.

When selecting the interview participants, the following restrictions were applied per company:

- No more than two individuals from the same company were interviewed, so as not to skew results to one particular company.
- No more than two companies operating in the same industry were selected, in order not to skew results to a particular industry, and obtain as varied a set of responses as possible.

In section 2.3.4 it was noted that companies who undergo voluntary audits are a rich source of information as an audit is not merely a compliance exercise for these companies, but truly a value-adding service. Accordingly, it was considered that perceptions from users of these companies' audited financial statements could provide valuable information regarding their expectations from auditors.

Accordingly, the initial plan was to include interview participants from companies that undergo voluntary audits as a separate interview group from those associated with companies subjected to mandatory audits. As the names of companies that undergo voluntary audits are not publicly available, it was difficult to identify a sufficient number of companies who undergo voluntary audits. However, as the study evolved and as interviews were conducted, all the interview participants from companies that undergo mandatory audits indicated that they would have opted for an audit regardless of the legal requirement. This meant that the importance of obtaining data from users of companies subject to a voluntary audit became less important. Therefore, these two groups were not investigated separately as initially planned, but variation was still sought by including interview participants from both these types of companies in the samples selected.

Table 10 sets out how interview participants were ultimately selected for the relevant interview groups. The sample size is consistent with Leedy and Ormord's (2015) suggestion of using 5 to 25 participants in phenomenological studies where interviews are used for data collection.

**Table 10: Sample selection indicating the number and distribution of interview participants**

<b>Company number</b>	<b>Industry in which the company operates</b>	<b>Voluntary / Mandatory Audit</b>	<b>Executive Management: Finance Role</b>	<b>Executive Management: Non-finance Role</b>	<b>Shareholders not involved in executive management</b>
1	Manufacturing	Mandatory	1		
2	Food retail/ wholesale	Mandatory	1		
3	Agriculture	Mandatory	1		
4	Financial services	Voluntary	1		1
5 <i>(Note 1)</i>	Transport	Mandatory	1		
6	Mining	Mandatory	1		
7	Liquor retail/ wholesale	Voluntary		1	1
8	Retail	Mandatory		1	
9	Sport	Mandatory		1	
10	Agriculture	Voluntary		1	
11	Logistics	Mandatory		1	
12 <i>(Note 2)</i>	Retail	Mandatory			1
13 <i>(Note 3)</i>	Agriculture	Mandatory			2
<b>Number of interviews conducted</b>			<b>6</b>	<b>5</b>	<b>5</b>
<b>Number of unusable responses <i>(Notes 1, 2 and 3)</i></b>			<b>(1)</b>	<b>0</b>	<b>(3)</b>
<b>Total number of usable interviews</b>			<b>12</b>		

*Source: Compiled by the researcher*

*Note 1:* During the interview, it was established that Company 5 had recently been acquired by a listed company, which impacted the selection of the auditor, as well as how management experienced the audit. Such companies were specifically excluded from this study (cf. 3.5.2) and therefore data from this interview was excluded from the findings of this study. An additional interview participant from a different company was selected to replace the one from Company 5.

*Note 2:* This interview participant was selected as the person indicated that he/she is a shareholder of a private company operating in the retail sector (Company 12). During the interview, some of the data collected did not make sense and therefore the researcher contacted the auditor of the company to verify and confirm certain details that were not confidential in nature. In this discussion, it was determined that the interview participant was, in fact, no longer a shareholder of the company and,

consequently, the data from this interview had to be excluded from the findings of this study.

*Note 3:* Both these interview participants are shareholders of a private company. During the interview, it was, however, established that Company 14 is the majority shareholder of a public, listed company. The private company (holding company) has no operations and merely holds the investment in the public, listed company. All operations therefore take place in the public, listed company, of which the interview participants were also shareholders. The responses from these interview participants, were therefore essentially informed by their experience as the shareholders of the public, listed company (where the operations take place) rather than the private company (which is just a “shell” to hold the investment). Consequently, the nature of their experiences and the company which they truly represent, does not fall within the scope of this study and had to be excluded from the findings.

As a consequence of the information documented in Notes 2 and 3 above, the remaining usable sample for the shareholders group, was two interview participants. The researcher attempted to source additional interview participants in this group, by applying the following strategies:

- Asking each interview participant from the Executive Management groups whether their employing company has any shareholders who are not involved in the daily operations of the company.
  - This enabled the recruiting of shareholders from Companies 4 and 7 (the remaining usable sample).
  - The interview participant from Company 2 indicated that the company does have two shareholders who are not involved in its daily management, but the interview participant was not willing to share these individuals' contact details.
  - Interview participants from all the other companies in the sample (Companies 1, 3, 5, 6, 8 – 11) indicated that these companies are entirely owner-managed and therefore there are no shareholders who are not involved in the daily management of these companies.
- Contacting audit partners from two of the largest audit firms in the Free State Province to assist with identifying suitable interview participants.

- From all of their clients, these audit partners were only able to identify two interview participants who met the criteria of shareholders for this study. However, these potential participants could not be interviewed due to serious, chronic illness of either themselves or family members.
- Requesting colleagues at the University of the Free State and business contacts for suitable interview participants who met the criteria for shareholders for this study.
  - No additional interview participants could be sourced with this approach.

With the sampling technique described above, the aim was to obtain a holistic understanding of the phenomenon (Suri, 2011), by including all users of the audited financial statements of private companies, including shareholders who are not involved in the daily operations of the business, to ensure heterogeneity. However, as shareholders of private companies are often directors/executive management themselves (Langli and Svanström, 2014), it was not possible, despite the best efforts of the researcher, to source additional interview participants in the shareholders group in order to meet the minimum sample size of five suggested by Leedy and Ormrod (2015). Shareholders who are not involved in the daily operations of private companies are clearly uncommon and, perhaps, the exception to the rule. The two interview participants in this group (from Companies 4 and 7) will, however, still be reported on in Chapter 4 as part of the “Management and Shareholders” group. The limited data from the shareholder group not involved in company management is recognised as a limitation to the study.

In summary, data from the following number of interviews are included in the findings from this study in Chapter 4 (usable sample) for the “Management and Shareholders” group:

- Executive management: Finance Role – Five (5) interview participants
- Executive management: Non-finance Roles – Five (5) interview participants
- Shareholders (not involved in management) – Two (2) interview participants

Although the aim of the study is not to generalise findings, variation was sought in the following ways in order to obtain as diverse a range of responses as possible:

- Participants included members of executive management in a finance role as well as those in a non-finance role;
- Participants were selected both from private companies who are mandated to be audited and from those who undergo voluntary audits;
- Participants from private companies in various industries were selected; and
- Participants from private companies audited by Big 4 audit firms and non-Big 4 audit firms were selected.

The details of each participant can be viewed in Table 15: Interview Participant Demographic and Other Relevant Information – Management and Shareholders Table 15, presented under 4.2.1 in Chapter 4.

While conducting the interviews, the researcher remained alert to new ideas or views from interview participants. According to Vogt, Gardner and Haeffele (2012), data saturation is reached when interviews provide only corroborating views, rather than new perspectives. It is recognised that the limited sample size per group does not allow the researcher to claim complete data saturation; however, while limited divergent opinions were recorded, there were no fundamentally different ideas that necessitated the selection of additional participants.

### **3.5.3.2. Sampling Method: Banking Institutions**

The population for Banking Institutions is regarded as credit approvers employed by locally-controlled banks of South Africa (South African Reserve Bank, 2022), operating in the Free State Province. Two options were considered as an appropriate sampling method for identifying banking institutions. As indicated in Table 9, snowball sampling is described as a sampling technique where readily available participants recommend other potential participants (Koerber and McMichael, 2008). This could have been applied by asking the managers/shareholders interviewed who their company's banker or banking institution is from which the sample of banking institutions could be determined. This was, however, determined not to be the most appropriate sampling

method, as it may have led to duplication (i.e. where different companies included in the sample make use of the same banking institution) or may not necessarily have included all the relevant banking institutions, detracting from the richness of the data that could be collected.

Accordingly, purposive sampling was also considered. For this user group of the study, Intensity Sampling, as a form of purposive sampling, was used by identifying key participants (i.e. from banking institutions) 'rich in information' about the particular phenomenon (Suri, 2011). South Africa has a number of banking institutions, but five banks are regarded as the major banks in South Africa – ABSA Bank, First Rand Bank, Nedbank, Standard Bank and Investec (PwC, 2019; BusinessTech, 2021). These banks are also the major commercial banks that operate within the geographical area of this study and therefore they were purposefully selected as the sample for Banking Institutions as users of auditors' reports in this study. Interview participants selected were banking officials who review and approve credit applications of private companies.

As an additional measure to ensure that all banking institutions relevant to the study were included in the sample, interview participants in the executive management and shareholder groups were also asked where their company obtains its finance from. Only the five major banks in South Africa were mentioned by these interview participants, which confirmed the appropriateness of the banking institutions included in the sample.

The recruitment strategy employed to identify and secure an appropriate sample, is set out in the following steps:

- Step 1: Business contacts of the researcher working at the identified banking institutions were contacted to identify banking officials who are responsible for reviewing and approving credit applications from private companies in the Free State.
- Step 2: These banking officials were approached informally by telephone call to test their interest/willingness to participate in the study in principle. The potential interview participant was also asked who the appropriate gatekeeper is and to share his/her contact details.

Step 3: Gatekeepers were contacted to request permission to conduct research at the banking institution and to interview the specific participants. The purpose of the study was explained, and the gatekeeper was provided with the *'Request for permission to conduct research from Gatekeepers'* form included in APPENDIX C in order to obtain permission.

Gatekeepers' permission could, however, only be obtained from four of the five selected commercial banks. Consequently, an additional interview participant was selected from one of the other four banks in order to include a minimum of five individuals in the sample for this interview group, as recommended by Leedy and Ormrod (2015). One participant was found to not be suitable due to a lack of experience, having only recently been appointed in their role at the bank. This participant was therefore replaced by another more suitable participant from the same banking institution.

In summary, six (6) interviews were conducted with relevant interview participants from four of the five major banks. Five (5) of these interviews from four of the five major banks provided usable data, of which the findings are discussed in Chapter 4 for the "External Stakeholders" group.

#### **3.5.3.3. Sampling Method: SARS**

SARS is the only revenue service and tax collecting authority of the South African Government (SARS, 2019). Purposive sampling was used to identify qualified and knowledgeable individuals, working with private companies, employed by SARS in the Free State province. These participants are regarded as part of the "External Stakeholders" group and are presented as such where the findings of this study are presented in Chapter 4.

The recruitment strategy employed to identify and secure an appropriate sample, is set out in the following steps:

Step 1: Colleagues of the researcher employed in the Taxation department of the School of Accountancy, University of the Free State, were asked for references of officials working at the SARS office in Bloemfontein, who may be suitable for this study.

Step 2: These SARS officials were approached informally by telephone call to test their interest/willingness to participate in the study in principle and to determine whether they work specifically with the 'tax compliance audits' of private companies in the Free State Province. Where they did not meet these criteria, the SARS official was asked for alternative references at SARS who met the criteria (whereafter this step was repeated). The potential interview participant was also asked who the appropriate gatekeeper was and how the gatekeeper could be reached. It was established that all research conducted at SARS need to be approved by the SARS Enterprise Research and Knowledge Management (ERKM) Committee (SARS, 2023) by submitting an online request to the ERKM Committee at the following link:

<https://tools.sars.gov.za/WebTools/OnlineResearchForm.aspx>.

Step 3: The online request was accordingly submitted to the ERKM Committee. Approval was subsequently obtained to interview three relevant SARS officials. The appropriateness of interview participants was confirmed with the relevant SARS Regional Director. Specific notice was taken of the confidentiality clauses within the Tax Administration Act (South Africa, 2011b), however, SARS officials were not expected to disclose any confidential information as described in section 68(1) of the Act, but rather share their own perceptions and needs as users of audited financial statements of private companies in general.

During the interviews it was confirmed with participants that the same process is followed by all SARS officials when tax compliance audits are performed. The similarity in responses from participants also corroborated this. During the interviews, it was further established that SARS currently has five officials who perform

compliance audits on private companies in the Free State, while another seven officials would assist with compliance audits of Free State-based companies from time to time. For this reason, three interview participants in this grouping were deemed sufficient. The data from all three interviews conducted were regarded as useful, meeting the relevant criteria, and therefore form part of the findings included in Chapter 4 for the “External Stakeholders” group.

### 3.5.4. Data analysis and coding methods

Data collection, data analysis and theory are all interweaved for qualitative studies (Babbie, 2016). The process of collecting, analysing and interpreting data happens simultaneously, as initial data may suggest certain patterns worth confirming or clarifying during further/subsequent data collection. This is also referred to as the ‘constant comparative method’ (Leedy and Ormrod, 2015).

As explained in the preceding sections, 25 interviews were conducted, of which 20 were useable (cf. 3.5.3). The 20 participants were categorised in the groups and sub-groups presented in Table 11 and data analysis and coding was done for the two groups respectively:

**Table 11: Interview Groups and Sub-groups**

Groups	1. Management and Shareholders [n = 12 ]	2. External Stakeholders [n = 8 ]
Sub-groups	Executive Management: Finance [n = 5]	Banking Institutions [n = 5]
	Executive Management: Non-Finance [n = 5]	SARS [n = 3]
	Shareholders [n = 2]	

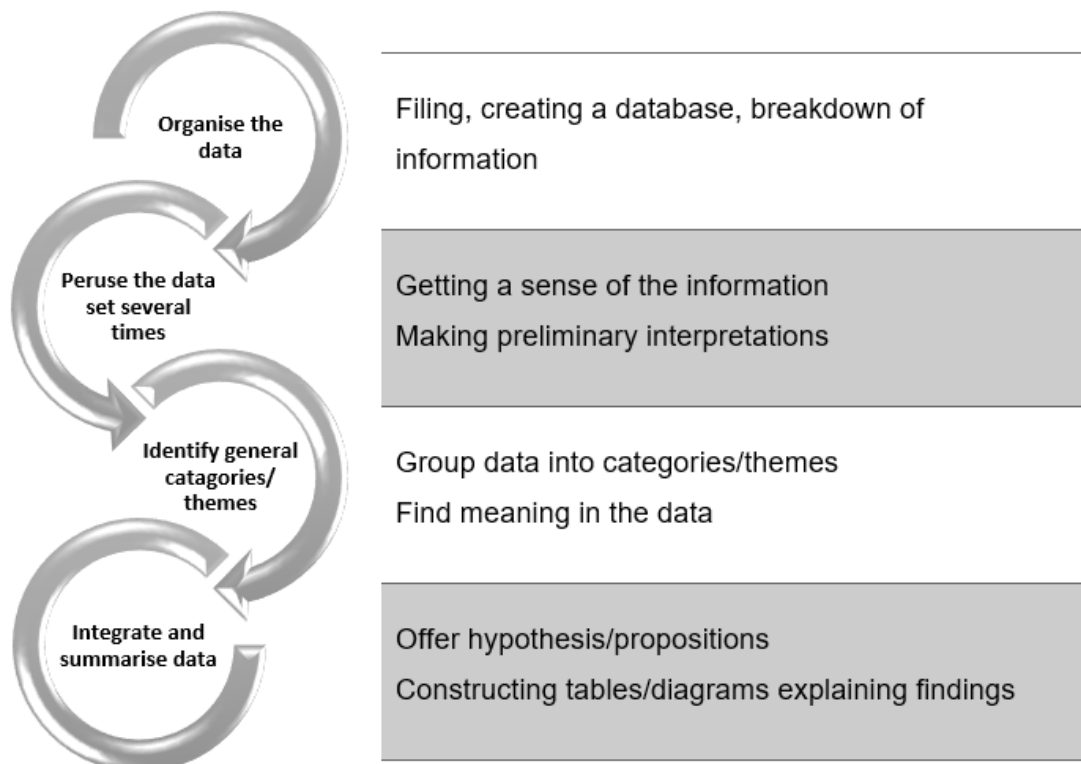
*Source: Compiled by the researcher*

As data analysis in qualitative research is often criticised for being subjective and biased (Bryman and Bell, 2011), this study made use of an independent co-coder to enhance credibility and to mitigate any potential biases of the researcher. This aims

to achieve inter-rater reliability between the researcher and the co-coder (Leedy and Ormrod, 2015) and investigator triangulation (De Vos *et al.*, 2005). The co-coder was an experienced qualitative researcher, with specific expertise in the coding of interviews. Moreover, she is not a subject specialist, i.e. she does not have experience in the field of auditing, which allowed for the identification of additional codes and perspectives, sometimes overlooked by the researcher who is a subject specialist. This further enhanced the credibility of the analysed data.

Cresswell (2013) recommends the following approach to analysing and coding data, where continuous analysis occurs, while gradually moving forward:

**Figure 5: Creswell Data Analysis Spiral**



Source: Cresswell (2013); Leedy & Ormrod (2015) (adapted by the researcher)

The Creswell Data Analysis Spiral as explained in Figure 5 was used by both the researcher and co-coder as a guideline to analyse and code data for this study, which is discussed in the following sections.

#### **3.5.4.1. Organising**

Data were collected by means of interviews, and subsequently transcribed. Due to the number of interviews and the extensive time involved in transcribing interviews, the service of a professional, independent transcriber was used. Immediately after every interview, the recording was uploaded from the researcher's password-protected computer to the password-protected storage site of the transcriber.

The transcriber did verbatim transcriptions and sent these back to the researcher as soon as each interview transcript was complete. A number was assigned to each transcript. These transcripts were stored and filed according to the type of financial statement user, i.e. shareholders, executive management (in finance and non-finance), banking institutions and SARS. The *Evasys* survey that participants were required to complete prior to the interview, was stored alongside the interview transcripts. Transcripts were sent to the research participants to provide them with the opportunity to review the transcript for accuracy, should they wish to do so.

All transcripts were de-identified by replacing the names of participants and companies with [PERSON] or [INSTITUTION] where applicable, before sharing the transcripts with the co-coder. As discussed under 3.5.3.3, SARS as an institution was not de-identified, as this is the only revenue service in South Africa and de-identification would be ineffective.

#### **3.5.4.2. Perusal**

Once all the transcripts per interview participant group were ready and de-identified, they were shared with the co-coder. The researcher and co-coder read the transcripts several times independently to familiarise themselves with their contents. As suggested by Leedy and Ormrod (2015), the interviewer continuously searched for patterns while collecting and analysing data throughout the data collection period. This enabled identification of data that required further investigation.

It is also here where the researcher and co-coder started to highlight particularly relevant sections and assign preliminary codes to the data. As recommended by

Sunstein and Chiseri-Strater (2012), while perusing the transcripts, the researcher and co-coder remained alert to statements that “surprised”, “intrigued” and “disturbed” them in specific relation to the research question.

#### **3.5.4.3. Classification**

At this stage, the researcher and co-coder started to interpret the data by formally assigning codes thereto. Coding is described as the categorisation or classification of data (Babbie, 2016). Coding is not purely about labelling text, but rather identifying meaningful concepts, integrating these into apparent distinctive experiences (Leedy and Ormrod, 2015).

Coding of qualitative data is usually done either deductively or inductively. Deductive coding refers to coding with a pre-determined set of codes or coding framework, developed independently of the data (theory-driven). Inductive coding, conversely, refers to coding that is developed from the collected data (data-driven) and is typically employed when limited literature is available about the phenomenon being studied (Leedy and Ormrod, 2015; Creswell and Creswell, 2018). A hybrid approach combining the two methods can be followed should it suit the needs of the study (Fereday and Muir-Cochrane, 2006; Saldaña, 2016).

In section 2.2.3, typical expectations from auditors were identified. Although these expectations were related to public/listed companies internationally, it was deemed possible that these expectations may also be identified by users of the auditor reports of private companies. This enabled deductive coding to some extent, whereby literature was used to pre-determine some codes. However, as the study aims to obtain a deeper understanding of the phenomenon, deductive coding alone would limit the findings. Expectations of users of private companies’ auditor reports remain largely unexplored and therefore inductive coding was also employed to identify new areas or concepts contributing to the audit expectation gap in private companies. As suggested by Saldaña (2016), a hybrid approach was therefore followed.

Initially, for the first cycle of coding, the descriptive coding method was employed. This entails assigning basic labels to data, resulting in an inventory of topics. A short phrase or word is used to summarise the *topic* of the data rather than the *content*, the

topic being the substance of the data (Saldaña, 2016). Certain code categories were identified from previous literature, while descriptive coding was used to update or expand codes as data were collected and analysed. Codes were reanalysed to identify noteworthy concepts and patterns, by making use of axial coding. Axial coding refers to analysing first-cycle codes to identify important concepts (Babbie, 2016). It should be noted that while the above process was followed, the coding of transcripts was a non-linear, back-and-forth exercise (Creswell, 2013). Once codes were assigned, the codes were grouped into categories. These categories are defined as the meanings that were derived from the data as interpreted by the researcher and co-coder (Saldaña, 2016).

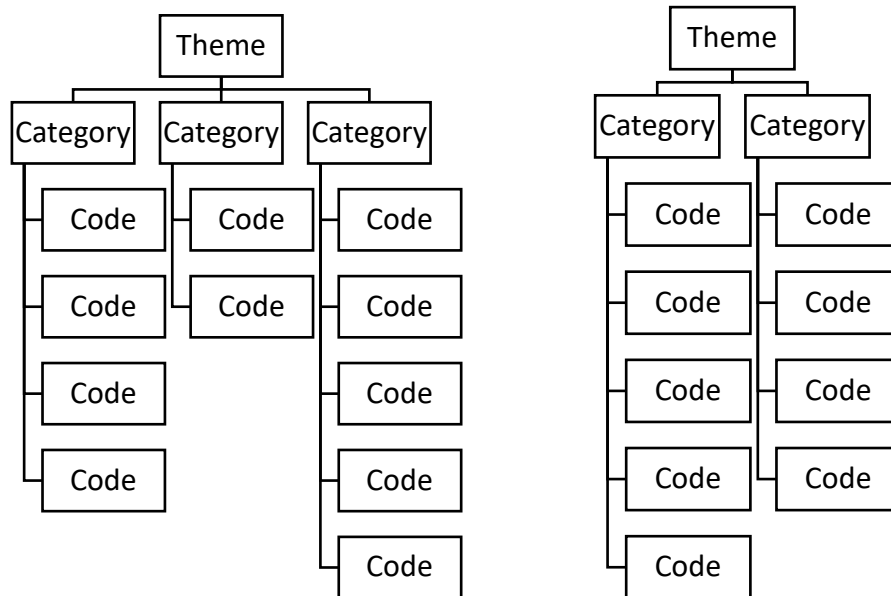
Initially, it was planned to make use of a Computer-Aided Qualitative Data Analysis Software (CAQDAS) program to aid in the coding process. However, as the researcher is a novice in the use of this software, it was decided to embark on a manual coding journey, whereby the researcher could practically engage with the data, enabling a more meaningful interaction with the data, although it slowed down the process. This also enabled “freedom in terms of constant comparison, trialling arrangements, viewing perspectives, reflection and ultimately developing interpretive insights”. (Maher, Hadfield, Hutchings and de Eyto, 2018; Mattimoe, Hayden, Murphy and Ballantine, 2021) Manual coding also has an advantage of having data visually displayed, which allows the researcher to physically engage with the data in a variety of ways over an extended period (Mattimoe *et al.*, 2021). The researcher and co-coder of this study, who consequently also applied manual coding, transferred codes to hard-copy concept maps, which remained a working document that the researcher engaged with throughout the data analysis and coding process.

#### **3.5.4.4. Synthesis**

Finally, codes and categories were synthesised into themes. Themes are the outcome of coding, categorising and analysing data and provide collective descriptions of the implied meanings drawn from the data on a theoretical or conceptual level (Saldaña, 2016).

Data was therefore organised as follows:

**Figure 6: Organising data from codes to theory**



Source: Saldaña, 2016 (adapted by the researcher)

Having worked through all the data, both the researcher and co-coder independently suggested codes, categories and themes. These codes, categories and themes were compared and discussed until consensus was reached between the researcher and co-coder on the collective synthesis of data. Reaching consensus between the researcher and co-coder was deemed important to ensure that a variety of experiences and viewpoints contribute to the ‘unravelling’ and understanding the complexities of the collected data (Hill, Thompson, Hess, Knox, Williams and Ladany, 2005).

Barrett (2007) investigates the researcher as a research instrument and comments the following: “Although methodological literature provides useful frameworks and heuristics to guide the process of transforming field data into credible findings, learning to analyse and interpret qualitative data also involves a transformation of the researcher as the primary instrument for making sense of the phenomenon under study.” The data analysis and coding process was a non-linear exercise where the researcher evolved in her way of thinking and interpreting data, becoming an integral part of the study. While some argue that these interpretations in their nature are subjective (Bryman and Bell, 2011), various strategies were implemented to enhance

trustworthiness of the findings as interpreted by the researcher. While the researcher does not claim to be completely objective, the following section details measures implemented to gain trustworthiness.

### **3.5.5. Trustworthiness of the study**

Lincoln and Guba (1985) suggest that to obtain trustworthiness in qualitative research, one should aim towards credibility, transferability, dependability and conformability, as complete objectivity is not necessarily possible. These characteristics and how they are achieved are described in Table 12, also indicating how they were applied in this study.

**Table 12: Characteristics of Trustworthiness Applied to the Study**

<b>Characteristic</b> (Lincoln and Guba, 1985)	<b>Description</b>	<b>Application in this study</b>
<b>Credibility</b>	This is achieved through ensuring that research is conducted by applying good practice and submitting research findings to those who were studied to confirm accuracy of the researcher's understanding of their experiences and realities (Bryman and Bell, 2011).	In this study, a systematic approach was followed to identify the philosophy, paradigm, approach to theory development, research design and strategy and research methods that would be appropriate to answer the research question. An experienced supervisor evaluated the process and recommended changes where necessary, which were duly applied. The research proposal was also evaluated by the Research Committee of the School of Accountancy, the Research Committee of the Faculty of Economic and Management Sciences and the Ethics Committee of the University of the Free State. This process enables good practice and therefore enhanced credibility.  Furthermore, copies of transcribed interviews were shared with the relevant interview participants to obtain confirmation of accuracy and enable participants to rectify or clarify necessary concepts or information. A copy of the study and its findings were also shared with research participants.
<b>Transferability</b>	Such rich detail should be recorded about findings that it enables readers to transfer information to other settings	In Chapters 4 and 5 the empirical findings are recorded and analysed in as much detail as possible. The coding strategies discussed in section 3.5.4 enabled complete and systematic recording of the findings. An external co-coder was used in the coding process to ensure that all relevant and necessary information was taken into account and properly documented. The co-coder also attested to the

	due to shared characteristics (Creswell and Poth, 2018).	richness of the findings. Readers are therefore enabled to transfer information from this study to their own experiences or settings (i.e. financial statement users, auditors and regulators could use the findings of the study to better understand the audit expectation gap in private companies, further enabling them to respond to the identified contributors to the audit expectation gap).
<b>Dependability</b>	Keeping complete, accessible records of the entire research process, enabling peers to verify that good practice was followed (Bryman and Bell, 2011).	The process applied in the data collection and analysis phase of this study was informed by credible research methodology texts and accredited research journal articles. An audit trail was kept of all evidence, such as field notes, interview recordings and transcripts, analysis by both coders and correspondence with supervisors. An external co-coder was used in order to achieve 'investigator triangulation'. The research process applied in this study was therefore logical, traceable and documented.
<b>Confirmability</b>	Confirmability is parallel to objectivity, but in the constructivist paradigm, confirmability rather than objectivity is sought (Mertens, 2015). Qualitative researchers should recognise that complete	Consistent with the guidance provided by Leedy and Ormrod (2015), the following strategies were implemented to increase the trustworthiness of data collected during interviews: <ul style="list-style-type: none"> <li>• Reflexivity: A continuous effort was made to avoid any biases in collecting and interpreting data.</li> <li>• Seeking of exceptions or contradictory information: Rather than just seeking to identify similarities or trends in interview responses, an active effort was</li> </ul>

	<p>objectivity is not possible, but should ensure that personal values and views do not knowingly influence the study (Bryman and Bell, 2011).</p>	<p>also made to identify contradicting information, such as a smaller or larger audit expectation gap, or perhaps no gap at all.</p> <p>Within qualitative studies, researchers apply a great deal of judgement and consequently, personal attitudes and opinions may bias interpretations. To mitigate this fact, a co-coder (not from an auditing context) was used, enhancing the reliability of codes through 'inter-rater reliability'. In addition, it should be noted that the researcher has no vested interest in the study.</p>
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Source: Compiled by the researcher

### **3.6. Ethical Considerations**

Research ethics form an integral part of all studies, with the aim of ensuring that no one suffers adverse consequences as a result of the study conducted (Cooper and Schindler, 2014). Especially in qualitative research, Creswell (2013) recommends that researchers should consider each phase of the study to identify possible ethical issues that may arise and to plan on how to address these issues. In addition to the moral considerations, there are also legal considerations, such as the South African National Health Act (No. 61 of 203) (South Africa, 2003), which requires all research that involves human participants to be approved by a relevant ethics committee.

Table 13 sets out how these ethical matters were considered and applied in this study.

**Table 13: Ethical Considerations applied to the study**

<b>Universal Ethical Principles</b>			
Autonomy and respect	Justice	Beneficence	Non-maleficence
<b>Research Ethics</b>			
Informed consent	Voluntary participation		Avoidance of harm
<b>Application within the Research Process</b>			
<b>Stage of the research process</b>	<b>Ethical principle / practice</b>	<b>Strategies employed to ensure adherence</b>	
Planning the study	Obtain approval from a Research Ethics Committee	Approval was sought from and granted by the General Human Research Ethics Committee of the University of the Free State (Ethical clearance number: UFS-HSD2022/0210/22). See APPENDIX A.	
	Obtain permission for execution of the study from relevant authorities of organisations involved in the study	A research proposal for this study was submitted to the Research Committee of the Faculty of Economic and Management Sciences, University of the Free State, whereafter permission to conduct the study was obtained.  Where applicable, gatekeepers' permission was obtained from the superiors of interviewees, which was also submitted to the General Human Research Ethics Committee of the University of the Free State before final approval for the study was obtained.	
Before fieldwork commences	The purpose of the research should be disclosed	In line with the guidelines of the Research Ethics Committee of the Faculty of Economic and Management Sciences, University of the Free State, the purpose of the study was communicated to each research participant in the	

		form of an <i>Information Leaflet and Consent Form</i> . It was also communicated to the gatekeepers, where applicable, in the form of a written <i>Request for Permission to Conduct Research from Gatekeepers</i> . See APPENDIX C.
	Voluntary participation and informed consent	In line with the guidelines of the Research Ethics Committee of the Faculty of Economic and Management Sciences, University of the Free State, research participants were informed that participation is voluntary and that participants may choose to withdraw from the study. It was also stated that no penalty or loss of benefit would occur should the research participant decline to participate or decide to withdraw from the study. This was communicated in the form of an <i>Information Leaflet and Consent Form</i> and it was verbally reiterated before the start of each interview conducted. A separate informed consent form was sent to each interview participant, which they were required to digitally agree to on an <i>Evasys</i> survey. See APPENDIX D and APPENDIX E.
	Include participants in discussions regarding research ethics applicable to the study	Before the start of the scheduled interview, research participants were reminded that participation was voluntary and that they may withdraw should they wish to do so. Participants were again reminded that their information will be kept confidential and that they will not be identified in the study.
Data collection	Respect the site where interviews take place and limit disruptions	Research participants were given a choice as to whether they prefer the interview to take place online (through making use of Microsoft Teams) or in person at a site that they prefer but which was also safe for the researcher to

		visit. A date and time for interviews were agreed on with the research participants in order to limit disruptions to their personal programmes.
	Respect research participants' privacy and ensure confidentiality of information	Interviews that were conducted in person, were done in a private office with a closed door and when there were interruptions, the interview was stopped until the person who had entered had left, whereafter the interview continued. Where interviews were conducted online, the researcher performed the interview in a closed office without disruptions.
	Respect preferences of participants (e.g. language preferences)	All interview questions were compiled in English, but research participants were given the choice as to whether the answers or discussions would be in English or Afrikaans.
	Do not exploit participants; avoid using participants without giving something in return	While interview participants were not remunerated, the findings of the study were shared with them, and they were granted the option to obtain access to the full study. Findings were also shared with professional bodies and regulators in order to consider the impact on standards and guidelines for auditing private companies, which is hoped to benefit the interview participants in future.
Data management	Ensure confidentiality of information	All information was stored on a password protected computer in digital format. Any hard copies, such as interview notes, were destroyed once converted into a digital format.  A professional service provider was contracted to transcribe interviews. The recorded interviews were shared with the service provider using a password

		protected cloud storage platform, which was erased once the transcripts were received from the service provider. The service provider agreed in writing that all information would be kept confidential.
Data analysis and interpretation	Ensure accuracy of information	As mentioned above, a professional service provider was used to transcribe interviews. The researcher read through each transcript once it was received to ensure that it was accurate. Where the transcriber indicated phrases in the transcript as 'unclear', the researcher revisited the recording of the interview and included the accurate wording.  Once the coding of the transcripts had taken place, the services of an external co-coder were used to ensure completeness and accuracy of interpretations.
	Authenticity: disclosing both positive and negative findings	While this study leans towards obtaining 'negative' feedback (where auditors' services are lacking, creating an audit expectation gap from the viewpoint of financial statement users), care was taken to also report on positive findings, which may lead to the conclusion that an audit expectation gap does not exist, or where it might be very small.
Writing and reporting research	Report findings to stakeholders in a manner that is easily accessible	Apart from sharing the results of the study with research participants, it will also be shared with relevant professional bodies and regulators (e.g. SAICA and the IRBA). Final findings will also be shared in accredited academic journals (in the form of articles) and at academic forums (in the form of conference presentations) to enable access to information by various stakeholders.

	Use sensitive language and avoid sharing findings that could harm participants	No findings were shared in a manner that is traceable to any individual person and can consequently lead to harm participants. Reference was made to interview participants as 'the participant' to avoid any conclusions drawn from more personal references, such as he/she, the manager/shareholder etc.
	Use clear and straightforward language	Reference was made to interview participants as 'the participant' to avoid any conclusions drawn from more personal references, such as he/she, the manager/shareholder etc.  Interview questions were reviewed to ensure that they were clear and did not contain double-barrel or leading questions.
	Avoid plagiarism	A declaration is included at the start of this study to confirm that this study is the researcher's own work.  All sources used to inform this study were duly referenced by making use of the <i>Mendeley Cite-O-Matic</i> feature that was downloaded as an add-in to Microsoft Word (see LIST OF REFERENCES). Limited direct quotations were used and indicated as such with proper referencing. Paraphrasing and summaries were used as a means of formulating the researcher's understanding of prior literature, which was also duly referenced.  Furthermore, the Turnitin software was used to detect any unreasonable direct wording used, which was also reviewed by the supervisor of this study.

	Do not falsify information	Care was taken to ensure that accurate and authentic information was reported on. A proper audit trail was kept of all information, including interview recordings and transcripts, to enable verification.
	Store data after completing the study	All data resulting from this study is stored digitally on a device of the University of the Free State (where this study is approved and conducted) and will be available for a minimum of five years.

Source: Adapted from Janse Van Rensburg (2015) and Creswell (2013).

### **3.7. Summary**

In this chapter, a detailed explanation was provided about the methodological considerations and the application thereof adopted in this study to answer the research questions posed in Chapter 1. This provided a systematic way to explore the phenomena of the audit expectation gap in private companies.

It was identified that this study is positioned within the constructivist paradigm as a form of interpretivism, which enabled alignment of the rest of the study thereto. Thereafter, the chapter dealt with the research design and described the strategy and methods employed, which included the data collection methods, sampling methods and coding and analysis of results. Lastly, the trustworthiness of the study and relevant ethical considerations were described as an integral component of the study.

These elements provide the background against which the empirical findings in the following chapters are presented and discussed.

## CHAPTER 4: RESULTS AND DISCUSSION

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### 4.1. Introduction

In the preceding chapter, the research methodology employed in this study was explained, while ethical considerations and factors contributing to the trustworthiness of the study were also outlined.

The study was positioned in the constructivist paradigm as a form of interpretivism. Induction was employed as the approach to theory development, while the strategy of this qualitative study was recognised as phenomenological. Primary data was collected through in-depth interviews, transcripts of which were analysed and coded systematically for two groups: Management and Shareholders (Group 1) and External Stakeholders (Group 2).

The purpose of the interviews conducted was to obtain an in-depth understanding of the perceptions and expectations that users of private company financial statements have from external audits/auditors. In this chapter, these perceptions and expectations as experienced by participants, analysed by coders and interpreted by the researcher are presented and discussed, while also comparing findings with applicable audit requirements and literature. In order to enhance the context of the findings obtained, demographic and other relevant information of participants is presented for each group before results are presented (cf. 4.2).

Throughout this chapter, direct quotations that best describe the views of the participants, as well as paraphrased wordings are provided to enhance the trustworthiness of the study. Where interviews were conducted in Afrikaans, quotations are translated to English and presented alongside the original, Afrikaans quotations. Where necessary, wording is included by the researcher within the direct quotations to provide better context. Square brackets and capital letters were used for this purpose. For example, in response to a question on whether it is the auditor's responsibility to ensure compliance with all laws and regulations, a participant's direct

response was: “*I think they are the custodians of the tax laws for instance...*”. This quotation is then presented as follows: “*I think [THE AUDITORS] are the custodians of the tax laws for instance...*”.

During the data analyses and coding phase (cf. 3.5.4), codes, categories and themes were identified. The coding for the Management and Shareholders group was done first and very limited new codes emerged from the analysis of the interviews of the External Stakeholders group. One data set is therefore presented in this chapter and, where applicable, differences between the two groups are indicated. The codes, categories and themes identified, guide the rest of this chapter as follows:

**Table 14: Themes, categories and codes emerging from data analysis**

<b>Themes</b>	<b>Categories</b>	<b>Codes</b>
<b>Section 4.3: Users of audited financial statements</b>	4.3.1 Influence of background on user perceptions/expectations	a. Audit versus non-audit b. Finance versus non-finance c. Experience
	4.3.2 Shareholders	a. Healthy investment
	4.3.3 Banks/Providers of finance	a. Security b. Interest rates and facilities
	4.3.4 SARS	a. Assurance b. Assistance to SARS
	4.3.5 Management	a. Auditor’s report: unread, but content known b. Value of management report
<b>Section 4.4: Audit purpose expectations</b>	4.4.1 Fraud	a. Material fraud b. Management’s responsibility c. Duty to report
	4.4.2 Errors	a. All vs. material errors b. Financial statements as a product of the audit
	4.4.3 Going concern	a. Management responsibility b. Duty to report/warn
	4.4.4 Good investment	a. Investors’ own assessment b. Accuracy of Financial Statements
	4.4.5 Systems of internal controls	a. All versus key financial controls versus separate engagement b. Duty to report
	4.4.6 Laws and regulations	a. All versus direct influence b. Duty to report

<b>Section 4.5: Audit value expectations</b>	4.5.1 Primary/Direct value	<ul style="list-style-type: none"> <li>a. Assurance/credibility versus Reassurance/accountability</li> <li>b. Safety net</li> <li>c. Independent external review</li> </ul>
	4.5.2 Secondary/Indirect value	<ul style="list-style-type: none"> <li>a. Open line to technical expertise</li> <li>b. Broad exposure to point out opportunities</li> <li>c. Association and brand reputation</li> <li>d. Agency conflict resolution</li> </ul>
<b>4.6 Auditor independence</b>	4.6.1 Relationships	<ul style="list-style-type: none"> <li>a. Longstanding association</li> <li>b. Personal relationships</li> <li>c. Familiarity</li> </ul>
	4.6.2 Other services	<ul style="list-style-type: none"> <li>a. Input to audit process</li> <li>b. Non-assurance services</li> </ul>

Source: Compiled by the researcher

The findings presented in section 4.3, address the first sub-question of this study: *Who are the external users of audited private company financial statements?* The findings are presented within each code/category/theme and compared to the relevant literature to confirm the appropriateness of the participants in this study.

This is followed by 4.4, 4.5 and 4.6, which address the second and third sub-questions of this study: *What are the expectations of the users of audited private company financial statements?* and *To what extent do the expectations of users differ from what is prescribed by applicable audit requirements?* Sub-questions two and three are dealt with within each code/category/theme by firstly analysing the finding and providing support for the finding by quoting the most relevant/descriptive statements made by participants (both presented as *i.*) and, thereafter comparing the finding to applicable audit requirements (and/or literature where applicable) (presented as *ii.*). This was done to enable the reader to immediately identify any differences between participants' expectations and applicable audit requirements. A preliminary conclusion of the finding's impact on the audit expectation gap is presented last in a grey box, under each finding.

During the interviews, participants often provided recommendations to auditors. These recommendations were not necessarily "expectations" as such, but rather preferences or desirables. These recommendations do not directly address the research question of this study and are, therefore, not presented as part of the core findings in this

chapter. They were, however, identified as valuable information that practitioners and standard-setters could consider to improve the audit service to private companies and possibly other entities as well. These recommendations were therefore documented in a similar manner as the findings in this chapter and are presented in APPENDIX F.

## **4.2. Description of participants in each group**

### **4.2.1. Group 1: Management and Shareholders**

The criteria and sampling method used to select interview participants in this group were discussed in detail in Chapter 3 (cf. 3.5.3.1). Table 15 presents a summary of the participants' demographical and other relevant information as gathered through a survey which participants completed prior to each interview. Where necessary, some survey details were updated with the consent of the participant after clarifying particulars during the interview. While the aim of the study is not to generalise its findings, variation was sought by including participants with a finance background and those with a non-finance background, different age groups, different industries/institutions, etc. to not skew results to a particular participant profile.

**Table 15: Interview Participant Demographic and Other Relevant Information – Management and Shareholders**

<b>Interview participant number (P)</b>	<b>Interview platform</b>	<b>Company Industry</b>	<b>Role/ Position in Company</b>	<b>Length of employment in current role</b>	<b>Level of qualification</b>	<b>Field of study</b>	<b>Previous experience working at an audit firm</b>	<b>Company Audit Firm</b>	<b>Mandatory / Voluntary Audit</b>
1	In person	Manufacturing	Financial Director	11 – 20 years	Honours Degree, CA(SA)	Accountancy	Yes	Non-Big 4	Mandatory
2	MS Teams	Agriculture	General Manager	1 – 5 years	Master's Degree, Professional Accountant(SA)	Accountancy	Yes	Non-Big 4	Voluntary
4	MS Teams	Liquor retail / wholesale	Director	6 – 10 years	Diploma	Information Technology	No	Non-Big 4	Voluntary
5	In person	Retail	Director	More than 20 years	Bachelor's Degree	Agriculture	No	Non-Big 4	Mandatory
6	MS Teams	Retail Liquor	Shareholder	n/a	Honours Degree	Corporate Communication	No	Non-Big 4	Voluntary
7	MS Teams	Wholesale and retail of food products	Group Finance Manager	1 – 5 years	Honours Degree, CA(SA)	Accountancy	Yes	Big 4	Mandatory
8	MS Teams	Open cast contract mining	Chief Financial Officer	6 – 10 years	Honours Degree, CA(SA)	Accountancy	Yes	Non-Big 4	Mandatory
13	In person	Financial services	Chief Financial Officer	More than 20 years	Honours Degree	Accountancy	Yes	Non-Big 4	Voluntary
16	MS Teams	Sport	Commercial Manager	6 – 10 years	Honours Degree	Business Management and Marketing	No	Big 4	Mandatory
18	MS Teams	Investment	Shareholder	n/a	Bachelor's Degree	Architecture	No	Non-Big 4	Voluntary
19	MS Teams	Poultry farming	Financial Manager	6 – 10 years	Honours Degree, CA(SA)	Accountancy	Yes	Big 4	Mandatory
21	In person	Transport	General Manger	11 – 20 years	Diploma	Civil Engineering	No	Big 4	Mandatory

Source: Compiled by the researcher

The interview numbers in the first column of Table 15 were assigned to participants in the sequence that interviews took place and bear no relation to the company numbers presented in Table 10 in Chapter 3. Four of the twelve participants in this group were interviewed in a face-to-face setting, while eight interviews were conducted online via Microsoft Teams. Participants represented private companies from a variety of industries, confirming that findings are not skewed to a particular sector. Participants' years of experience also varied, which indicates that findings are not skewed to a particular age group or generation. Of the 12 participants in this group, six studied in the field of accountancy and previously worked for an auditing firm, while the other half of the participants do not have an accountancy or auditing background, again providing variation in the sample. Participants represented private companies audited by both Big-4 firms (four) and non-Big 4 firms (eight), of which five were related to voluntary audits and seven to mandatory audits, again proving diversity in these areas.

#### **4.2.2. Group 2: External Stakeholders**

The criteria and sampling method used to select interview participants in this group were explained in Chapter 3 (cf. 3.5.3.2 and 3.5.3.3). Five senior individuals employed in the business credit divisions of four of South Africa's five major banks were interviewed, while three of the five SARS officials who regularly perform compliance audits on private companies in the Free State province were interviewed.

Table 16 presents a summary of the participants' demographic and other information as gathered through a survey which participants completed prior to each interview. Where necessary, some details gathered through the surveys conducted prior to interviews were updated with the consent of the participant after clarifying particulars during the interview. The interview numbers were assigned to participants in the sequence that interviews took place and bear no relation to the order in which the Banking Institutions are listed under 3.5.3.2 in Chapter 3.

**Table 16: Interview Participant Demographic and Other Information – External Stakeholders**

<b>Interview participant number (P)</b>	<b>Interview platform</b>	<b>Employing Institution</b>	<b>Role/ Position in Institution</b>	<b>Length of employment in current role</b>	<b>Level of qualification</b>	<b>Field of study</b>	<b>Previous experience working at an audit firm</b>
3	In person	Bank 1	Catchment Credit Evaluation Manager	6 – 10 years	Honours Degree	Investment Management	No
10	MS Teams	Bank 2	Credit Manager	6 – 10 years	Bachelor's Degree	Accountancy	No
11	MS Teams	Bank 3	Senior Commercial Credit Manager	6 – 10 years	Honours Degree, CA(SA)	Accountancy	Yes
20	In person	Bank 1	Credit Evaluation Manager	1 – 5 years	Post-Graduate Diploma	Accountancy	No
23	MS Teams	Bank 4	Senior Credit Manager	1 – 5 years	Master of Business Administration (MBA)	Accountancy	Yes
24	MS Teams	SARS	Compliance Auditor	11 – 20 years	Bachelor's Degree	Accountancy	No
25	MS Teams	SARS	Auditor – Corporate Tax	6 – 10 years	Post-Graduate Diploma	Accountancy (specifically, Taxation)	Yes
26	MS Teams	SARS	Compliance Auditor	More than 20 years	Bachelor's Degree	Statistics and Taxation	No

Source: Compiled by the researcher

As with Table 15, the interview numbers in the first column of Table 16 were assigned to participants in the sequence that interviews took place and do not relate to any other information in this study. Two of the eight participants in this group were interviewed in a face-to-face setting, while six interviews were conducted online via Microsoft Teams. Five participants represented four banking institutions, while three SARS representatives were interviewed. Participants' years of experience and qualifications varied, while three of the eight participants in this group have previously worked for an auditing firm. Findings are therefore not skewed to a particular background, institution, age group or generation.

### **4.3. Users of audited financial statements**

In answering the first sub-question of this study, it was important to identify who the users of private company financial statements are. The literature review documented in Chapter 2 identified four primary categories of financial statement users: Shareholders, Providers of Finance, SARS and Management. The users of audited financial statements identified by interview participants coincided with those identified in the literature review and are presented as the categories of the theme discussed in this section. The following additional user categories of audited private company financial statements, not previously identified, were reported by interview participants:

- Labour unions: Private companies sometimes use their audited financial statements in wage negotiations. (P19)
- Main/core suppliers: Where inventory is purchased on credit, some suppliers request audited financial statements to determine and maintain credit limits granted to private companies. (P4)
- Issuers of tenders/contracts: When responding to a *Request for Tender*, companies are often required to submit audited financial statements as part of the mandatory tender documents. (P8)

As these user categories did not form part of the participants interviewed for this study, no insights on the audit expectation gap relating to them were obtained. This is recognised as a limitation to the study. All three of these additional user categories,

however, request audited financial statements on an *ad hoc* basis and are not regarded as general/frequent users of audited private company financial statements, a point confirmed by interview participants.

#### 4.3.1. Influence of background on user perceptions

Theme	Category	Code
Users of audited financial statements	Influence of background on user perceptions/ expectations	a. Audit vs. non-audit b. Finance vs. non-finance c. Experience

Throughout the interview phase it became apparent that the professional background of users of audited financial statements plays a significant role in a user's perceptions of and expectations from auditors. It became evident that similarities in participants' perceptions and expectations were often identified where participants were of a similar professional background, and not only when participants currently fulfil a similar role. Three codes emerged from the analysis of data which relate to how a participant's background influences their perceptions.

##### a. Audit versus non-audit

Of the 20 interview participants, nine participants had previously worked at a registered audit firm and, therefore, had some background in the auditing field, while the other 11 participants had never worked in the auditing field. The nine participants who did have auditing experience, unsurprisingly had a greater understanding of the purpose of an audit and what an audit entails. They also appeared to have a higher regard for auditors and the work that auditors perform, thereby attaching more value to the auditor's report. Participants without an auditing background seemed to pay less attention to the auditor's report and often not read it at all.

Participants from both groups who have an auditing background acknowledged the influence thereof on their understanding of an audit and expressed it as follows:

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*...I think it is because I come from an audit environment, I don't think [TO TEST ALL INTERNAL CONTROLS] is then [THE AUDITORS] primary responsibility. (P19)*

*... ek dink dis omdat ek uit 'n oudit omgewing uitkom, ek dink nie [OM ALLE INTERNE KONTROLES TE TOETS] is dan [DIE OUDITEURE SE] primêre verantwoordelikheid ...nie. (P19)*

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*It is my background ... The general feeling is that [IT IS AUDITORS' RESPONSIBILITY TO DETECT ALL FRAUD], but, of course, with the background that I have and all, I know that it is not actually what it is. But my colleagues all feel that it is. ...and when I look at my colleagues...they only have banking backgrounds. (P23)*

*Dit is maar my agtergrond. ... Die 'general' gevoel is dat [DIT OUDITEURE SE VERANTWOORDELIKHEID IS OM ALLE BEDROG OP TE SPOOR], maar natuurlik met die agtergrond wat ek het en alles, weet ek dit is nie eintlik wat dit is nie. Maar my kollegas almal voel dit is. ... en as ek nou kyk na my kollegas ..., hulle het maar net bank agtergrond. (P23)*

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Participants from an auditing background have therefore also experienced the perceptions of their colleagues without an auditing background, which led them to emphasise the impact that their background has on their perceptions of expectations from auditors. Participants who do not have an auditing background did not place any emphasis on this matter as they would not necessarily be aware of the influence that it might have on how they perceive auditors and the audit service.

b. Finance versus non-finance

It became clear that the roles that interview participants in the Management and Shareholders group fulfil (finance versus non-finance) directly influence their perceptions of and expectations from auditors. Those in a finance role deal with the company's auditors on a frequent basis and they also have a background of working in an auditing environment (cf. 4.3.1 a.). This enables participants in a finance role to understand an external audit better compared to those in a non-finance role, due to their frequent exposure to auditors and the auditing environment.

Individuals who work as compliance auditors at SARS and those who fulfil senior roles in the credit divisions of banking institutions (participants in the External Stakeholders group), would naturally have a finance background/qualification as a prerequisite for these roles.

Management and Shareholders in a non-finance role also rely on auditors and do deal with auditors, but on a less frequent basis. They also rely more on their finance

colleagues to address any issues that may arise with the auditors and to ensure that the company's auditors fulfil their role appropriately. When this is combined with these participants' qualifications (mostly not in the field of Accountancy) and lack of experience in the field of Auditing, it is understandable that these participants' perceptions and expectations sometimes differed compared to participants in a finance role.

This finding was articulated by participants as follows:

<p><i>It is ... the CEO and then... our financial director [WHO DEALS WITH THE AUDITORS], I mean, every year with the financial statements and stuff, they go through the basic things with us, but we don't go through it in detail. (P5)</i></p>	<p><i>Dit is maar ... die CEO is en dan ...ons finansiële direkteur [WAT MET DIE OUDITEURE WERK], ek meen, elke jaar met die finansiële state en goed, gaan hulle net met ons deur die basiese goed maar ons gaan nie in detail deur dit nie. (P5)</i></p>
<p><i>...I don't know up to which level an audit goes, but I know they have given me hell because I lost a toll gate slip and that came out in an audit. (P21)</i></p>	<p><i>...ek weet nie tot op watter vlak gaan 'n oudit nie, maar ek weet hulle het my al hel gegee oor ek 'n tolhek slippie verloor het en dit het toe in 'n oudit uitgekom. (P21)</i></p>

Literature identifies 'management' as users of the financial statements and auditor reports, which was corroborated by the findings documented in 4.3.5. Literature, however, does not differentiate between users in a finance role and those in non-finance roles. In analysing some of the findings, it is evident that the management roles that participants fulfil, often as a result of their background and qualifications, impact their perceptions of and expectations from auditors.

### c. Experience

The extent of participants' experience in their roles also influenced their view of auditors and the audit service. Participants who are part of executive management have often worked with the same auditor or audit firm for many years and have come to know their staff and audit methodology, and even have frequent access to the firm's audit workpapers. This finding is evident from the following quotation:

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*So I have seen many times that I can just [REQUEST FROM THE AUDITOR] information that we can generate ourselves. I know with the audit...they have done calculations in much detail and put information together and then I can just ask the information from them. I think their workpapers are a source of information that I have found useful many times. (P1)*

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*So ek het al baie keer gesien ek kan sommer inligting wat ons self kan genereer [VANAF DIE OUDITEUR AANVRA]. Ek weet met die oudit... het hulle in baie detail somme gedoen en inligting bymekaar gaan sit en dan kan 'n ou sommer vir hulle die inligting vra. Ek dink hulle werkspapiere is 'n bron van inligting wat ek al baie keer handig gevind het. (P1)*

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The above would contribute to a better understanding of what an audit entails, particularly in participants' employing companies.

Participants in the External Stakeholders group with extensive experience in their roles have, on the other hand, through time and exposure, become more sceptical of the auditor's report and the work that auditors do, which ultimately also influences their perceptions of and expectations from auditors. This view was voiced by one of these participants as follows:

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*Skepticism comes from somewhere. So, in this respect, it comes from the history of the firms. The experience that you have had with them. No, you know these people. You interact with them every day. You have got meetings every day with different auditors and we know them. So, it is based on your experience. There is nothing in the SARS policies that say, no, if it is [A PARTICULAR FIRM], open your eyes. No, it just comes from experience. (P25)*

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While the literature is not particularly focused on the background of financial statements users in the context of the audit expectation gap, the background of the user was found to impact many of the findings that follow in this chapter. Participants' previous employment, current roles and experience/interaction with auditors all play a part in how these participants view auditors and the audit service. Therefore, where appropriate, in the remainder of this chapter, perceptions of participants from similar backgrounds are presented as opposing views to others.

### 4.3.2. Shareholders

Theme	Category	Code
Users of audited financial statements	Shareholders	a. Healthy investment

All participants identified the companies' shareholders as users of audited financial statements, although in most instances, the companies were owner-managed. This meant that there were very few instances where shareholders were dependent on only the audited financial statements to evaluate their investments in these companies.

Participants perceived audited financial statements as a useful tool for shareholders to measure the 'health' of their investments. Given that the financial statements are presented consistently year-on-year and that they are independently verified, shareholders are able to perform their own analysis of whether their investment is secure, growing and/or declining. Financial statements are therefore seen as a tool for shareholders to perform consistent, comparable, and accurate financial analysis.

A participant articulated these perceptions as follows:

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*Well, [THE SHAREHOLDERS] have an investment. So, they want to ensure that the money that they have put in is busy growing and that is that their investment is busy growing, because it is a lot of money for them. They, of course, want [THE COMPANY] to be as successful as possible. And they ensure that they look at the figures, they ask questions and they provide guidance. (P7)*

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*Wel, [DIE AANDEELHOUDERS] het 'n 'investment'. So, hulle wil seker maak die geld wat hulle ingesit het is besig om te groei en dit is dat hulle belegging besig is om te groei, want dit is baie geld vir hulle. Hulle wil natuurlik hê [DIE MAATSKAPPY] moet so suksesvol wees soos moontlik. En hulle maak seker dat as hulle na die syfers kyk, hulle vrae vra en gee leiding. (P7)*

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The above perception aligns well with literature, stating that shareholders typically use financial statements to gather information about profitability, how much profit can be withdrawn, the value of shares and to determine whether the company is still a good investment (Medintu, Manache and Domnisor, 2016).

One of the participants, who does not have an Accountancy background and does not often work in a business environment, however, conveyed a divergent opinion regarding shareholders' use of audited financial statements by stating:

*[OTHER SHAREHOLDERS] are also more trained in accounting, so they look at it. Those who actually understand it. The rest of us just hear, yes, okay, this way or that way. I believe it is reliable, so I do not doubt the reliability thereof. And as long as no one makes a big fuss and ask big questions, I assume that everything is under control. (P6)*

*[ANDER AANDEELHOUERS] is ook meer opgelei in rekeningkunde, so, hulle kyk daarna. Die wat dit actually verstaan. Die res van ons hoor maar net, ja, okey, hierdie kant of daardie kant toe. Ek glo dit is betroubaar, so ek betwyfel nie die betroubaarheid daarvan nie. En, solank niemand 'n groot bohaai maak nie, en groot vrae het nie; neem ek aan dat alles is onder beheer. (P6)*

The level of financial literacy of shareholders therefore appears to play a role in whether they use audited financial statements at all and whether they rely on and merely take comfort in the fact that an audit is done.

To summarise, the interviews confirmed that shareholders are users of audited financial statements of private companies and the way in which they use these financial statements aligns with literature. In private companies, not all shareholders are, however, necessarily financially literate and able to use these financial statements effectively to determine the health of their investments.

#### **4.3.3. Banks/Providers of Finance**

<b>Theme</b>	<b>Category</b>	<b>Code</b>
Users of audited financial statements	Banks/Providers of finance	a. Security b. Interest rates and facilities

All participants in the Management and Shareholders group perceived their companies' bankers to be users of private company financial statements. They also conveyed their belief that banks require these financial statements to be audited, with several benefits to both the bank and the company resulting from having an audit undertaken.

The participants from banking institutions (part of the External Stakeholders group) confirmed that they do, in fact, use audited financial statements of private companies when these are submitted by private company clients. They expect that when private

companies are required by law to be audited that these companies would submit the audited set to the bank; however, banking institutions seldom verify adherence to legal requirements in terms of the Companies Act and often just “work with what they get”. Should banking institutions, however, feel that it is necessary to request audited financial statements, they can do so, although it seldom happens.

a. Security

Participants in the Management and Shareholders group believe that audited financial statements provide a form of security to banks who lend money to these companies. They perceived that providing an unmodified auditor’s report provides evidence to banks that these companies are doing “clean business”, thereby providing support that the banks’ investments in these companies are secure.

<i>I think the purpose thereof is to now sign off afterwards and say yes, you do your things right. So the idea is then to say there is a third party who signs off on our statements and who says yes, your statements are correct. Which will, of course, help with SARS and the bank and all those types of places to say that we do clean, good business. (P16)</i>	<i>Ek dink die doel daarvoor is om dan nou te kan na die tyd afteken, sê ja julle doen julle goed reg. So die idee is dan om te sê daar’s ‘n derde party wat afteken of op ons state wat sê, ja julle state is korrek. Wat ons natuurlik sal help by SARS en by die bank en al daai tipe plekke, om te sê ons doen skoon goeie besigheid. (P16)</i>
<i>The bank uses the [FINANCIAL STATEMENTS] to ensure that the facilities that we have in the group have sufficient security... (P13)</i>	<i>Die bank gebruik [DIE FINANSIËLE STATE] om seker te maak dat die fasiliteite wat ons het in die groep voldoende sekuriteit het... (P13)</i>

This finding aligns to literature stating that banks use financial statements to determine whether a company has the financial ability to pay interest and repay capital, i.e. verifying the recoverability of the finance granted (Medintu, Manache and Domnisor, 2016). However, doing “clean business” implies that the financial statements are free of fraud and irregularities. This is identified as a common contributor to the audit expectation gap in literature and is elaborated on in 4.4.1 and 4.4.6.

The participants from banking institutions (part of the External Stakeholders group) were, however, of the view that having an audit done does have its benefits, but that an audit as such does not necessarily provide the necessary security. An audit is a small part of a big picture that is considered. The fact that an audit provides assurance on historical financial information, makes it less useful to banking institutions that are

forward-looking in their assessment of the client. Banking institutions attach more value to clients' credit records and their repayment history than the opinion expressed by the client's registered auditor. This finding was articulated by one of the interview participants from banking institutions as follows:

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*Yes, so the financial statements are one side of the reflection and then the other side is obviously the handling of the account. There are other internal things as well. I almost want to say, you cannot only look at the financial statements in isolation. (P23)*

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*Ja, so die finansiële state is een kant van die weerspieëling en dan die ander kant is obviously die hantering van die rekening. Daar is ander interne goeters ook. Ek wil amper sê, jy kan nie net na die finansiële state in isolation kyk nie. (P23)*

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Participants from banking institutions confirmed that they make use of financial statements to perform ratio analysis and risk assessments. When financial statements are audited, it makes the individual credit analysts' work easier as they can, to some extent, rely on the figures provided when performing ratio analysis and risk assessments. Banking institutions do read the auditor's report when available, specifically the opinion paragraph, to identify qualifications. This, however, does not affect the outcome of credit applications, but rather enables credit analysts to know where to focus their attention and perhaps obtain corroborating support. When a company is not audited, credit analysts have to do more work on their side, e.g. do deed searches to confirm the title deeds of assets. While having audited financial statements therefore enables banking institutions to process credit requests easier, it does not necessarily have an impact on the outcome of credit applications. This finding is supported by the following quotations:

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*... if I was dealing with certain financials that are not audited, I would obviously interrogate the information a bit more, ask more questions, particularly around where the client has maybe made estimates around closing stock values etcetera, I would then want to interrogate that information further just to make sure that it makes sense, it's fair, it's accurate, etcetera. So, I don't think it would make me completely disregard the [CREDIT] application or financial information [WHEN THE FINANCIAL STATEMENTS ARE NOT AUDITED], but I would definitely interrogate the information a lot more. (P20)*

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In summary, management and shareholders perceived that audited financial statements enhance their companies' credibility with banking institutions and that these financial statements are used by banking institutions to determine whether

granting loans to companies would, in fact, make business sense. Banking institutions confirmed that they do read the auditor's report, but that it was only used to identify riskier areas. A clean auditor's report does not necessarily result in any benefit for the company from a banking perspective, but it does make the work of banking officials easier as they need to do fewer verifications and confirmations.

b. Interest Rates and Facilities

Participants in the Management and Shareholders group believed that submitting audited financial statements with an unmodified auditor's report to banking institutions as part of a request for finance directly impacts the interest rates charged on finance, as well as the amount of the facility granted by the bank. It was perceived that an unmodified auditor's report leads to lower risk, which, in return, enables lower interest rates and higher loans or credit limits. This was articulated by some participants as follows:

<p><i>The bank works with risk and rewards: the higher the risk, the higher the interest rate. So, definitely, if the risk is lower, our interest rates are more favourable. And the same argument for more financing. (P8)</i></p>	<p><i>Die bank werk mos met risk en rewards, hoe hoër die risiko, hoe hoër die rentekoers. So, definitief, as die risiko laer is, is ons rentekoerse meer gunstig. En dieselfde argument vir meer finansiering. (P8)</i></p>
<p><i>I believe that yes, if [THE AUDITOR'S REPORT] is qualified, they are going to ask, then the bank will ask, then it immediately goes into a risk. I am certain that a credit committee, they look at the statements. If there is a qualified auditor's report, a lot of red lights immediately go on. You know, they handle a risk by increasing interest rates and restricting facilities. ... No definitely it will play a role. (P1)</i></p>	<p><i>Ek glo dit ja, as [DIE OUDITVERSLAG] gekwalifiseerd is gaan hulle mos vra, dan gaan die bank vra, dan gaan dit onmiddellik in 'n risiko in. Ek is doodseker 'n krediet-komitee, hulle kyk na die state. As daar 'n gekwalifiseerde ouditverslag is gaan daar onmiddellik 'n klomp rooi ligte aangaan. Jy weet hulle hanteer 'n risiko deur rentekoerse te verhoog en fasiliteite in te kort. ... Nee definitief sal dit 'n rol speel. (P1)</i></p>

One participant, however, had a divergent opinion. The participant believed that an unmodified auditor's report would lead to higher facilities/loan amounts but that it would not necessarily lead to lower interest rates. The participant articulated this opinion as follows:

*I don't know about the interest rates. I would say that the interest rate has a lot to do with how much money you borrow from them, that would make sense to me to give a better interest rate to the guy who will borrow a lot of money, because that is how the bank does its business. So I would want to get the guy who wants to borrow a lot of money to borrow it from me, provided that he isn't a risk to me... (P21)*

*Ek weet nie van die rentekoers nie. Ek sou sê die rentekoers het baie te doen met hoeveel geld jy by hulle leen, dit sou vir my sin gemaak het om vir die ou wat baie geld gaan leen, 'n beter rentekoers te gee, want dit is mos maar hoe die bank sy besigheid doen. So ek sou wou die ou wat baie geld leen kry om dit by my te kom leen, mits hy nie 'n risiko vir my is nie... (P21)*

Various literature have reported that having audited financial statements is likely to contribute to securing finance and reducing interest rates (Hope, Thomas and Vyas, 2011; Minnis, 2011; Dedman, Kausar and Lennox, 2014; Langli and Svanström, 2014) Literature, also, has some divergent findings suggesting that audited financial statements will not directly reduce borrowing costs, but rather that the companies will become valued clients of banks over time, which will contribute to better interest rates (Esplin, Jamal and Sunder, 2018).

When interviewing the participants from the four banking institutions (part of the External Stakeholders group), divergent opinions were recorded as all four banking institutions provided different views on the impact that audited financial statements and the auditor's report have on interest rates and credit facilities. These differences are presented in Table 17:

**Table 17: The impact of an audit on interest rates and facilities**

<b>Banking Institution</b>	<b>Findings</b>	<b>Quotations/Support</b>
1	Whether a company is audited or not impacts the company's risk rating. This has a marginal impact on the interest rate charged to the company, but has no effect on the facility (amount of funding) that is made available to the company. Whether a company receives a modified or unmodified audit	<i>I have tested 3 clients: Risk Grade did change when I changed the selection from "Audited..." ... to "Unaudited...". Risk grade deteriorated and thus would impact pricing charged to the client. ...There is no selection for qualified/unqualified. (P20)</i> (Confirmed via email subsequent to the interview as the participant was

	opinion, however, makes no difference to either the interest rate or the facility.	unsure during the interview and offered to do a test.)
2	If a company has a qualified auditor's report, it increases the company's risk, which leads to a higher interest rate charged to the company. Having an unmodified auditor's report, however, does not decrease the interest rate. The fact that the company is audited has no impact on the facility granted to the company.	<p><i>...een van die vrae is of is jou ouditverslag gekwalifiseerd of nie gekwalifiseerd nie, en dit maak jou Basel rating hoër of laer wat weereens vir jou sê [DIE BANK] gaan meer of minder kapitaal hou so ek kan 'n beter of 'n slegter trade gee. (P10)</i></p> <p><i>...one of the questions is whether your audit report is qualified or not qualified, and that increases or decreases your Basel rating which again tells you [THE BANK] has to keep more or less capital so I can give a better or worse trade. (P10)</i></p>
3	Whether a company is audited or not and whether the audit opinion is qualified or unmodified, does not impact the interest rate charged to the company nor the facility granted to the company.  The only instance where an audit makes a difference is when the audit opinion is adverse or a disclaimer of opinion is issued, in which cases the request for finance will be denied.	<p><i>[DIE RENTEKOERS IS] glad nie gelink met is hy ge-qualify of nie. So hulle kyk glad nie, die rentekoers wat ons gee bepaal glad nie of dit 'n skoon oudit verslag is of nie. (P11)</i></p> <p><i>[THE INTEREST RATE IS] not linked at all with whether it is qualified or not. So they do not look at all, the interest rate that 111eg rant is not determined by whether it is a clean audit report or not. (P11) There is no effect in terms of ...scoring and rating when a company is audited or non-audited. (Subsequently confirmed with P11 via email.)</i></p>

4	<p>When a company receives a qualified audit opinion, it affects the company's risk rating, which impacts both the interest rate charged (increased) and the facility granted (decreased).</p> <p>When an adverse audit opinion or a disclaimer of opinion is issued, the request for finance will be denied.</p>	<p><i>So, ons werk op 'n risk grading band... So, as jy 'n qualified opinion het, ... dan is die risiko hoër vir die bank, en natuurlik gaan die bank jou 'n hoër rentekoers vra om hulleself te cover want die risiko is ook groter. So, daar is 'n direkte korrelasie ten opsigte van dit. ... Kom ons sê die risk score is [X-TELLING], dan sal hy gewoonlik maar prima plus een kry, en kom ons sê ons finansier 'n gebou, dan sal hy 80% loan to value kry. (P23)</i></p> <p><i>So we work on a risk grading band... So, if you have a qualified opinion, ... then the risk is higher for the bank, and of course the bank will ask you a higher interest rate to cover themselves because the risk is also higher. So there is a direct correlation in terms of that. ...Let's say the risk score is [X-SCORE], then he would usually get prime plus one, and let's say we are financing a building, then he would get 80% loan to value. (P23)</i></p>
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Source: Compiled by the researcher

While Table 17 sets out how banking institutions differ with regards to how they view the value of an audited set of financial statements and how an audit impacts interest rates and facilities granted, there are a number of factors, which most banking institutions agree on, that do influence either or both interest rates and facilities. These factors include:

- The history of the client (company), which includes the client's payment history, how the client handles its debt and the relationship with the bank;

- The client's official credit record;
- Ratio analysis on the financial statements (whether audited or not; if it is unaudited, the bank will verify the relevant information as far as possible by obtaining supporting evidence);
- Cash flow forecasts (accompanied by supporting evidence); and
- Judgement applied by the credit analysts and credit managers.

Although Management and Shareholders believe that unmodified auditor's reports contribute to higher facilities and better interest rates, the impact that the auditor's report has on the way in which banking institutions determine the interest rate charged to companies and the facilities granted to companies, differs considerably per banking institution and the factors in the bullet points above seem to carry more weight in these considerations.

#### 4.3.4. SARS

Theme	Category	Code
Users of audited financial statements	SARS	a. Assurance b. Assistance to SARS

Participants in the Management and Shareholders group perceived SARS to be one of the users of audited private company financial statements. As the financial statements include information such as the tax rate reconciliation in their notes, management and shareholders believed that these provide valuable information to SARS, if audited.

The participants from SARS (as part of the External Stakeholder group) confirmed that they sometimes scan through the auditor's report when it is available, briefly glancing at the auditor's opinion. They added that they do not, however, request an auditor's report if it is not submitted together with the financial statements.

a. Assurance

Participants in the Management and Shareholders group were of the view that an unmodified auditor's report leads to fewer queries from SARS as audited financial statements provide an additional level of assurance with regards to the accuracy of financial figures. According to participants, these figures are used in compiling and submitting tax returns, which would enable SARS to place reliance on their accuracy.

This perception was voiced as follows:

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<i>... for me if everything is in place, then SARS does not ask questions the whole day... (P4)</i>	<i>... vir my as alles in plek is dan vra SARS nie die heeldag vrae nie... (P4)</i>
<i>...I now can't talk from their side, but I do think that if you have a query from SARS on what you have done and you send your audited financial statements, I feel that that they will be comfortable with it quicker. (P19)</i>	<i>...ek kan nou nie van hulle kant af praat nie maar ek dink tog as jy 'n query het van SARS af op dit wat jy gedoen het en jy stuur jou geouditeerde finansiële state voel ek hulle gaan tog vinniger gemaklik wees met dit. (P19)</i>

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The literature is consistent with this school of thought as Ojala et al. (2016) reported that audited financial statements provide greater tax return credibility with tax authorities. Literature in this area is, however, limited and differs from the findings derived from interviews with SARS officials.

All interviewed SARS officials (part of the External Stakeholders group) were strongly of the opinion that when a company submits an unmodified auditor's report along with its financial statements, this does not lead to fewer queries being raised by SARS. The responses from these participants to the question whether an unmodified auditor's report would lead to fewer tax queries follow:

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<i>It would not ... Because the tax system works differently, so, it is very difficult to marry it with what the auditors have done. Because they are only auditing on the accounting side. Auditing the accounting side of things, and tax is a language on its own. (P25)</i>	
<i>No, not at all, not necessarily. Because the treatment for tax and for accounting is so different. I can definitely not say that an audited company has fewer tax adjustments, no. (P26)</i>	<i>Nee, glad nie, nie noodwendig nie. Omdat die hantering so verskillend is vir belasting en vir "accounting". Ek kan definitief nie sê dat 'n ge-ouditeerde maatskappy minder belasting aanpassings het nie, nee. (P26)</i>

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One participant in the Management and Shareholders group had a divergent view in that it matters who the auditor of the financial statements is. The participant argues that SARS would know which audit firms or auditors are more credible from the history of queries where these firms were involved. This was articulated as follows:

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*...I think that SARS already knows on its own database which audit firms' stuff they can trust, and which audit firms' stuff they cannot trust. So, if I arrive there with the wrong auditor's stuff, it will rather raise a query at SARS than what it will give confidence. (P13)*

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*...ek dink dat SARS weet ook al klaar op sy eie databasis watter ouditfirmas se goed hulle kan vertrou, en watter ouditfirmas se goed hulle nie kan vertrou nie. So, as ek met die verkeerde ouditeurs se goed daar aankom gaan dit eerder 'n query raise by SARS, as wat dit confidence gaan gee. (P13)*

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This divergent perception agrees, to some extent, with the data gathered from SARS as interview participants from SARS acknowledged that, over time, they have picked up a trend in the work of certain auditors. While auditors with a 'good reputation' do not necessarily contribute to fewer tax queries, those with a 'bad reputation' cause SARS officials to look more closely when performing compliance audits. This was voiced as follows:

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*...over the years you sort of build knowledge of specific guys' whose stuff you have to go through with a fine-tooth comb. I do not think it is prejudice, it is just from experience that you know there is usually something not completely, 100% correct. (P26)*

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*...jy bou, oor die jare bou jy kennis soort van op van spesifieke ouens se goed moet jy maar met 'n "fine-tooth comb" deurgaan. Ek dink nie dit is "prejudice" nie, dit is net uit ervaring weet jy dat daar is gewoonlik ietsie nie heeltemal, 100%, korrek nie. (P26)*

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On being selected for a tax audit, interview participants from SARS (part of the External Stakeholders group) were also convinced that having an audit done does not reduce the chances of being selected. The basis on which companies are selected for tax audits is, however, regarded as "a massive secret" (P26), even for most employees working at SARS. SARS has an automated Risk Engine which selects entities for tax audits based on information that is completed in the tax return, referred to as 'triggers' in the tax return. What these triggers are, are unknown by most, although participants from SARS agreed that having an external audit done has no impact on this selection, as articulated by participant 24:

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*The Risk Engine does not look at the financial statements. It looks at the Income Tax Return submitted. So, it will identify the risk from the return. (P24)*

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The perceived value of an external audit for tax purposes by participants in the Management and Shareholders group, therefore, differs considerably from its actual value to SARS. The only time that the presentation of audited financial statements influences SARS (compared to unaudited financial statements) is when the audit is done by a practitioner whom SARS officials have personally come to distrust. This leads to SARS officials performing compliance audits in more detail, or at least, being more cautious. Having an audit done, therefore, has no benefit for private companies from the perspective of SARS.

b. Assistance to SARS (Tax Reconciliation and Analysis)

In addition to the perception of participants in the Management and Shareholders group that audited financial statements provide assurance and, thereby, enhance the credibility of a company's tax calculations, these participants also perceived audited financial statements to be useful to SARS in recalculating or verifying computations. Participants regarded calculations such as the tax rate reconciliation, presented in the notes to the financial statements, to be of particular value to SARS. They also suggested that SARS may use audited financial statements to do detailed analyses supporting tax calculations.

This finding was articulated by a participant in the Management and Shareholders group as follows:

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<i>I think that if a guy has a clean auditor's report, the tax and the VAT are also reconciled – which is important to SARS – are also looked at and audited... (P1)</i>	<i>Ek dink, as 'n ou 'n skoon ouditverslag het, die belasting en die BTW is ook mos gerekon – wat vir SARS belangrik is, is mos ook na gekyk en geoudit... (P1)</i>
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From the literature, Medintu, Manache and Domnisor (2016) also reported that audited financial statements enable tax authorities to easily determine the taxes owed by the company. The perceptions of participants employed by SARS (part of the External Stakeholders group), however, do not align with this. Consistent with the finding in 4.3.1, those who have a background in auditing had a higher regard for the work of

auditors and mentioned that in some instances, they would use the audited information as corroboration for their own calculations/findings, as explained below.

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*But based on certain risks, then I can take what the auditors have said into consideration. That I have looked at this, and the external auditors, who I assume are independent, they have also said this. And when I put them together, I do not need to go further. (P25)*

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Those who do not have a background in auditing, on the other hand, do not place a higher reliance on the figures in the financial statements when they are audited. This was articulated as follows:

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*...we can rely more on audited ones more than the unaudited ones. But I do not actually, to be quite honest, I do not actually look at whether the financial statements have been audited or not audited. (P24)*

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It is only in cases where the tax compliance auditor comes from an audit background, where the audited financial statements are used as confirmation of the tax compliance auditors' own findings/calculations; i.e. they assist the SARS official to a limited extent.

#### 4.3.5. Management

Theme	Category	Code
Users of audited financial statements	Management	a. Auditor's report: unread, but content known b. Value of management report

While in the interviews members of management all made reference to their own internal management reports that provide useful information in decision-making and monitoring, management was also identified in the literature as a user of its company's audited financial statements. As reported earlier in 4.3.2, private companies are often owner-managed and, in these cases, management would also use financial statements to monitor the health of their own investments.

a. Auditor's report: Unread, but content known

Participants largely agreed that members of management in general do not read the auditor's report, but their recognition that an audit has been undertaken provides them with comfort. What was also clear, was that the content of the auditor's report is no secret or surprise to management, due to the continuous communication that takes place between the auditor and management throughout the audit process. Participants mentioned that they were often involved throughout the audit process, enabling frequent discussions with the audit team, including discussions around audit issues that need adjustment. This was particularly highlighted by management who are employed in a finance role.

An external audit was viewed as an "assurance on assurance" as participants were of the view that management already has various controls and processes in place to achieve credible financial reporting. Participants in a finance management role indicated that they saw the audit as a "challenge" – to have their figures as accurate and ready as possible, leading to as few as possible audit adjustments. For these participants, the audit confirmed what they believed they already knew.

Although participants recognised the auditor's report as the 'end product' of the audit; for management, the value of an audit lay within the process of the audit rather than the 'end product'.

This finding is demonstrated by the following quotations:

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*I am very involved in the arrangement of the audit and as the audit takes place I am updated, so long before the report comes, I know if there are any problems. So I am informed continuously, because even audit work that is outstanding or information that is outstanding I would know, I would help to get it together, contact people to get it together. So continuously, I know how it is going with the audit... Actually, I never look at the audit report...because I know what is in it. So for me it is not important, the auditor's report, I know what it will say, I know what their findings will be, I also know that if something is materially not correct, we will correct it. So I have never been worried that there will*

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*Ek is maar baie betrokke by die reël van die oudit en soos wat die oudit gebeur word ek opgedateer, so lank voor die verslag kom weet ek al as daar enige probleme is. So ek word maar deurlopend ingelig want selfs net oudit werk wat uitstaande is of inligting wat uitstaande is sal ek weet, ek sal help om dit bymekaar te kry, mense kontak om dit bymekaar te kry. So deurlopend weet ek hoe gaan dit met die oudit... Eintlik kyk ek nooit na die ouditverslag nie...want ek weet wat daarin is. So vir my is dit nie belangrik nie, die ouditverslag, ek weet wat daar gaan staan, ek weet wat hulle gaan bevind, ek weet ook dat as daar iets wesentlik nie*

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*come a report that is negative, because at the end our whole aim is for the statements to, in any case, be a reasonable reflection and our involvement helps for it to be like that throughout. (P1)*

*reg is nie sal ons dit reg maak. So, ek was nog nooit bekommerd oor dat daar 'n verslag gaan kom wat negatief is nie, want op die einde is ons hele strewe dat die state in elk geval mos 'n redelike weergawe moet wees en ons betrokkenheid help dat dit deur die tyd so is. (P1)*

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*I read whether it says qualified or not. That is basically it. And I do not event think I read that. I just assume from our discussions, but further I do not read a word of that audit report. (P7)*

*Ek lees of staan daar qualified of nie. Dit is basically dit. En ek dink nie eers ek lees dit nie. Ek net neem aan van wat ons discussions is, maar verder, ek lees nie 'n woord van daardie ouditreport nie. (P7)*

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Participants employed in a non-finance role or who were not actively involved in the company, were not as familiar with the content of the auditor's report compared to their finance colleagues. Despite this, however, they still did not read the auditor's report. They relied on the work of management in finance positions and the verbal feedback obtained from auditors at management meetings.

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*I do not read it, and just because of that it won't really make a difference to me ... but I am comfortable that external people also look at it, that it does not only take place in-house. There is an element of assurance, but that is enough for me to not have to read [THE AUDITOR'S REPORT]. (P2)*

*Ek lees hom nie, en net as gevolg van dit gaan nie rêrig vir my 'n verskil maak nie ... maar ek is wel gemaklik dat daar eksterne mense ook na dit kyk, dat dit nie net inhouse plaasvind nie. Daar is 'n mate van 'n gemoedsrus maar dis vir my genoeg sodat ek [DIE OUDITVERLAG] nie hoef te lees nie. (P2)*

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*I have a lot of trust in the auditors, so I have never, to be honest, ever read the audit report... I have full confidence that if something needs to jump out that I need to know of they will tell me. (P4)*

*Ek het 'n baie groot vertrouwe in die ouditeure so ek het in der waarheid nog nooit 'n oudit report gelees nie... ek het volle vertrouwe dat as daar iets moet uitspring waarvan ek moet weet gaan hulle vir my sê daarvan.(P4)*

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There is no literature on whether management reads the auditor's report, but various sources have indicated that management uses the audited financial statements as a tool in decision-making (Van Auken and Yang, 2014; Van Auken, Ascigil and Carraher, 2014; Akhtar and Liu, 2018). This emphasises the usefulness of the financial statements, whereas the role of the auditor's report is to enhance the credibility of these financial statements.

However, in this study, participants from the management group indicated that their own, internal management reports are the preferred tool for decision-making and control, while the audited financial statements would be of more use to external users, such as the bank and SARS. This finding was supported by the following quotations:

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*In terms of financial reports, we get every month what we call a pack. And this I call my financial reports, but I don't think it is the same financial reports that you are referring to, because I do not see a balance sheet. So in terms of how it is going with the business, I need to use my own head and my own common sense and say that I think if we reach a certain profit, we must surely be okay, because all my division's expenses are also in here. So I get a complete report in terms of income and expenses to the last cent that is given to me. What the rest of the financial reports are concerned, in terms of how SARS would look at it, I do not look at that. For me it is about, I use this pack to better manage my business, my division ... I do not look at the auditor's report, I look at my pack monthly. (P21)*

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*In terme van finansiële verslae kry ons elke maand, wat ons noem, 'n pack. En dit noem ek my finansiële verslae, maar ek dink nie dis dieselfde finansiële verslae waarna jy verwys nie, want ek sien nie 'n balansstaat nie. So in terme van hoe dit met die besigheid gaan, moet ek maar my eie kop gebruik en my eie common sense gebruik en sê ek dink as ons 'n sekere wins behaal, moet ons tog okay wees, want al my afdeling se uitgawes is ook hier in. So, ek kry 'n volledige verslag in terme van inkomste en uitgawes tot op die laaste sent toe wat vir my gegee word. Wat die, die res van die finansiële verslae betref in terme van hoe SARS daarna sal kyk, ek kyk nie na dit nie. Vir my gaan dit oor, ek gebruik hierdie pack om my besigheid, my afdeling beter te bestuur... ek kyk nie na die ouditverslag nie, ek kyk elke maand na my pack. (P21)*

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*Look, at the end we prepare months' management information and ... we are deeply immersed in our own figures, we manage the different division directly like that ... through our management information we actually know what is going on in the statements. (P1)*

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*Kyk, op die einde, ons stel maande se bestuursinligting op, en ... ons is redelik goed ingegrawe in ons eie syfers, ons bestuur die verskillende divisies direk so... deur ons bestuursinligting weet ons eintlik wat aangaan op die state. (P1)*

While members of management do not read the auditor's report, and find their internal reports to be more useful in decision-making and monitoring compared to the audited financial statements, they are still regarded as users of audited financial statements, as the audited financial statements are the end result of an audit process. It is this audit process and the assurance and reassurance that they derive from it that management perceive as valuable. This is further elaborated on in 4.5.1 where the primary/direct value of an audit is discussed.

b. Value of management report

International Standards on Auditing 260 and 265 require of an auditor to communicate with those charged with governance and management observations from the audit that are significant and relevant to their responsibility to oversee the financial reporting process, and significant deficiencies noted in the company's internal control. In a private company setting those charged with governance and management are often the same individuals. This communication often takes the form of a management report, which accompanies the auditor's report, but is only available to those charged with governance and members of management.

Participants in this group perceived the management report to be more useful and of more value compared to the auditor's report. While the auditor's report may not be read, the management report is scrutinised in detail. This finding was articulated by participants as follows:

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*I read the [MANAGEMENT] report, we have quite a discussion about it. Our report is not usually very large, there are some of the points that we know carry over, that is not necessarily always a priority for us, but that we know we eventually will need to pay attention to. Often these are items that we move to the side for a bit when it is pressure time and so ... we read it and we discuss it in relative detail with the auditors when the audit has been completed. (P19)*

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*Ek lees die [BESTUURS]verslag, ons het nogal 'n redelike bespreking daaroor. Ons verslag is nie gewoonlik baie groot nie, daar is van die punte wat ons weet kom oor, wat nie noodwendig vir ons altyd prioriteit is nie, maar wat ons weet ons eventually aan aandag moet gee. Maar baiekeer is dit items wat ons eers weer eenkant skuif as dit druktyd is so ja-nee, ons lees dit en ons bespreek dit ook relatief in detail met die ouditeure, as die audit afgehandel is. (P19)*

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*... we receive [A MANAGEMENT REPORT] and in the past we discussed it as a senior management group and looked at the specific points. So there are definitely pointers made on such a document. (P16)*

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*... ons kry ['N BESTUURS-VERSLAG], en het ons in die verlede dit as 'n senior bestuursgroep bespreek ook en na daai spesifieke punte gekyk. So daar word definitief uitwysings gedoen op so 'n dokument. (P16)*

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*They provide us with the management report and we do our action plan accordingly to address it, or any findings to communicate to the rest of management as well. (P8)*

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*Hulle verskaf ons met die bestuursverslag en daarvolgens doen ons dan ons aksieplan om dit aan te spreek, of enige bevindinge te kommunikeer aan die res van die bestuur ook. (P8)*

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This finding echoes Weaver's (2008) submission that the management report is, arguably, the most important part of the audit process as it enables management to

be informed of significant issues arising from the audit process and gives them the opportunity to respond to the auditor on these issues and to act to improve the entity's financial reporting function.

#### 4.4. Audit purpose expectations

To contextualise the content of this section, the definition of the audit expectation gap and Figure 3 in 1.1.1 are revisited. This study investigates the Evolution Gap component of the audit expectation gap, which is the difference between what auditors are supposed to do and what is expected by users from auditors. The findings in this section are presented in response to the second and third research sub-questions:

- i. What are the expectations of the users of private company auditor reports? and*
- ii. To what extent do the expectations of users differ from what is prescribed by applicable audit requirements?*

In the theme of Audit Purpose Expectations, views of participants on areas that have typically been identified in the literature as contributing to the audit expectation gap are dealt with (cf. 2.2.3). Participants' expectations (presented as *i.*) are compared to applicable audit requirements (presented as *ii.*) enabling preliminary conclusions on whether a difference exists, i.e. whether the finding contributes to the audit expectation gap. The interview questions can be viewed in APPENDIX B, while the process to formulate these questions can be viewed in 3.5.1.2.

As explained in 3.5.1.2, participants were asked to rate the auditor's responsibility regarding certain aspects, e.g. detecting all fraud. What is noteworthy is that the ratings initially provided by participants often did not agree with the discussion or explanation that followed, as they started to reflect more deeply on the question. When participants started reasoning or elaborating on their rating, they often arrived at a different conclusion compared to the rating given at the starting point. This finding is corroborated by Creswell and Creswell (2018), who submitted that results are influenced when the **meanings** that individuals ascribe to a problem are explored, focusing on the complexity of the matter rather than broad perceptions that are generalised.

The discussion that follows picks up on areas that were identified from the literature as typical areas contributing to the audit expectation gap (cf. 2.2.3).

#### 4.4.1. Fraud

Theme	Category	Code
Audit purpose expectations	Fraud	a. Material fraud b. Management's responsibility c. Duty to report

Quick (2020) established that the most common contributor to the audit expectation gap was the belief that auditors are responsible for detecting **all** fraud in the companies which they audit. This implies that when an auditor's report is unmodified, it is perceived that the company is free from all fraud.

In contrast with the view expressed in the literature, the participants in this study did not perceive it to be the responsibility of the external auditor to detect **all** fraud that is perpetrated in audited private companies.

##### a. Material fraud

###### *i. Finding*

With the exception of limited divergent views, participants' perceptions regarding the auditor's role in fraud detection was that it is not possible to detect **all** fraud and, therefore, auditors cannot be expected to detect **all** fraud. However, participants did believe that auditors should be responsible for detecting **all material** fraud that is perpetrated in audited private companies, especially financial statement fraud. These views were articulated as follows:

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*Researcher: So which fraud would you say [THE AUDITORS] should detect?*

*Participant: No big, in the first place big fraud that is material, for that they must detect everything, that I agree with. ...Big fraud yes, not all fraud. Steinhoff, absolutely yes, that they should have picked up. (P1)*

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*Navorsers: Nou watter bedrog sou jy sê moet [DIE OUDITEURE] optel?*

*Deelnemer: Nee groot, in die eerste plek groot bedrog wat wesenlik is, dit moet hulle alles optel, daarmee stem ek saam. ... Groot fraud ja, nie all fraud nie. Steinhoff, vir seker ja, hulle moes dit opgetel het. (P1)*

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*I do not think you can make [THE AUDITOR] responsible for fraud detection and tell him but he must only look at a little part of the work. It just does not make logical sense to me. ... if you can tell me which procedures you can do to detect fraud, we can completely eradicate all fraud in any business. There just aren't things like that. Theoretically, people talk a lot about it, we can do this and this and this and that is all fine. But fraud will always be there, and I cannot place that responsibility on someone else. (P13)*

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*Ek dink nie jy kan [DIE OUDITEUR] verantwoordelik maak vir fraud detection, en vir hom sê maar hy moet net na 'n gedeeltetjie van die werk kyk nie. Dit maak net nie vir my logies sin nie. ... as jy vir my kan sê watter prosedures jy kan doen om fraud te detect, dan kan ons fraud totaal en al uitwis in enige besigheid. Daar is net nie sulke goed nie. Teoreties praat die mense baie daarvan, ons kan dit doen, en dit doen, en dit doen, en dit is alles fine. Maar, fraud gaan daar vir altyd wees, en ek kan nie daardie verantwoordelikheid op iemand anders plaas nie. (P13)*

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Participants also seemed to have a good understanding of some of the inherent limitations of an audit, supporting their perception that it is not possible to detect all fraud. Particularly interesting to note was that many participants who are not in a finance role also came to this conclusion through their own reasoning (rather than textbook knowledge). The following quotations support this finding:

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*[THE AUDITORS] are not necessarily responsible, according to me, to sniff out everyone's fraud. And someone who commits fraud is not going to just give it on a platter. ... There are probably red lights that go on here and there and then they probably do what they can do, but I cannot see that it is their responsibility. (P6)*

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*[DIE OUDITEURE] is nie noodwendig verantwoordelik, volgens my, om almal se bedrog uit te snuffel nie. En iemand wat bedrog pleeg, gaan dit nie so op 'n skinkbord gee nie. ... Daar gaan dalk seker rooi ligte aan hier en daar, en dan doen hulle seker wat hulle kan doen, maar ek kan nie sien dat dit hulle verantwoordelikheid is nie. (P6)*

---

*[THE AUDITORS] are not there to be policemen. They cannot audit every transaction. They also take samples. They also look at controls. So, I don't think they are there to detect all fraud and errors... It is more a sample. (P8)*

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*[DIE OUDITEURE] is mos nie daar om polisiemanne te wees nie. Hulle kan nie elke transaksie oudit nie. Hulle neem ook mos maar steekproewe. Hulle kyk ook maar na kontrole. So, ek dink nie hulle is daar om alle bedrog en foute op te tel nie... Dit is mos maar meer 'n steekproef. (P8)*

---

The above findings contradict current literature reporting that it is perceived by users that auditors should detect all fraud (Epstein and Geiger, 1994; McEnroe and Martens, 2001; Gray *et al.*, 2011; ACCA, 2019; Brydon, 2019b; SAICA, 2019; Quick, 2020). This finding is, however, aligned reasonably well to what is expected from auditors in terms of applicable audit requirements.

Limited divergent opinions were encountered, particularly from selected participants who did not come from an audit or accountancy background. When asked whether auditors should detect all fraud perpetrated in the companies which they audit, one of these participants voiced the following view:

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*Because why would I then do an audit? It is their job. So for me it is really what you should do, go look for what is wrong and that 'fraud' is a very strong word, but sometimes a mistake, you know. It's not, I would not only call it fraud, but I would want them to pick it up and that is why they do an audit. (P16)*

*Want hoekom sou ek dan 'n oudit gedoen het? Dis mos hulle werk. So vir my is dit rêrig wat jy moet doen is, gaan soek iets wat foutief is en daai 'fraud' is 'n baie sterk woord, maar partykeer 'n fout, jy weet. Dis nie, ek sal dit nie net fraud noem nie maar ek sal graag wil hê hulle moet dit optel en dis hoekom hulle die oudit doen. (P16)*

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## ***ii. Comparison with applicable audit requirements***

ISA 240 deals with the auditor's responsibility relating to fraud. Overall, the auditor is responsible for obtaining reasonable assurance that the financial statements as a whole are free from **material** misstatement, whether due to **fraud** or error. It, however, also recognised that, due to the inherent limitations of an audit, detecting all material fraud may not be possible even though the audit is properly planned and performed in accordance with the ISAs. These inherent limitations include the fact that fraud is deliberately concealed (compared to errors that are not concealed), making it much more difficult to detect. It also includes limitations brought about by making use of samples and materiality levels, as well as dependence on the audit client to make all information available to the auditor (IAASB, 2022b).

Auditors' responsibility relating to fraud also includes assessing the risk of material misstatement due to fraud and designing appropriate audit procedures to respond to the assessed risk, while also applying professional scepticism throughout the audit (IAASB, 2022b). Auditors are, moreover, required to respond appropriately when fraud

is suspected or detected. This is commonly referred to as “auditors should follow the scent of fraud” (Financial Times, 2019).

*With regards to the detection of fraud, the expectations of participants align well with applicable audit requirements, and no clear audit expectation gap is identified.*

b. Management’s responsibility

***i. Finding***

Participants in the Management and Shareholders group also perceived fraud detection to be the responsibility of management and those charged with governance, rather than that of the auditor. They recognised that management should have controls in place to prevent fraud, as well as to detect fraud. This finding was articulated as follows:

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*...management also has a role to play [TO DETECT FRAUD]. They can’t just shrug and everyone can do as they please. Everything cannot be the audit’s work. (P19)*

*...bestuur het ook mos ‘n rol om te speel [OM BEDROG OP TE SPOOR]. Hulle kan mos nou ook nie net skouers optrek en almal maak soos hulle wil nie. Als kan nie die oudit se werk wees nie. (P19)*

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No mention of the responsibility for preventing/detecting fraud was made by participants in other interview groups.

***ii. Comparison with applicable audit requirements***

This finding also aligns well with applicable audit requirements, as ISA 240 explicitly states that the primary responsibility for the prevention and detection of fraud is that of those charged with governance and management. It also emphasises the importance of fraud prevention, “which may reduce opportunities for fraud to take place”, and fraud deterrence, “which could persuade individuals not to commit fraud because of the likelihood of detection and punishment” (IAASB, 2022b).

*In terms of management's role regarding fraud prevention and detection, the expectations of participants align well with applicable audit requirements, and no clear audit expectation gap is identified.*

c. Duty to report

*i. Finding*

Participants were strongly of the view that, although auditors may not be responsible for detecting all fraud, all fraud that is detected through the audit process should be reported to the appropriate governance structures. In participants' opinion, the duty to report fraud is not limited to material fraud, but should include any form of fraud detected throughout the audit, regardless of its size or nature.

This view was articulated as follows:

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*So I would say that I would expect from [THE AUDITORS] to report... all detected fraud. So what I want to say is, I would expect that an auditor should not say, but okay, I saw someone put three spoons of coffee in his pocket and that is not important. In terms of that, I would want everything to be exposed. (P21)*

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*So ek sou sê dat ek sal van [DIE OUDITEURE] verwag om alle fraud wat opgespoor is... te rapporteer. So wat ek wil sê is, ek sou verwag dat 'n ouditeur moenie sê, maar okay, ek het gesien hoe een drie lepels koffie in sy sak druk en dis nie belangrik nie. In terme van dit sou ek alles wou expose hê. (P21)*

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*If they pick up [FRAUD] they have to report on it, but they will never be able to test everything or express an opinion on every transaction. (P8)*

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*As hulle [BEDROG] optel moet hulle daarop rapporteer, maar hulle sal nooit als kan toets of op alles 'n opinie kan uitspreek nie, op elke transaksie nie. (P8)*

A participant also pointed out that, although the auditor is not responsible for detecting all fraud, an increased responsibility should be placed on the auditor to test **fraud prevention controls** and **report** on these controls to the users of financial statements. The participant further elaborated that testing and reporting on fraud prevention controls may contribute actively to fraud prevention and detection, as well as narrow any potential audit expectation gap in this area.

## **ii. Comparison with applicable audit requirements**

ISA 240 does require of auditors to communicate any detected or suspected fraud with the appropriate level of management and those charged with governance on a timely basis. This is to enable them to respond appropriately with regards to their responsibility for the prevention and detection of fraud (IAASB, 2022b). The ISA does not limit the required communication to material fraud only and includes any “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.”

The ISA, however, does not require auditors to test or report on fraud prevention controls specifically, although auditors will obtain an understanding of the control environment within an entity, which would influence their risk assessment, including the risk of fraud, and consequent audit responses (IAASB, 2022b (ISA 315)).

*With regards to the communication to management and those charged with governance on identified or suspected fraud, the expectations of participants align well with applicable audit requirements, and no clear audit expectation gap is identified.*

### **4.4.2. Errors**

<b>Theme</b>	<b>Category</b>	<b>Code</b>
Audit purpose expectations	Errors	a. All versus material errors b. Financial statements as a product of the audit

The auditor’s responsibility to detect errors in the financial statements links closely to the level of assurance that is provided by an audit. The literature has identified a misunderstanding on the level of assurance provided by an audit as a common contributor to the audit expectation gap (cf. 2.2.3). An unmodified auditor’s report is perceived to imply that the financial statements are one hundred percent accurate and therefore contain no errors (Epstein and Geiger, 1994).

Participants' perceptions on this matter were somewhat divergent and are presented in the two codes discussed below. While some participants reasoned that, as with fraud, it is not possible to detect all errors, others felt that the financial statements are the 'product' of the audit and should be 'correct'.

a. All versus material errors

***i. Finding***

Participants mostly expressed the view that auditors may not be able to detect **all** errors in underlying records of the financial statements, but that **all material** errors should be detected. Reference was made to the same inherent limitations of an audit discussed under Fraud (cf. 4.4.1). If it were to be possible for auditors to ensure that financial statements are one hundred percent accurate, participants indicated that they would be willing to pay much more for the audit service, but they expressed doubt as to whether this would be possible. This finding was articulated in the following quotations:

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*Again, I do not agree, I don't think [AUDITORS SHOULD DETECT ALL ERRORS]. I think they do sampling, to see whether there are errors. They can't do every single transaction, they will, let me say so, if they have to do that, then they have to spend the same time as what the finance section of [THE COMPANY] spends and that is a whole year. (P18)*

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*Weereens, ek stem nie saam nie, ek dink nie dit is so [DAT OUDITEURE ALLE FOUTE MOET OPTEL] nie. Ek dink hulle doen steekproewe, om te kyk of daar foute is. Hulle kan nie elke liewe transaksie doen nie, hulle sal wel, laat ek so sê, as hulle dit moet doen, dan moet hulle dieselfde tyd spandeer as wat die finansiële afdeling van [DIE MAATSKAPPY] spandeer en dis 'n hele jaar. (P18)*

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*You can only have 100% certainty if you do a 100% audit. (P13)*

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*Jy kan net 100% sekerheid hê as jy 'n 100% oudit doen. (P13)*

Limited divergent perceptions were noted, which were again, as with the Fraud category, raised by specific individuals employed in non-finance roles. These participants, again, expected from auditors to detect all errors in the financial statements, and voiced this view as follows:

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*Yes, I think it is their job, I think to point out these things. (P5)*

*Ja, ek dink dis mos hulle job, dink ek om sulke goed uit te wys. (P5)*

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Previous literature reported that one of the big contributors to the audit expectation gap is the belief that auditors provide absolute assurance and therefore detect all errors in the financial statements (Epstein and Geiger, 1994; Coram *et al.*, 2011; Ruhnke and Schmidt, 2014). With the exception of limited participants' views, this finding therefore contradicts current literature.

One participant (P7) did express the opinion that, with the recent focus on data analytics, it should become possible in future to obtain absolute assurance that the financial statements are free from error, and added that this should, in fact, decrease the audit fee due to the automation of the audit process.

#### ***ii. Comparison with applicable audit requirements***

The finding above is in line with the ISAs stating that the purpose of an audit is to obtain **reasonable** assurance that the financial statements as a whole are free from **material** misstatement, whether due to fraud or **error**, also recognising the inherent limitations of an audit (IAASB, 2022b). International Standards on Auditing state that auditors cannot provide absolute assurance that financial statements are free from material misstatement, but that reasonable assurance is a high level of assurance. Similar to the discussion on Fraud, the focus is again on **material** misstatements and not all misstatements.

*With regards to the detection of errors in the accounting records, the expectations of participants align well with applicable audit requirements, and no clear audit expectation gap is identified.*

b. Financial statements as a product of the audit

***i. Finding***

While participants were rather forgiving when it comes to auditors' responsibility regarding fraud detection and errors in accounting records, they were less forgiving with regards to the auditor's detection of errors in the financial statement preparation process. Participants felt that the financial statements are ultimately the product of the audit and the transfer of data from the accounting records should be without error. Participants therefore explicitly differentiated between the recording of accounting transactions and transferring accounting records to a full set of financial statements (the financial statement preparation process).

In the latter, participants were of the view that the financial statements should be accurate, and no reference was made to the size or materiality of errors. Some participants even recognised that the trial balance may contain undetected misstatements, but felt that the accuracy of the presentation of the trial balance figures in the financial statements (i.e. how figures are transferred to the financial statements, its related disclosures, etc.) is not negotiable.

The following quotations illustrate this finding.

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*I think [THE FINANCIAL STATEMENTS] are the product ... [THE AUDITORS] express an opinion on the statements... I am quite fixated on the statements that it should be as correct as possible. So, yes, the better opinion you, or the more detail you have on the statements, the better. (P8)*

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*So, if there are errors in the format of the financial statements then I feel it is 100% [THE AUDITORS'] responsibility. If the data that they receive is corrupt and they haven't identified it as fraud, then that is the data that you work with. If there is an obvious difference between the previous year's closing and an opening balance, and they do not pick up such things then, that is for me their responsibility... (P2)*

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*Ek dink [DIE FINANSIËLE STATE] is mos maar die produk. ... [DIE OUDITEURE] spreek mos maar 'n opinie op die state uit... Ek is nogals redelik fixated op die state dat dit so reg as moontlik moet wees. So, ja, hoe beter opinie jy, of hoe meer detail jy het op die state, hoe beter. (P8)*

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*So, as daar foute is in die formaat van die finansiële staat dan voel ek dis 100% [DIE OUDITEURE SE] verantwoordelikheid. As die data korrup is wat hulle gekry het, en dis nie opgetel as bedrog nie, dan is dit die data waarmee jy werk. As daar 'n ooglopende verskil is tussen 'n vorige jaar se sluitings en 'n openingsbalans, en hulle tel nie sulke goeters op nie dan, dis vir my hulle verantwoordelikheid... (P2)*

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This leads to the finding that, although the financial data used to prepare the financial statements may still contain errors, participants conveyed that the way in which this data is presented in the financial statements should be completely accurate as this is the ultimate product of the auditor.

***ii. Comparison with applicable audit requirements***

Current literature does not differentiate between errors in the general accounting/processing of transactions and errors in the transfer of accounting records to a full set of financial statements. ISA 330 does, however, specifically require of auditors to agree or reconcile the financial statements with the underlying accounting records, which includes related disclosures (IAASB, 2022b). Auditors are, however, still only required to detect material misstatements and provide reasonable assurance on the financial statements as a whole and therefore, complete accuracy cannot be guaranteed.

Moreover, the subject matter under audit is the full set of financial statements, which includes the accounting policies, the statement of profit and loss and other comprehensive income, the statement of financial position, the statement of changes in equity, the cash flow statement and the notes accompanying these statements (IAASB, 2022b (ISA 210)). The selection and application of accounting policies, classification of accounts and narrative descriptions in the financial statement notes are not populated from general accounting data and often require judgement. Participants' expectation that the financial statement preparation (the transfer of accounting records to a set of financial statements) should be without any error and that it is auditors' responsibility to ascertain this, exceeds the applicable audit requirements.

*In terms of the financial statement preparation process (the transfer of accounting records to a set of financial statements), the expectations of participants exceed applicable audit requirements, and an audit expectation gap is identified.*

#### 4.4.3. Going Concern

Theme	Category	Code
Audit purpose expectations	Going Concern	a. Management responsibility b. Duty to report/warn

Another strong contributor towards the audit expectation gap in publicly listed companies is the perception that an unmodified auditor's report confirms that the company is a going concern. This has also led to the perception that the role of an auditor is to prevent company failure and thereby ensure that a company is, in fact, a going concern (Campbell and Mutchler, 1988; Gray *et al.*, 2011; Brydon, 2019b; ACCA, 2019; Quick, 2020). This perception was, however, not shared by the participants in this study and is therefore not regarded as a contributor to the audit expectation gap for private companies. *Management responsibility* and *Duty to report/warn* are codes that emerged from the data analysis with regards to auditors' responsibility relating to the going concern principle in private companies and are discussed below.

##### a. Management responsibility

###### ***i. Finding***

Preventing private company failure and ensuring that a company remains a going concern were perceived by participants to be the responsibility of management. Participants were of the view that auditors cannot dictate how a company is run and can therefore not be held responsible when management makes poor business decisions. This finding was articulated as follows.

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*It is a company's own responsibility to, to keep head above water, you cannot blame the auditors for that. (P21)*

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*Dit is 'n maatskappy se eie verantwoordelikheid om, om kop bo water te hou, jy kan nie ouditeure daarvoor blameer nie. (P21)*

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*I think management is the one responsible for making sure that the company continues to be a going concern ... it is the complete responsibility of the management. (P24)*

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The findings in this category were shared by all participants, regardless of their background (finance or non-finance). Participants were of the view that management is primarily responsible for ensuring that a company remains a going concern.

**ii. Comparison with applicable audit requirements**

The IESBA Code prohibits auditors from assuming management responsibilities for an audit client, which includes setting the strategic direction of the company (IESBA, 2022). While the ISAs do not specify whose responsibility it is to prevent company failure, ISA 570 deals with the auditor's responsibilities pertaining to the assessment of the entity's ability to continue as a going concern, where it specifically states that it is a requirement of management to assess the entity's ability to continue as a going concern. It recognises that this assessment involves judgement about uncertain future events or conditions (IAASB, 2022b).

*In terms of 'preventing company failure' or 'confirming that the company is a going concern' the expectations of participants align well with the requirements of applicable audit requirements, and no clear audit expectation gap is identified.*

b. Duty to report/warn

**i. Finding**

Participants were of the view that, because auditors have a lot of experience in and exposure to various businesses, they would often be in a better position than management to identify 'red lights' or indicators that could negatively influence companies' ability to continue as a going concern. Accordingly, participants were of the opinion that auditors should warn management or report these indicators to management. Auditors should therefore take on an advisory role in these cases, enabling management to take timely action. The following quotations support this finding.

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*So, they can prevent it to some extent by providing advice when they pick up that something is happening. They can give the right advice and make report or whatnot, for management to do something about it. So, preventatively, I think they can play a role. (P25)*

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<p><i>...I don't think that it is [THE AUDITORS'] project, it is not their job to ensure that it stays a going concern. It is their job to advise, if they can see from the financial statements, that there are problems yes, I agree with that. (P18)</i></p>	<p><i>...ek dink nie dis [DIE OUDITEURE SE] projek, dis nie hulle werk om te verseker dat dit 'n going concern bly nie. Dit is hulle werk om te adviseer, as hulle kan sien uit die finansiële state uit, dat daar probleme is ja, ek stem daarmee saam. (P18)</i></p>
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One participant (P13) articulated that auditors should place more focus on the controls that management have in place to prevent business failure. Apart from this one participant, participants did not hold the view that auditors should perform specific procedures with regards to the going concern assumption, but only that they should report and advise in cases where they happen to detect indicators affecting the going concern basis of accounting.

***ii. Comparison with applicable audit requirements***

ISA 570 prescribes the responsibility of the auditor with regards to the entity's ability to continue as a going concern, which entails to obtain sufficient, appropriate audit evidence to be able to conclude on the appropriateness of the use of the going concern basis for accounting. A conclusion also needs to be made on whether material uncertainty exists about the ability of the entity to continue as a going concern (IAASB, 2022b). ISA 570 also warns that although the auditor may not detect material uncertainty regarding the entity's ability to continue as a going concern, this cannot be seen as a guarantee that the entity is, in fact, a going concern, as auditors cannot predict the future (IAASB, 2022b).

ISA 570 does require of auditors to report on matters that may cast significant doubt on a company's ability to continue as a going concern. While ISA 570 also requires auditors to perform various procedures with regards to an entity's use of the going concern basis of accounting, it does not require auditors to play an advisory role when material uncertainty exists over the entity's ability to continue as a going concern.

*With regards to auditors reporting on findings that could impact the company's ability to continue as a going concern, the expectations of participants align well with the requirements of applicable audit requirements, and no clear audit expectation gap is identified.*

*The expectation of participants that auditors should play an advisory role in this regard, however, exceeds applicable audit requirements, and an audit expectation gap is identified.*

#### 4.4.4. Good Investment

Theme	Category	Code
Audit purpose expectations	Good investment	a. Investors' own assessment b. Accuracy of Financial Statements

Participants' understanding of, and expectations from, auditors with regards to determining whether a company is considered to be a good investment, was mostly in line with what applicable audit requirements prescribe. Previous literature indicates that users of publicly listed company financial statements often perceive an unmodified auditor's opinion to imply that it would be a good financial decision to invest in the company (McEnroe and Martens, 2001), but participants' views in this study on private companies did not support this finding.

##### a. Investors' own assessment

###### ***i. Finding***

The view of participants was that auditors are clearly not responsible for determining whether a company is a good investment, but that this responsibility lies with the investor him/herself. Some participants commented that this responsibility would impair auditors' independence. One participant (P16), however, had a divergent opinion in that it was regarded the role of an auditor to determine whether the company is a good investment. This participant is a non-finance member of

management, but the view is not held by the other non-finance members of management.

According to the vast majority of participants, investors should perform their own assessment of companies in which they consider investing and that auditors merely provide the information to enable investors to undertake this assessment. Reference was also made to the role of financial analysts, who are trained to perform investment analyses, which do not form a significant part of auditors’ formal training. The following quotations support this finding:

<p><i>To give investment advice is a very risky business. That is why you have guys who study CFA and those things, because you need to make sure you do your analysis. Now for [THE AUDITORS] to just come and have a look at the books and then say [THE COMPANY] is a good investment – that just doesn’t make sense. (P7)</i></p>	<p><i>Om investment advice te gee, is ‘n baie risky business. Dit is hoekom jy ouens het wat CFA en daardie goed gaan swot, want jy moet seker maak jy doen jou analysis. Nou vir [DIE OUDITEURE] om net te kom kyk na die boeke en dan te sê of [DIE MAATSKAPPY] ‘n goeie investment is - dit maak net nie sin nie. (P7)</i></p>
<p><i>...it is not the auditor’s prerogative to say [WHETHER THE COMPANY IS A GOOD INVESTMENT] ... if it goes wrong then he can be held accountable for it. I feel in that regard the auditor should stand independent of the financials which he audits. (P10)</i></p>	<p><i>...dit is nie die ouditeur se prerogative om te sê [OF DIE MAATSKAPPY ‘N GOEIE BELEGGING IS NIE] ... as dit verkeerd gaan dan kan hy mos aanspreeklik gehou word daarvoor. Ek voel in daai opsig moet die ouditeur independent staan van die financials wat hy audit. (P10)</i></p>

**ii. Comparison with applicable audit requirements**

While the international auditing standards do not specifically address this matter, it is clear that it does not fall within the scope of an audit, which ISA 200 explains as expressing an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework (IAASB, 2022b). International ethics standards, which auditors should uphold, also refer to an advocacy threat that arises and could compromise an auditor’s independence when an auditor needs to promote a client’s position, for example, by claiming that investing in the client would be a good business decision (IESBA, 2022).

*With regards to expressing an opinion on whether a company is a good investment, the expectations of participants align well with the requirements of applicable audit requirements, and no clear audit expectation gap is identified.*

b. Accuracy of Financial Statements

***i. Finding***

Participants agreed that, while it is not the responsibility of the auditor to draw the conclusion as to whether a company is a good investment or not, auditors do have a role to play in enabling others to draw such conclusions. The view was that, because auditors enhance the credibility of companies' financial statements, this enables investors to make their own assessments based on credible information. This finding was articulated as follows.

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*[THE AUDITORS] leave information for you that you can then interpret so they can't ... take any blame if I interpret something differently and whether it is a good investment or not. But I think there is somewhat of a responsibility with them to ensure that you don't ... misstate something because then I am going to interpret it incorrectly and then I possibly think it is a good investment and then it is not. But at the end of the day, they can't put the set of financial statements there for me and then I blame them because I read things incorrectly. (P2)*

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*[DIE OUDITEURE] los vir jou inligting wat jy dan kan interpreteer, so hulle kan ... niks blaam vat as ek iets anders interpreteer en of dit 'n goeie investment is of nie. Maar ek dink daar is 'n mate van verantwoordelikheid by hulle om seker te maak dat jy nie 'n ding ... wanvoorstel nie want dan gaan ek dit verkeerd interpreteer en dan dink ek heel moontlik dis 'n goeie belegging en dan is dit nie. Maar op die einde van die dag, kan hulle nie die stel state vir my daar sit en dan blame ek hulle oordat ek goed verkeerd geles het. (P2)*

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*[THE AUDITORS] give assurance to the financial statements, and investors must interpret the financial statements themselves, and obviously read the audit reports and make their own assessments. (P23)*

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*[DIE OUDITEURE] gee assurance tot die finansiële state, en die investors moet self die finansiële state interpreteer, en obviously die audit reports lees, en hulle eie assessment maak. (P23)*

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***ii. Comparison with applicable audit requirements***

Again, participants' view was in line with auditing standards (ISA 200) which require auditors to issue an opinion on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the applicable

financial reporting framework (IAASB, 2022b). When auditors, therefore, perform a quality audit in line with auditing standards and the relevant ethical requirements, they enable investors to make informed decisions by providing credible information.

*In terms of auditors' role in ensuring that financial statements are fairly stated, enabling investors to make informed investment decisions, the expectations of participants align well with the requirements of applicable audit requirements, and no clear audit expectation gap is identified.*

#### 4.4.5. Systems of Internal Control

Theme	Category	Code
Audit purpose expectations	Systems of Internal Control	a. All vs. key financial controls vs. separate engagement b. Duty to report

Previous literature on publicly-listed companies identified a contributor to the audit expectation gap relating to auditors' responsibility to test and express an opinion on the effectiveness of companies' systems of internal control. Financial statement users in these studies interpreted an unmodified auditor's report as a confirmation or certification that all systems of internal control were tested and operated effectively (Fadzly and Ahmad, 2004; Pourheydari and Abousaiedi, 2011).

In this study on private companies, the perceptions of participants were particularly divergent in this area and are discussed using the two codes below that were identified as relating to the category of Systems of Internal Control.

a. All versus key financial controls versus separate engagement

***i. Finding***

Some participants were of the opinion that it is, or should be, external auditors' duty to ensure that **all** internal controls are effective and that this should be done as part of their normal audit procedures. These participants also interpreted an unmodified

auditor's report as a confirmation that no material deficiencies in any of the company's systems of internal controls were identified. Internal controls are regarded by these participants as the heart of the business and therefore something that should receive significant attention by the auditors.

Other participants were, however, of the opinion that auditors are not responsible for ensuring that **all** internal controls are effective, but that all **key financial controls** should be tested. This view was mostly raised by participants who are appointed in finance roles in private companies, although not all participants in this category shared the same view.

There were also participants in financial roles who argued that ensuring that internal controls are effective is the role of an internal audit function or that it should be a separate engagement, which does not form part of the scope of the external audit. These participants also highlighted the importance of internal controls but viewed the monitoring thereof as part of risk management and not the auditor's duty.

The above divergent views, which could not be categorised to a specific group of participants, are articulated by participants in the following quotations.

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*Because in a business you would have the internal control function right, and the people who would design the processes... The auditor's responsibility is to make sure those controls actually make sense and those processes actually make sense and are effective in terms of mitigating the ... and ensure that the shareholders get the best value that they can out of the business. So, I think definitely, if the controls are not effective, [THE AUDITORS] should be the first people to say, "Hey!, it's not". (P20)*

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<i>We would like for [THE AUDITORS] to look at [THE INTERNAL CONTROLS] which have a direct effect on the figures. But again, not all, but some of these have a direct effect on whether the statements would be a reasonable representation or not. (P1)</i>	<i>Ons sal graag wil hê [DIE OUDITEURE] moet kyk na [DIE INTERNE KONTROLES] wat 'n direkte effek op die syfers kan maak. Maar weer nie alles nie, maar van dit het nie 'n direkte invloed op of die state 'n redelike weergawe gaan wees of nie. (P1)</i>
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<i>I think it is a separate engagement. I think that if you are going to ask [THE AUDITORS] to look at all your internal controls then you would sort of more get someone who can fulfil an internal audit role for you. Understand, I don't think in the duration of the audit, ... they can't in two weeks, they focus on the big things, they won't look at all your internal controls. (P19)</i>	<i>Ek dink dit is 'n aparte aanstelling. Ek dink as jy vir [DIE OUDITEURE] gaan vra om na al jou interne kontroles te kyk dan gaan jy dalk half meer iemand kry wat vir jou 'n interne oudit rol kan vervul. Verstaan, ek dink nie in die tyd van die oudit, ... hulle kan nie in die twee weke fokus hulle op die groot goed, hulle gaan nie na al jou interne kontroles kan kyk nie. (P19)</i>
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## **ii. Comparison with applicable audit requirements**

While auditors are required, according to ISA 315R, to obtain an understanding of an entity's system of internal control, this is done to assist in assessing the entity's risk of material misstatement and not to express an opinion on the effectiveness of internal controls.

*In terms of testing and expressing an opinion on the effectiveness of internal controls, the expectations of participants exceed applicable audit requirements, and an audit expectation gap is identified.*

It is interesting to note that the Sarbanes Oxley Act in the United States of America requires that, in addition to the audit report, auditors of public, listed companies must issue joint reports on clients' internal control over financial reporting. (United States of America, 2002; Asare and Wright, 2012). The Sarbanes Oxley Act was passed in the United States of America in response to the Enron Scandal (Perino, 2002). No such requirement, however, exists in South Africa.

### **b. Duty to report**

#### **i. Finding**

Although perceptions surrounding the auditor's role with regards to testing the effectiveness of private companies' internal controls were divergent, participants agreed that where auditors do come across deficiencies in the system of internal control, these deficiencies should be communicated or reported on. Participants in the Management and Shareholders group were of the view that these deficiencies should be communicated to management, but not necessarily reported to external users. Participants in the External Stakeholders group, however, expressed the view that they would like auditors to disclose material internal control deficiencies as part of the auditor's report. The following quotations support this finding:

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<i>If [AUDITORS] see something is a problem or the process does not look right, [THEY] must report on it. (P7)</i>	<i>As [OUDITEURE] sien iets is 'n probleem, of die proses lyk nie reg nie, moet [HULLE] rapporteer daarop. (P7)</i>
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*I understand that [THE AUDITORS] cannot identify all controls and test everything as such. ... my recommendation is maybe just that they highlight it more on the [AUDIT] report... it comes back to materiality or the impact that that control has on the bigger picture. ...financial and non-financial controls. (P23)*

*Ek verstaan dat [DIE OUDITEURE] nie al die kontroles kan identifiseer en alles toets as sulks nie. ... my recommendation is dalk net dat hulle dit meer uitlig ook op die [OUDIT-]verslag ... dit kom maar terug op materiality of die impak wat daai kontrole het op die groter prentjie het. ... financial en non-financial controls. (P23)*

**ii. Comparison with applicable audit requirements**

ISA 265 requires of auditors to communicate significant, but not all, identified deficiencies in internal control to those charged with governance and management. A significant deficiency is regarded as a deficiency that has led to or is likely to lead to misstatements in the financial statements, also considering the potential magnitude of the misstatement (IAASB, 2022b).

*With regards to auditors reporting all identified internal control deficiencies, the expectations of participants exceed applicable audit requirements, and an audit expectation gap is identified.*

**4.4.6. Compliance with Laws and Regulations**

<b>Theme</b>	<b>Category</b>	<b>Code</b>
Audit purpose expectations	Laws and Regulations	a. All versus direct influence b. Duty to report

The last common contributor to the audit expectation gap, as identified by literature on publicly listed companies, is the perception that auditors test and confirm compliance with all laws and regulations applicable to the companies which they audit (McEnroe and Martens, 2001; Ruhnke and Schmidt, 2014). This perception was also tested in this study on private companies and the views of participants in this study were especially divergent in this area.

a. All versus direct influence

***i. Finding***

Participants' view of the auditor's role with regards to their clients' compliance with laws and regulations ranged from those who believed auditors are responsible for confirming compliance with **all** laws and regulations applicable to the company under audit, to others who believed auditors should only test compliance with laws and regulations which a direct influence the financial statements. Results could not be categorised to certain participant characteristics and were diverse across the 'Management and Shareholders' and the 'External Stakeholders' groups.

Those who believed auditors should test **all** laws and regulations interpreted an unmodified auditor's report as evidence of the company's compliance with all laws and regulations. It was notable that this perception was not limited to participants in a non-finance role, but also those in finance positions or with an auditing background. The following quotations support this finding:

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*Participant: ...I think [THE AUDITORS] are the custodians of the tax laws for instance ensuring that the companies that they audit are complying with the tax regulations. So, it's definitely their responsibility to ensure that when they compile that report or they tick or sign off clean audits that all those checks and balances and regulations have been complied with.*

*Interviewer: Only the tax law?*

*Participant: No, and every other companies act...\_Yes, all laws that are applicable to the company. (P20)*

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*...all the laws, that is from tax laws to the green laws and all those things...[THE AUDITORS] must in some way see whether it is complied with...look and there are many laws, it is actually scary if you bring all the laws together. But it is important that a company complies with them...I would expect the auditors to tell me if there is something, a law, where I do not comply. (P1)*

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*...al die wette, dis nou van belastingwette tot die groen wette en al daai goeters...[DIE OUDITEURE] moet op 'n manier kyk of daaraan voldoen word... kyk en daar is baie wette, dis eintlik scary as mens al die wette bymekaar bring. Maar dit is belangrik dat 'n maatskappy daaraan voldoen...ek sal verwag die ouditeure moet vir my sê as daar iets, 'n wet is waar ek nie voldoen nie. (P1)*

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Other participants distinguished between general laws and regulations and those with a direct effect on the financial statements. These participants articulated their views as follows:

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*...from a financial side definitely, but I mean you cannot ...hold the auditors accountable if I breach the Labour Law. (P2)*

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*...from a financial side definitely, maar ek bedoel julle kan nie ..die ouditeure verantwoordelik hou as ek die Arbeidswet oortree nie. (P2)*

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**ii. Comparison with applicable audit requirements**

According to ISA 250, compliance with laws and regulations is the responsibility of management and those charged with governance. Auditors are not expected to prevent or detect non-compliance with all laws and regulations, and a distinction is made between laws and regulations with a direct influence on the financial statements, such as tax law, and other laws and regulations, such as laws relating to an entity's operating aspects. While penalties due to non-compliance to the latter may affect the financial statements, this is not considered as having a direct effect on the financial statements. It is only for those laws and regulations that have a direct effect on the financial statements that auditors are required to obtain sufficient and appropriate audit evidence regarding an entity's compliance thereto. For other laws and regulations, auditors are only required to perform limited procedures to identify possible non-compliance, but confirming compliance thereto, is not required (IAASB, 2022b).

*In terms of auditors confirming 'compliance with all laws and regulations', the expectations of participants often exceed applicable audit requirements, and an audit expectation gap is identified.*

b. Duty to report

**i. Finding**

Participants generally agreed that auditors are responsible for communicating non-compliance with laws and regulations when it is detected. This perception was articulated as follows:

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*I think throughout their audit there are certain checks that they do and if they would see there that there are certain requirements that are not complied with, then it is their responsibility to point it out. (P18)*

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*Ek dink gedurende hulle oudit is daar sekere checks wat hulle doen en as hulle daar sou sien dat daar aan sekere vereistes nie voldoen is nie, dan's dit hulle verantwoordelikheid om dit uit te wys. (P18)*

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*He would have to point out [NON-COMPLIANCE WITH LAWS AND REGULATIONS], I feel you have to disclose it, the external auditor, or report or whatever and provide guidance. (P26)*

*Hy sal [NIE-VOLDOENING AAN WETTE EN REGULASIES] moet uitwys, ek voel jy moet dit “disclose”, die eksterne ouditeur, of rapporteer of wat ookal en leiding gee. (P26)*

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**ii. Comparison with applicable audit requirements**

ISA 250 requires auditors to communicate identified instances of non-compliance with laws and regulations to those charged with governance, unless they are clearly inconsequential. In addition, the Auditing Profession Act of South Africa, 2005, also requires auditors to consider whether unlawful acts have been committed by management, which have led to fraud or theft, caused material financial loss or have led to a material breach of fiduciary duty. If auditors have reason to believe that these conditions exist, auditors are also required to report a ‘reportable irregularity’ to the IRBA (South Africa, 2005).

*In terms of auditors reporting to management when non-compliance with laws and regulations is identified, the expectations of participants align well with the requirements of applicable audit requirements, and no clear audit expectation gap is identified.*

To address the expectation gap identified in this area, one participant (P13) offered a view that could serve as a recommendation for auditors. This included that auditors should focus more on the controls that are in place within the company to ensure compliance with laws and regulations, with the intent to express an opinion on these controls as follows: “We have reviewed the procedures for compliance to laws and regulations, and we have found them to be acceptable”. The participant is of the opinion that this would add value. In addition to this, the participant also suggested that auditors should have a database of all laws and regulations in South Africa, with tick boxes for which laws and regulations would typically apply to companies in particular industries. This would enable constructive discussion between auditors and clients on clients’ consideration of relevant laws and regulations and add value to clients in general.

#### **4.4.7. Summary: Audit Purpose Expectations**

This theme included categories related to areas generally identified in literature as contributing to the audit expectation gap in public, listed companies. The findings are summarised below for ease of reference:

**Table 18: Summary of Audit Purpose Expectations**

Literature	Participants' Expectations	Auditor's Responsibilities i.t.o. Applicable Audit Requirements	Conclusion
<p>Auditors are responsible for detecting all fraud that is perpetrated within the companies which they audit.</p>	<p>Auditors should detect material fraud, not all fraud (and recognise the inherent limitations of the audit). Fraud detection is management's responsibility, but auditors should report fraud when detected.</p>	<p>Auditors should design procedures to respond to the identified risk of fraud and should ensure that financial statements are free from material misstatement due to fraud. Auditors should report fraud detection to those charged with governance and other regulatory bodies where applicable. Management remains primarily responsible for fraud prevention and detection.</p>	<p>No expectation gap identified.</p>
<p>Auditors are responsible for detecting all errors in the financial statements of the companies which they audit.</p>	<p>Auditors should detect material errors, not all errors (recognises inherent limitations). Presentation of financial statements should be accurate, i.e. although the accounting records may contain errors, the way in which information is transferred and presented in the financial statements should be without any error.</p>	<p>Auditors should design procedures to detect material errors to ensure that financial statements are free from material misstatement due to error. Substantive procedures include reconciling amounts and disclosures in the financial statements to their underlying records/data.</p>	<p>No expectation gap identified regarding errors in accounting records. The expectation that the transfer of financial data to the financial statements must be without error (i.e. the accuracy of how financial information is presented in the financial statements), contributes to the expectation gap.</p>

<p>Auditors are responsible for preventing company failure (i.e. ensuring that the company is a going concern).</p>	<p>Not auditors' responsibility, but that of management. Auditors should report on problem areas generally identified. Auditors should play an advisory role where problem areas are identified.</p>	<p>Auditors should obtain sufficient, appropriate audit evidence to be able to conclude on the appropriateness of the use of the going concern basis for accounting. Auditors are not required to take on an advisory role; this could compromise independence.</p>	<p>No expectation gap regarding preventing of company failure or reporting on identified going concern risk indicators.</p> <p>The expectation of advisory services on how to address going concern risk indicators, contributes to the audit expectation gap.</p>
<p>Auditors are responsible for determining whether the companies which they audit are good investments.</p>	<p>Not auditors' responsibility, but that of investors/ analysts. Enhancing the credibility of the financial statements enables investors/ analysts to make informed decisions.</p>	<p>Not required of auditors in terms of the ISAs. Performing an audit in line with the ISAs will enhance the credibility of the financial statements.</p>	<p>No expectation gap identified.</p>
<p>Auditors are responsible for confirming whether all internal controls within the companies which they audit are effective.</p>	<p>Some expectations to confirm efficiency of all internal controls, some expectations to test only (but all) financial controls. Various divergent opinions, mostly not in line with ISAs.</p>	<p>Auditors should obtain an understanding of an entity's internal control environment to enable risk assessment procedures. No opinion is expressed on the effectiveness of internal controls, but material deficiencies should be communicated to those charged with governance.</p>	<p>Contributes to the audit expectation gap in all aspects.</p>

<p>Auditors are responsible for confirming that the companies which they audit are complying with all laws and regulations applicable to those companies.</p>	<p>Divergent opinions; some participants agreed on all laws and regulations while others limited auditors' responsibility to finance-related laws and regulations.</p>	<p>Design and perform procedures to ensure compliance with laws and regulations with a direct effect on the financial statements; and perform limited procedures to identify non-compliance with other laws and regulations.</p>	<p>Expectation to test/confirm compliance with all laws and regulations contributes to the audit expectation gap.</p> <p>No gap identified regarding the expectation to report identified non-compliance to management.</p>
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Source: Compiled by the researcher

## 4.5. Audit value expectation

As with the previous section, the findings in this section relate to the second and third research sub-questions:

- i. What are the expectations of the users of private company auditor reports? and*
- ii. To what extent do the expectations of users differ from what is prescribed by applicable audit requirements?*

All the participants viewed an external audit as a value-adding service and not only a compliance exercise. Participants all confirmed that they would opt for an audit regardless of the legal requirement as they receive more from an audit than just an auditor's report. These value-adding services or benefits are ultimately also what participants expect from an audit to make it worthwhile. The theme of 'Audit value expectations' consequently emerged. In this section, these value expectations/perceptions are presented in two categories, the first being the primary/direct value perceptions and the other, secondary/indirect value perceptions. These expectations/perceptions are then also compared to applicable audit requirements.

It should be noted that, in many cases, the expectations that participants have of auditors are being met by auditors, although not all these expectations are prescribed by applicable audit requirements. This study, however, focuses on the evolution gap component of the audit expectation gap (cf. Figure 3 in 1.1.1) and does not address what is actually delivered by auditors, i.e. the performance gap. A comparison is therefore done only between the expectations of participants and what is prescribed by applicable audit requirements.

#### 4.5.1. Primary/Direct Value

Theme	Category	Code
Audit value expectations	Primary/Direct Value	a. Assurance/credibility vs Reassurance/accountability b. Safety net c. External independent review

The category of Primary/Direct Value emerged from the perceived benefits of an audit which do not require any additional work or services from the auditors. These benefits were perceived as the natural, sometimes unintended, consequences directly linked to the audit process and resultant unmodified auditor's report. These factors contribute to why participants of audited private company financial statements regard an audit as 'worthwhile'.

##### a. Assurance/credibility versus Reassurance/accountability

###### *i. Finding*

Participants valued that an external audit provided assurance on the accuracy of financial statements. While participants did not elaborate on the level of assurance that they perceived an audit to provide, they agreed that audited financial statements are more trustworthy and accurate, thereby enhancing the integrity of the financial statements.

In addition to the enhanced assurance, participants within the Management and Shareholders group also strongly emphasised that an audit provides reassurance, thereby confirming what they already know. For many of these participants, they regarded the reassurance that they gain through having an audit done, as the biggest benefit of an audit. Participants in a management capacity conveyed that an audit provides them with additional confidence as it confirms that they are doing their work correctly and that processes followed are effective, while also holding them accountable where necessary.

The above views are mirrored by the following quotations:

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*Interviewer: ...in your opinion, what is the purpose of an audit of financial statements...?*

*Participant: ... to at least give the person who uses it, a reassurance or assurance that it is an actual or true version of the company's state of affairs, ...that you can at least trust what you read. (P26)*

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*Interviewer: What would you regard as the biggest benefit of having an audit done?*

*Participant: ...I think just the reassurance to know that your things are correct and in place. (P5)*

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*...And it gives you confidence and especially for directors, if at the end of the financial year you can go and say, look [THE AUDIT FIRM] came and had a look and they did not find major issues, you also feel, okay, you are on the right track. (P7)*

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*Interviewer: ...in jou mening, wat is die doel van die oudit van finansiële state...?*

*Participant: ... om darem vir die persoon wat dit gebruik, 'n gemoedsrus of gerusstelling te kan gee dat dit darem 'n werklike of 'n ware weergawe van die stand van sake van die maatskappy is, ...dat jy kan darem vertrou op dit wat jy lees. (P26)*

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*Interviewer: Wat sal jy beskou as die grootste voordeel van om 'n oudit te laat doen?*

*Participant: ...ek dink net die gemoedsrus om te weet jou goed is reg en in plek. (P5)*

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*... En dit gee mense confidence en veral vir direkteure, as jy aan die einde van die finansiële jaar kan gaan en sê, kyk [DIE OUDITFIRMA] het kom kyk, en hulle het nie major issues gekry nie, voel jy ook, okay, jy is op die regte spoor. (P7)*

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Literature does not address the value that an external audit provides to management in the form of reassurance. While assurance is provided on the financial statements (the final result), for management, reassurance is not only linked to the financial statements, but also to other factors such as the control environment and how they do their jobs. Finance staff specifically appreciate that the audit confirms to those charged with governance that the finance division is well operated and can be trusted. While these participants commented that they “already know this”, they appreciate that it is confirmed by the auditors.

## ***ii. Comparison with applicable audit requirements***

According to ISA 200, the purpose of an audit is to provide reasonable assurance that the financial statements are free from material misstatement (IAASB, 2022b). When asked about the purpose or benefits of an audit, participants did not specifically make reference to the words “reasonable” or “material misstatement”, but participants agreed that an audit enhances confidence in the financial statements.

Providing reassurance, as described above, is not addressed by international auditing standards and is not regarded as the purpose of an audit. While external auditors do

not express an opinion on the effectiveness of a company's internal control environment, ISA 265 does require of them to communicate significant control deficiencies identified during the audit (IAASB, 2022b), which is usually done in the form of a management representation letter. When the management report, containing no or few control deficiencies, is presented to those charged with governance, accompanied by an unmodified auditor's report, it may be a positive unintended consequence that the quality of the work of finance (and other) staff is perceived as high. This outcome is achieved without external auditors doing anything more than what is expected of them in terms of international auditing standards.

*Regarding the value that participants perceived in the form of 'assurance' provided by auditors corresponds with applicable audit requirements' description of the purpose of an audit and no audit expectation gap is identified.*

*The 'reassurance' that participants receive through/expect from the audit process, is not prescribed by applicable audit requirements and an audit expectation gap is identified.*

b. Safety net

***i. Finding***

In addition to confirming the quality of work and holding relevant participants accountable, participants also regarded the audit as a safety net, catching misstatements that may be missed by the financial statement preparers. This was particularly evident for participants employed in a management capacity at private companies, although other participants also made reference to this.

Participants were of the view that they would rather the auditors detect misstatements than, for example, SARS identifying problems with tax matters. Senior members of management also perceived the 'safety net' of an audit to extend beyond their own work, but also identifying problems with the work of staff at lower levels. Where they as managers may miss problems with their own staff's work, they perceived auditors to be an additional safeguard in this regard. The following quotations support this finding:

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*...there is a financial manager who looks and there are accountants so [WITH AN AUDIT THERE IS] almost a review on top of a review. (P1)*

*...daar is 'n finansiële bestuurder wat kyk en dan is daar rekenmeesters so [MET 'N OUDIT IS DAAR] 'n oorsig amper op 'n oorsig. (P1)*

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*...it is not nice when you sit inside and people come and delve through your books, but ...one should see it as a safety net, rather than as a policeman. So they may come and point out something to you which is not right, rather than you having to find out later at a SARS audit, for example. (P16)*

*...dit is nie lekker as jy in die binnekant sit en mense kom krap in jou boeke nie, maar ...'n ou moet dit as 'n safety net sien, eerder as 'n polisieman. So hulle kom wys dalk vir jou 'n ding uit, wat nie reg is nie, eerder as wat jy dit na die tyd by 'n SARS oudit byvoorbeeld moet agterkom. (P16)*

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*Interviewer: What would you regard as the biggest benefit of the audit done on the company?*

*Interviewer: Wat sal jy beskou as die grootste voordeel van die oudit wat gedoen word op die maatskappy?*

*Participant: Cover my ass. (P13)*

*Participant: Cover my ass. (P13)*

---

## **ii. Comparison with applicable audit requirements**

The aim of an audit is to identify material misstatements, and after correction by management, enabling an auditor to express an opinion that the financial statements are a fair representation of the company's financial position (IAASB, 2022b). The King IV Report on Corporate Governance™ (2016) makes reference to the concept of a combined assurance model, which implies that various role players contribute to enhancing confidence in reports issued by an entity, including both management and external auditors. While providing a safety net to management may be convenient and valuable, this is not the purpose nor a requirement of an audit. Participants were of the view that they have sufficient controls and procedures in place within their employing companies, but they still appreciate and expect the additional assurance provided by the auditors as a safety net for possible internal flaws.

*The expectation of participants that an audit should be a safety net, is not prescribed by applicable audit requirements, and an audit expectation gap is identified.*

c. Independent external review

***i. Finding***

Participants in all groups of this study placed a high premium on the independence of auditors. They perceived that because auditors are external and independent of the entities they service, they are free from bias and their opinions can be trusted. This, in return, also enhanced the credibility and integrity of the financial statements. Participants generally held auditors in high regard because of these qualities. Notably, these views are in contrast with other comments made by participants in the Management and Shareholders group, which indicated a variety of threats to auditor independence. The magnitude of these contradictory findings was such that they were dealt with separately in section 4.6.

Participants therefore expect auditors to be independent and also value their independence. This finding was summarised by a participant as follows:

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*The purpose of an external audit of a financial statement, firstly I would say it's to give an external opinion apart from an opinion of the managers and also from a segregation of opinion perspective to say, "We've had a second look at the information that has been presented and this is our interpretation of it". So, more like an objective view, because obviously, the management putting together the financials and that, they're got a biased view of what the numbers are and the estimates and things that they make, whereas an external person would have a look at, are the estimates that are made reasonable, do they make sense? ... So, almost like they would audit the support that they get and see that it actually tells the financial story that is the true picture of the business. (P20)*

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***ii. Comparison with applicable audit requirements***

ISA 200 requires of an auditor to be independent and to uphold the International Ethics Standards Board for Accountants' International Code of Ethics for Professional Accountants, including International Independence Standards (IAASB, 2022b). The International Independence Standards of this Code emphasise in its introduction that it is in the public interest and a requirement of the Code that external auditors are independent of their audit clients. Independence is further defined as being independent of mind and in appearance (IESBA, 2022).

As independence is a requirement of the Code and participants expect and perceive auditors to be independent, independence is not viewed as a contributor to the audit expectation gap.

*The expectation of participants that auditors should be independent, aligns well with the requirements of applicable audit requirements, and no audit expectation gap is identified.*

*(Note that the understanding that participants have of auditor independence does contribute to the audit expectation gap and is addressed in 4.6.)*

**4.5.2. Secondary/Indirect Value**

Theme	Category	Code
Audit value expectations	Secondary/Indirect Value	<ul style="list-style-type: none"> <li>a. Open line to technical expertise</li> <li>b. Broad exposure to point out opportunities</li> <li>c. Association and brand reputation</li> <li>d. Agency conflict resolution</li> </ul>

The category of Secondary/Indirect Value emerged from the additional benefits that are perceived by participants. While the codes identified in this category are all indicators of the value of an audit, they do not all necessarily link to the purpose of an audit as defined by international auditing standards.

One participant described these additional benefits of an audit as the auditors’ way of justifying the high cost of an audit. While it may not be the primary role of an auditor, these benefits are expected from auditors, as participants perceive that they also pay for the audit engagement, and it makes the audit worthwhile from a value-adding perspective.

a. Open line to technical expertise

***i. Finding***

As many private companies are smaller businesses, they do not always have access to individuals with a high level of technical accountancy expertise. An audit is one way of gaining access to technical accountancy expertise without necessarily having to cover an additional expense. For those companies with in-house technical expertise, an audit still provides access to the latest developments in the field of accountancy, which professional accountants in business may not be aware of or have detailed knowledge of. Participants therefore described having access to technical accountancy expertise as one of the benefits of having an external audit done.

In addition to having access to this technical expertise, participants in the Management and Shareholders group also attributed value to the continuous open line that they have to their auditors. These participants regarded their auditors as a soundboard for technical decision-making throughout the financial year and not only during the time of the audit. These participants agreed that they are able to contact their auditors at any time, making access to technical expertise readily available.

This finding is depicted by participants' comments below:

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*Interviewer: ...do you have any insight as to whether the company's management...has access to expertise, because they undergo an audit?*

*Participant: You pick up the phone and say, sherbet, I don't know what to do here. Can I come and talk with you? And then [THE AUDIT PARTNER] says yes. (P6)*

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*Remember, we are old fashioned when it comes to numbers... many times before, [THE MANAGING DIRECTOR] has said to me, but let's phone [THE AUDIT PARTNER], ...you know he is always willing to then tell us do this and do this and do this, you know. (P21)*

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*Interviewer: ...het jy enige insig of die maatskappy se bestuur...toegang het tot expertise, omdat hulle 'n oudit doen?*

*Participant: Jy tel die foon op en sê, sherbet, ek weet nie wat om hier te doen nie. Kan ek by jou kom praat. En dan sê [DIE OUDITVENNOOT] ja. (P6)*

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*Onthou ons is agter die klip as dit kom by syfers... [DIE BESTURENDE DIREKTEUR] het al baie keer vir my gesê, maar kom ons bel vir [OUDITVENNOOT], ...jy weet hy is altyd bereid om dan vir ons te sê maak so en maak so en maak so, jy weet. (P21)*

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*...we have now entered a new industry ..where the accounting is something completely different to what we are used to. So, we agreed with [THE AUDITORS] before the audit that we haven't done that accounting, but a while before that we could phone them and have discussions around what the best method would be to continue with the accounting, so we phone, or I mean we phone easily and they provide us with advice easily. (P19)*

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*...ons het nou 'n nuwe bedryf ingegaan ...waar die accounting heeltemal iets anders is as wat ons gewoon is aan. So, ons het met [DIE OUDITEURE] ooreengekom voor die oudit, ons het nog nie daai te boekstelling gedoen nie, maar 'n rukkie voor dit kon ons hulle bel en gesprekke hê rondom wat die beste metode sal wees om voort te gaan vir die te boekstelling, so ons bel of, ek bedoel ons bel maklik en hulle verskaf maklik vir ons raad. (P19)*

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## **ii. Comparison with applicable audit requirements**

During an audit, auditors propose correcting journal entries where misstatements were identified and will require clients to correct material misstatements, as required by ISA 450 (IAASB, 2022b). This could be perceived as providing technical guidance to clients, especially where the auditors discuss these corrections and the reasons for the corrections with the client. It is, however, not required of auditors in terms of international auditing standards to continuously be readily available to provide technical or other guidance to audit clients.

*The expectation that participants should continuously have access to auditors' technical expertise through an open line of communication, is not prescribed by applicable audit requirements and an audit expectation gap is identified.*

*Note that this finding also impacts participants' understanding of auditor independence, which is addressed in 4.6.2.*

## **b. Broad exposure to point out opportunities**

### **i. Finding**

Participants were in agreement that, because auditors work with a variety of clients and industries, they have rich business insights and access to valuable information, business contacts and general 'best practice'. Many participants articulated that their companies' auditors share these insights with them, which enhances the value of the

audit service that they receive. Other participants expressed the desire for auditors to share more of these insights and recommendations as well as business opportunities with them, not only from a financial statement perspective, but also on the operational side of the business. Whether auditors currently do share this information or not, it is clear that the expectation exists that auditors should enhance their clients' businesses by providing recommendations arising from their wide exposure.

Participants expressed this expectation from auditors as follows:

*I mean as a guy in my position you always want to know if you can do something better or when there are other opportunities or better opportunities or whatever. ...the more access you have to funds the easier the discussions get and the easier [THE AUDITORS] can share information with you on where you can channel your funds. (P4)*

*Ek meen as 'n ou in my posisie wil jy altyd weet as jy iets beter kan doen of as daar ander geleenthede is of beter geleenthede of wat ook al. ... hoe meer toegang jy het tot fondse hoe makliker raak gesprekke en hoe makliker kan [DIE OUDITEURE] ook met jou inligting deel van waarnatoe jy jou fondse kan kanaliseer. (P4)*

*[AUDITORS] are exposed much wider than us, this is where it makes them as auditors very valuable. We become specialists in our own area and we are buried in it, and we manage that, but there are also some things that they see – that type of programme works better to do something because they saw it at X ... one expects from an auditor to share new developments with you. (P1)*

*[OUDITEURE] is blootgestel baie wyer as ons, dis waar dit hulle as ouditeure baie waardevol maak. Ons raak spesialiste in ons eie gebied en ons is baie ingegrawe, en ons bestuur dit, maar daar is ook party goed wat hulle sien - daai tipe program werk beter om iets te doen want hulle het dit by X gesien.... 'n ou verwag van 'n ouditeur om nuwe verwickelinge met 'n ou te deel. (P1)*

## **ii. Comparison with applicable audit requirements**

In terms of international auditing standards, there are again no requirements of auditors to share business opportunities or insights from other clients with their audit clients. There is, however, a requirement of auditors, in terms of ethics standards, to maintain client confidentiality (IESBA, 2022), and therefore, by sharing this type of information, a threat may be created to the fundamental principle of confidentiality.

*The expectation that auditors should share with their clients any best practice, opportunities and business insights resulting from their exposure to various clients and industries, is not prescribed by applicable audit requirements and an audit expectation gap is identified.*

c. Agency conflict resolution

***i. Finding***

Consistent with the literature, participants in the Management and Shareholders group agreed that auditors contribute greatly towards the resolution of agency conflict, which is prominent in many private companies. Because auditors are trusted, independent third parties, management and owners of private companies are comfortable sharing information with them and obtaining their objective opinions where parties within the company disagree or where they are just unsure and in need of a trusted, second opinion, albeit informal. Participants valued that auditors bring knowledge to the table and that opinions are based on facts and not emotions. Where conflict arises, auditors are often viewed as mediators or the final “trump card”. Participants expressed this finding as follows:

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*Because it is about facts and not about I think or you thought or you said. It is facts on the table in the sense of figures and no one can argue with the facts. Especially when it is done independently by experts in the field. It will definitely minimise that type of conflict, because there are facts on the table. (P6)*

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*Want dan gaan dit oor feite en nie oor ek dink of jy het gedink of jy het gesê nie. Dit is feite op die tafel, in die sin van syfers en niemand kan stry teen die feite nie. Veral as dit nog onafhanklik gedoen is deur kenners in die veld. Dan gaan dit vir seker daardie tipe konflik kan minimaliseer, want daar is feite op die tafel. (P6)*

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*...it is nice to get guys from the outside and then one thinks it is a family decision because it is all those inside intrigues and all those things ...it opened one's eyes a bit because sometimes you think with your heart instead of your mind... (P5)*

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*...dit is net lekker om ouens van buite af te kry en dan 'n ou dink dis 'n familie besluit want dis nou al daai inside intriges en al die goed ...dit het 'n ou se oë net bietjie laat oopgaan want baie keer dink jy met jou hart in plaas van jou verstand... (P5)*

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***ii. Comparison with applicable audit requirements***

International auditing standards do not require of auditors to play a mediation role in resolving agency conflict, but participants in the Management and Shareholders group clearly expected auditors to perform such a role where the need arises. In some instances, the mere fact that an audit is done and figures are deemed to be reliable, contributes to resolving potential agency conflict. In other instances, however, auditors are approached for opinions beyond the normal scope of an audit, which not only falls

outside of the requirements of international auditing standards, but also has the potential to threaten auditors' independence should they take on a management role in decision-making (IESBA, 2022).

If this is a separate engagement with a different auditor to the one responsible for the audit of the company's financial statements, it may be acceptable (cf. 4.6.2 for further discussion), but participants' responses suggested that they expect and receive this service from their auditors as part of the audit offering.

*Participants' expectation that auditors should assist (directly or indirectly) with agency conflict resolution, is not prescribed by applicable audit requirements and an audit expectation gap is identified.*

d. Association and brand reputation

***i. Finding***

Participants in the Management and Shareholders group attributed value to the size and brand of audit firms with specific reference to Big-4 and non-Big 4 firms. As indicated in Table 15, variation was obtained by ensuring participants with Big 4 firms and non-Big 4 firms as their companies' auditors were selected. Participants were requested to describe why their companies appointed a Big 4 or non-Big 4 firm and it was clear that the value of both categories of audit firms was recognised.

Participants from companies who appointed non-Big 4 firms perceived that they receive more personal attention compared to Big 4 firms where they perceive a smaller company to be 'a small fish in a big sea'. These participants also did not attribute much value to the brand reputation of Big 4 firms and did not perceive the quality of an audit to differ between Big 4 and non-Big 4 firms as all auditors need to follow the same standards.

Participants from companies who appointed Big 4 firms, however, did not experience their relationship with their audit firms as being 'just a number', and these participants valued the access gained to a wider network of expertise within Big 4 firms. These

participants also perceived the association with a Big 4 firm as a factor that enhances their company's credibility and stature.

Moreover, it was clear that participants in the Management and Shareholders group were very loyal towards their audit firm, and in particular to their audit partner. One participant who had recent exposure to both Big 4 and non-Big 4 firms, commented that it is more about the person (i.e. the audit partner) than the firm, while others also shared these sentiments.

Participants articulated their perceptions as follows:

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*...I definitely think small or medium has a benefit. Because you could possibly ask them for, you will probably get more advice out of them compared to when you literally sit with a clerk that does a small part of your things. ...I think you have a benefit to directly contact whether a partner or a senior person and you will be able to reach the person. They are perhaps small, but to them you are a reasonably big fish. (P2)*

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*...ek dink definitief klein of medium het 'n voordeel. Want jy kan hulle moontlik vra vir, jy gaan dalk moontlik meer advies uit hulle uit kan kry as wat jy letterlik net met 'n klerk sit wat 'n deeltjie van jou goeters doen. ... ek dink jy het die voordeel om direk met 'n moontlik hetsy 'n vennoot of 'n senior persoon te skakel en jy gaan die persoon in die hande kry. Hulle is dalk klein maar jy is vir hulle 'n redelike groot vis. (P2)*

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*I know we chose them because of the brand. So, the Big 4 brand. Plain and simple. ...It was definitely a search for something that we can associate with. We associate with Big 4. So, you as investor or as the bank, here is assurance. Understand? Because they have assurance in the brand. (P7)*

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*Ek weet ons het hulle gekies as gevolg van die brand. So, Groot 4 brand. Plain en simple. ... Dit was definitief 'n soeke na iets waarmee ons kan associate. Kyk ons associate met Groot 4. So, jy as investor en as die bank, hier is vir jou gerusstelling. Verstaan? Want hulle het gerusstelling in die brand. (P7)*

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In 2.3.3 of the literature review of this study, it was detailed why the expectations of users of audited financial statements undertaken by Big 4 and non-Big 4 firms may differ, thereby addressing why the audit expectation gap in private companies may differ compared to public, listed companies. It is, however, clear that the views presented in this study were shared by participants, regardless of whether the company is audited by a Big 4 or non-Big 4 firm. Participants attributed value to both types of firms and were generally satisfied with the service they received from their auditors. It should be noted that this study is limited to the Free State province, where the presence of public, listed companies is extremely limited, perhaps explaining why

the services rendered by Big 4 and non-Big 4 firms in this region do not differ significantly.

Participants in the External Stakeholders group were also requested to elaborate on whether the size of their clients' audit firms, in particular whether it is a Big 4 or non-Big 4 firm, has any impact on how these companies' financial statements are evaluated or viewed. Apart from one divergent response from a participant from a banking institution, who stated that in some instances the bank would approve higher credit limits where companies appointed Big 4 audit firms, participants in this group concluded that this factor does not impact how financial statements are evaluated. Participants in this group did, however, note that reputation overall does influence their evaluations, although it does not necessarily entail public reputation, but rather trends that they have identified themselves over time, causing them to question the work of some firms more than others. One participant mentioned that recent scandals in the audit profession also play a role in how they evaluate financial statements.

The following quotations support this finding:

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*Interviewer: Does [SARS] differentiate between a Big 4 firm or a non-Big 4 firm, does it matter at all?*

*Participant: No, it cannot matter. ...because we get errors on the Big 4 as well, so you cannot say they are the Big 4, so we trust them more. (P26)*

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*Interviewer: Onderskei [SARS] tussen 'n Groot 4 firma, of 'n nie Groot 4 firma, maak dit enigsins saak?*

*Participant: Nee, dit kan nie saak maak nie. ...want ons kry foute op die Groot 4 ook, so jy kan nie sê hulle is die Groot 4, so ons vertrou hulle meer nie. (P26)*

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*Participant: ...you know who the reputable firms are, so we do check that and by now having been through enough financial statements you do know, these guys legit, these guys are legit, and then we see a new one, then we do research and find out whether he is registered and, and, and.*

*Interviewer: Okay, but you don't differentiate between Big 4 and non-Big 4?*

*Participant: No. (P20)*

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It was, however, clear that while there is no difference from a procedural point of view, participants from an audit background who were previously employed at a Big 4 firm, were clearly biased in their evaluations, placing somewhat more reliance on financial statements audited by Big 4 firms, as evidenced by the following:

---

*Interviewer: ...does it matter to you who the auditor is of the company that applies? In other words, do you differentiate between big four and non-big four?*

*Participant: I have my preferences and unfortunately we are not computers...technically I shouldn't, but yes, I do it. ... The bank doesn't differentiate if you, say, do the credit rating, between big four and non-big four, it is more a personal conviction...*

*It is, let's call it a reputable company that has been around for many years, and because I come from one of the big four, I know the attention to detail personally, yes. But as I say, it is a personal thing. It really doesn't have anything to do with the bank. (P23)*

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*Interviewer: ...maak dit vir jou saak wie die ouditeur is van die maatskappy wat aansoek doen? Met ander woorde, differensieer jy tussen groot vier en nie-groot vier?*

*Participant: Ek het maar my voorkeure en ongelukkig is ons nou nie rekenaars nie...tegnies moet ek nie, maar ja, ek doen dit. ... Die bank onderskei nie as jy, sê nou maar, daai credit rating doen, die big four of non-big four nie, dit is meer 'n personal oortuiging...*

*Dit is maar, noem dit 'n reputable company wat al jare daar is, en omdat ek uit een van die big four uitkom, ken ek mos nou persoonlik die attention to detail, ja. Maar soos ek gesê het, dit is maar 'n persoonlike ding. Dit het regtig niks te doen met die bank nie. (P23)*

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Whether a private company is audited by a Big 4 or non-Big 4 firm, therefore, this does not necessarily have an impact for purposes of evaluations by SARS or banking institutions from a procedural point of view, i.e. employees of SARS and banking institutions are not required to differentiate between these firms. What is evident is that all participants valued the audit and the audit process for a range of reasons, while indicating high levels of satisfaction with the service companies receive from their audit partners in particular.

## ***ii. Comparison with applicable audit requirements***

Applicable audit requirements do not differentiate between large and small firms. Guidance sometimes differs for large and small or medium clients, but all registered audit firms are bound by the same requirements and standards.

*It is, therefore, concluded that in this study, whether a private company is audited by a Big 4 or non-Big 4 firm, this does not impact the audit expectations of participants, and therefore has no impact on the audit expectation gap.*

## 4.6. Auditor independence

In 4.5.1c. it was confirmed that participants in this study value the independence of external auditors, as this enhances trust and credibility in the financial statements. This was the case for both participants in the Management and Shareholders group and those in the External Stakeholders group.

Participants in the External Stakeholders group emphasised the importance and expectation of auditors' independence, evidenced by the following statements:

<i>...I must be able to get assurance that the statements are independent. (P3)</i>	<i>...ek moet kan sekerheid kry dat dit onafhanklike state is. (P3)</i>
<i>Well [AN AUDIT] is independent so I mean it is an independent party that is independent with regards to that entity... (P10)</i>	<i>Wel [‘N OUDIT] is onafhanklik so ek meen dit is ‘n onafhanklike party wat onafhanklik is ten opsigte van daardie entiteit... (P10)</i>

While participants in the Management and Shareholders group also attributed great value to auditor independence, these participants frequently shared views and comments which contradicted auditor independence requirements. The magnitude of these contradictory findings indicated that participants' understanding and perception of independence does not align with applicable audit requirements. These participants seemed to be unaware that some of the circumstances cited by them created threats to the independence of auditors, and further did not consider these as factors impacting the audit expectation gap. The level of auditor independence that participants deem as appropriate, therefore seems to be much lower than what applicable audit requirements prescribe, creating an inverse expectation gap, i.e. participants expect less from auditors than what is prescribed by applicable audit requirements.

Toumeh, Yahya and Siam (2018) found a direct link between auditors' independence and the perceived expectation gap, as well as an indirect link due to the impact of independence, or a lack thereof, on the quality of an audit. Auditors' violation of independence requirements constitutes 'deficient performance' (cf. 1.1.1), which contributes to the broader audit expectation gap (Quick, 2020). This is confirmed by

Barrett (2012) who argues that it is important that auditors demonstrate accountability for independence as this would enhance users' understanding of and confidence in the outcome of an audit, thereby addressing elements of the audit expectation gap. This study, however, does not address the performance gap component of the audit expectation gap and, therefore, no conclusions can be drawn on whether auditors of private companies are, in fact, independent of their clients.

The concept of independence is often subjective. The IESBA Code of Ethics provides guidance to professional accountants on how to identify, evaluate and address threats to independence, but this guidance is also subject to the particular professional accountant's judgement. The IESBA Code of Ethics often provides stricter guidance and prohibitions for audit clients that are public interest entities, due to their higher risk and wide interest. Auditors of non-public interest audit clients, which includes private companies, are mostly left to apply judgement in evaluating threats to independence. In this context, no accusations can be made of auditors breaching independence requirements as it is not possible to know how these auditors may have addressed possible threats to independence. From the statements made by participants, it does, however, seem that auditors of private companies perhaps push the boundaries of independence, and this area is therefore recommended for future research (cf. 5.4).

This section will focus on the contradictions between participants in the Management and Shareholders group's expectation that auditors should be independent (cf. 4.5.1c.) and their understanding of or inability to identify threats to auditor independence, which also impacts their expectations from auditors.

#### 4.6.1. Relationships

Theme	Category	Code
Threats to independence	Relationships	<ul style="list-style-type: none"> <li>a. Longstanding association</li> <li>b. Personal relationships</li> <li>c. Familiarity</li> </ul>

The category of Relationships emerged from various references made by participants regarding the relationship they have with their auditors, specifically the audit partner responsible for signing the auditor's report of the company. Participants were not prompted to comment on their auditors' independence or any form of relationship with their auditors beyond their satisfaction with and perceived value of the audit service. Participants, however, commented freely on the general good relationship they have with their auditors, often citing the length of time that the auditors have been involved with the company, as well as other personal relationships, some developing even before the audit service started, as supporting evidence.

a. Longstanding association

***i. Finding***

Many participants in the Management and Shareholders group commented on the long-lasting relationship that their companies have with their audit firms and audit partners. Participants perceived this to be a benefit as the auditor knows the company very well and is in a position to add value because of this knowledge. As much as participants acknowledge the perceived value of a longstanding relationship with their auditor, they failed to recognise that this could impair the auditor's independence. While auditors do seem to adhere to the Companies Act of South Africa, requiring audit partners (the individuals) to rotate every five years (South Africa, 2008), participants do not perceive this rotation to have a negative effect on the audit service as the audit partners stay involved in the audit, although they do not sign off on the audit during the 'cooling off' period of two years, also required by the Companies Act.

The following quotations support this finding:

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<i>Look, we've come a long way with our current auditors, so they're very well dug in here, they know the company very well. The audit partner who works specifically on this audit has probably been involved in this for 18 years, ...there are certainly advantages in that the knowledge of the business is there. She is also regularly here on our premises</i>	<i>Kyk, ons kom 'n lang pad met ons huidige ouditeure, so hulle is baie goed ingegrawe hierso, hulle ken die maatskappy baie goed. Die oudit vennoot wat spesifiek op hierdie oudit werk is seker al 18 jaar betrokke hierby, ...daar is vir seker voordele in, daardeur dat die kennis van die besigheid is daar. Sy is ook gereeld hier op ons perseel</i>
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<i>throughout the year, not just at audit time.</i> (P1)	<i>deur die jaar, dis nie net by oudit tyd nie.</i> (P1)
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<i>...my dad has from his first business..., I don't know how long ago, he was [WITH THE AUDIT FIRM], he knew them, they were also guys who studied at [THE SAME UNIVERSITY]... we have a really nice relationship with these guys who have been here over the years and we have just stayed loyal towards them.</i> (P5)	<i>...my pa het van sy heel eerste besigheid..., ek weet nie hoe lank terug nie, was hy [BY DIE OUDITFIRMA], hy het hulle nou geken, hulle was ook ouens wat daar by [DIESELFDE UNIVERSITEIT] geswot het... ons het 'n regtige nice verhouding met hierdie ouens wat nou al jare kom en ons het maar net lojaal teenoor hulle gebly.</i> (P5)
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## **ii. Comparison with applicable audit requirements**

The IESBA Code of Ethics for Professional Accountants does not prescribe the length of time that an auditor may be involved with an audit client that is not a public interest entity. It does, however, state that long association of individuals with audit clients may create self-interest and familiarity threats to independence. These threats are increased when the individual is in a senior position and has the ability to influence the outcome of the audit, as is the case with audit engagement partners. The nature, extent and frequency of interaction with the client's management also increases the threat to independence (IESBA, 2022). As mentioned, section 92 of the Companies Act of South Africa requires audit engagement partners to rotate every five years, with a cooling-off period of two years, for all mandatory audits (South Africa, 2008).

Where an audit client is a public interest entity, clear guidance exists that prohibits auditors from being involved in the audit in any form during the cooling-off period (IESBA, 2022). Most private companies, including all companies in this study, are, however, not public interest entities and no clear guidance is provided for these entities on what is allowed during the two-year cooling-off period. It is, however, unlikely that the intention of the cooling-off period prescribed by the Companies Act is merely a compliance exercise for whose signature is on the auditor's report. While the wording of the Companies Act is not explicit, one should also consider the spirit of the law. These provisions clearly aim to strengthen auditor independence, which will not be fully achieved if the same individuals remain closely involved in the audit and merely rotate who signs the auditor's report as audit engagement partner, which seems to be the case with many private companies.

*Participants' lack of understanding that the long association of audit partners may negatively impact their independence, which is clearly addressed by applicable audit requirements, contributes to the audit expectation gap.*

b. Personal relationships

***i. Finding***

In some cases, close personal relationships between audit partners and key members of management or shareholders of the auditee were identified. These relationships were described as close friendships, childhood friendships and mentor-mentee relationships. These relationships were identified through the following comments made by participants:

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<i>[THE AUDIT PARTNER AND I] see each other rather often. We have a very good relationship. ...[NAME OF AUDIT PARTNER] is also like one of my important youngsters. I have a very big mentorship role over him. I sit and discuss his practice problems and those types of things with him. (P13)</i>	<i>[EK EN DIE OUDITVENNOOT] sien mekaar redelik gereeld. Ons het 'n baie goeie verhouding. ...[NAAM VAN OUDITVENNOOT] is vir my ook soos een van my belangrike jongmense. Ek het 'n baie groot mentorskap rol oor hom. Ek sit met hom en gesels met hom oor sy praktykprobleme, en sulke tipe goed. (P13)</i>
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<i>[NAME OF AUDIT PARTNER] and I are like brothers, so we sit over weekends with a glass of whiskey in the hand and chat. (P4)</i>	<i>...ek en [NAAM VAN OUDITVENNOOT] is soos broers, so ons sit oor naweke met 'n glas whiskey in die hand en gesels. (P4)</i>
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***ii. Comparison with applicable audit requirements***

The ethics standards that auditors should uphold require auditors to be independent from their audit clients, stating that close personal relationships between auditors and client personnel in a position to exert significant influence, could cause self-interest, intimidation or familiarity threats to independence. While close relationships between audit team members and audit client personnel are not prohibited, the IESBA Code requires auditors to consult within their firms to address these relationships. In the

conceptual framework of the IESBA Code, professional accountants, a term which includes auditors, should evaluate potential threats to their fundamental principles, as well as the principle of independence and respond to these threats in order to reduce threats to an acceptable level (IESBA, 2022)

Threats to independence that arise as a result of close personal relationships, are increased when it involves a senior member of the audit team (such as the audit partner) and if the person employed by the audit client is in a position to exert significant influence (such as members of executive management), which seems to be the case with private companies. The Code also recommends removing the team member from the audit when these threats arise in order to eliminate the threat (IESBA, 2022).

*Participants' acceptance and expectation of close, personal relationships with their auditor, contradicts applicable audit requirements, which contributes to the audit expectation gap.*

c. Familiarity

***i. Finding***

Apart from close and long-standing relationships, there also seems to be a general familiarity between management of private companies and their auditors. In some instances, members of management and their companies' audit partners used to work at the same firm, often with one being in a supervisory role towards the other. In other cases, auditors are referred to as an extra non-executive financial manager or a business partner. This finding was articulated as follows:

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<i>...it's really nice for me because it's almost like I have a business consultant that I can call... (P2)</i>	<i>... dit is rêrig vir my lekker want dit is amper asof ek 'n business consultant het wat ek kan skakel... (P2)</i>
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***ii. Comparison with applicable audit requirements***

Having a good business relationship with one's auditor is not necessarily a threat to the auditor's independence, but the IESBA Code cautions against familiarity threats to

independence, which can occur when an auditor becomes too sympathetic towards their interests or too accepting towards their work, which is often because of long-standing or close relationships as described in this category (IESBA, 2022).

*Participants acceptance of and expectation of general familiarity with their auditor, could contradict applicable audit requirements, which could contribute to the audit expectation gap.*

#### 4.6.2. Other services

Theme	Category	Code
Threats to independence	Other services	a. Input to audit process b. Non-assurance services

Participants in the Management and Shareholders group made reference to other services rendered by the auditor, of which some are separate non-assurance engagements (i.e. audit clients are billed separately for these services), while others were additional benefits that companies had access to through the audit process. Both of these could impact auditors' independence, while the additional benefits (i.e. services that are not paid for as an additional engagement) are regarded as participants' expectations from auditors when an external audit is performed.

In addition, these participants were also asked to comment on the extent of their involvement in the audit to determine whether they expect to have influence in the audit process.

##### a. Input to audit process

##### *i. Finding*

Participants were asked to comment on their involvement in the audit process, such as areas of focus, type of procedures, selection of the audit team, etc. This was to determine whether they have a specific need or expectation to be included in these

decisions. It was, however, found that participants did not particularly wish to influence the audit process and accepted that 'it is not their place'. Some participants did mention that they would highlight areas of concern to their auditors, where they would appreciate specific assurance or an objective view, but participants did not want to 'interfere' in the audit itself. This finding was articulated in the following quotations:

*I think that if you want to, I would say ... the non-executive members of the audit committee [COULD HAVE INPUT TO THE AUDIT PROCESS], but for me as a non-executive normal director [AND SHAREHOLDER], I don't have any desire to have a say in it. Not at all. (P18)*

*Ek dink, as 'n ou sou wou, sou ek sê ... die nie-uitvoerende lede van die oudit committee [KAN INSAE HÊ IN DIE OUDITPROSES], maar vir my as 'n nie-uitvoerende gewone direkteur [EN AANDEELHOUER], het ek nie 'n behoefte om enigsins daarin 'n sê te hê. Glad nie. (P18)*

*There are specific areas where we always ask, see, please have a look from an external viewpoint. ...they will also come to us and say, listen, is there anything specific or a high-risk area, or something you want us to look at. Then it is some things, like for example, ...we received a complaint this guy is drawing too much pay... (P8)*

*Daar is spesifieke areas wat ons altyd maar vra kyk, gooi vir ons 'n bietjie 'n oog van 'n eksterne oogpunt af. ... hulle sal ook na ons toe kom en sê, hoor hier, is daar iets spesifiek of 'n hoë risiko area, of iets wat julle wil hê ons moet na kyk. Dan is dit nou maar iets, soos byvoorbeeld, ...ons het 'n klagte ontvang die ou trek te veel pay... (P8)*

## **ii. Comparison with applicable audit requirements**

Participants' expectations in this area seems to be in line with International Auditing Standards, with ISA 315 and 240 requiring auditors to do a risk assessment and perform enquiries of management regarding areas with a high risk of fraud, amongst other risks (IAASB, 2022b). This enables auditors to plan and perform an audit effectively. Audit clients, however, dictating how an audit should be conducted and who the individuals on an audit should be, is not appropriate and compromises auditors' objectivity, independence and professional competence and due care. This does not seem to be the case within the private companies included in this study.

*Participants' expectation to influence the planning and execution of the audit aligns well with the requirements of applicable audit requirements, and no clear audit expectation gap is identified.*

b. Non-assurance services

***i. Finding***

Participants often made reference to additional services provided by their companies' auditors. They viewed some of these services as 'add-on' services that they expect to receive from an audit, while others were separate engagements which they pay for. In both instances, auditor independence may be compromised, while with the former, a potential expectation gap arises.

Some of the additional services that participants expect to receive along with an audit, include assurance on compliance with laws and regulations and the effectiveness of internal controls. These were dealt with under 4.4 and summarised under 4.4.7 where the typical areas contributing to the audit expectation gap in public, listed companies were tested within the context of private companies. In addition to this, the most common benefit/additional service that participants in the Management and Shareholders group expect from auditors, is advisory services. Examples included support with restructuring when an owner passed away or where the new generation of family members became involved in the company. Private companies do not pay an additional fee for these services. It is seen as 'part of the package' and therefore a clear expectation from auditors.

This was articulated as follows:

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*... you know [THE AUDITOR] knows your business well, gives a lot of advice on different things, so there's that advice again and stuff and then there's the audit. And it's actually two different things but at a private company it's focused in one. There is now the standard you may not actually give advice, certain advice if you are an audit partner. I think with a private company only out of practical considerations and things those things are very closely intertwined. (P1)*

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*... jy weet [DIE OUDITEUR] ken jou besigheid goed, gee 'n klomp advies oor verskillende goed, so daar is daai advies weer en goed en dan is daar die oudit. En dit is eintlik twee verskillende goed maar by 'n privaat maatskappy is dit in een gefokus. Daar is nou mos die standpunt jy mag nou mos nie eintlik advies, sekere advies gee as jy 'n oudit vennoot is nie. Ek dink by 'n privaat maatskappy net uit praktiese oorwegings en goed is daai goed baie na aan mekaar gevleg. (P1)*

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*... the help that we received to just enquire and just ask for some advice from [THE AUDIT FIRM]... so I think it is more about the extra support that they can give us that makes it worthwhile. (P18)*

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*...die hulp wat ons gekry het om net dalk te raadpleeg en net bietjie raad te vra by [DIE OUDITFIRMA]... so ek dink dit gaan meer oor die ondersteuning wat hulle ons ekstra kan gee wat dit vir ons die moeite werd maak. (P18)*

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## **ii. Comparison with applicable audit requirements**

Section 600 (Provision of non-assurance services) of the IESBA Code of Ethics addresses auditors providing general advice and recommendations to audit clients, while section 610 (Corporate finance services) addresses the provision of structuring advice. In both cases, self-review threats to independence may arise as a result of these advisory services, especially when it impacts the figures in the financial statements (IESBA, 2022).

The IESBA Code of Ethics is again not explicit on whether advisory services like these are allowed. Auditors are required to evaluate the threat to independence and respond by implementing safeguards, such as using professionals who are not part of the audit team to provide the advisory services or having an appropriate reviewer review the audit work or services performed. Although not stated specifically by the Code, these services could also create a familiarity threat to independence where auditors become so involved in their clients' affairs that they may be too sympathetic towards clients' interests.

*Participants' expectation of advisory services that they receive from auditors as part of the audit service (the 'add-on benefit' to an audit), exceeds applicable audit requirements, and an audit expectation gap is identified.*

## 4.7. Conclusion

This chapter presented and discussed the empirical findings of this study. The participants of this study were firstly described and categorised into two groups:

- Management and shareholders; and
- External stakeholders, which included banking institutions and SARS.

Most findings in the chapter applied to both groups and, therefore, the findings are presented in one data set. Where findings differed for the two groups or only applied to one of the groups, this was indicated within the relevant category or code.

Furthermore, the findings in this chapter were presented in four themes. The first theme, 'Users of audited financial statements', confirmed the accuracy and appropriateness of the population for the study, which included shareholders, members of executive management, banking institutions and SARS.

The second theme, 'Audit purpose perceptions', sets out how the typical areas contributing to the audit expectation gap identified in the literature (mainly for public, listed companies) were perceived by the participants in this study, thereby indicating similarities and differences between the audit expectation gap in private and public, listed companies.

The theme of 'Audit value perceptions' was presented thereafter. This theme detailed what participants expect from auditors, beyond the audit purpose expectations identified in the second theme. These were the factors that made the audit a value-adding process, making the audit worthwhile from the participants' perspective.

Lastly, 'Auditor independence' was included as the fourth theme, due to the magnitude of the contradiction between the value that participants attribute to auditor independence on the one hand and the misunderstanding or acceptance of lower levels of independence on the other.

Final conclusions and recommendations resulting from this study are presented in Chapter 5, which also emphasises the value and limitations of this study.

## **CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS**

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### **5.1. Introduction**

In the previous chapter, the results and findings of the study were presented, discussed, and interpreted using four themes: Users of audited financial statements, Audit purpose perceptions, Audit value perceptions and Auditor Independence. Each finding was discussed and supported with quotations that were rich in description, after which the finding was compared to applicable audit requirements to identify differences and similarities. This allowed preliminary conclusions on each finding.

In this chapter, the study's conclusions, aligned with the research questions and objectives, are assimilated. Recommendations based on the study's findings and conclusions are also provided, along with suggestions for future research. Finally, the study's limitations and its value are addressed as closing reflections on the study.

### **5.2. Conclusions – answering the research questions**

The primary objective of this study was to determine the existence of the audit expectation gap within the context of audited private companies and to determine whether there are differences between user expectations and what is prescribed by applicable audit requirements, i.e. the cause(s) of the expectation gap.

In order to achieve this objective, the three research sub-questions had to be answered. Figure 6 visually depicts how these sub-questions were answered through the findings, generated by inductive coding, presented in Chapter 4.

**Figure 6: Alignment between the findings of the study and the research sub-questions**

THEMES	CATEGORIES	RESEARCH SUB-QUESTIONS
THEME 1: USERS OF AUDITED FINANCIAL STATEMENTS	Influence of background on user perceptions/expectations	<i>Who are the external users of audited private company financial statements?</i>
	Shareholders	
	Banks/Providers of finance	
	SARS	
	Management	
THEME 2: AUDIT PURPOSE EXPECTATIONS	Fraud	<i>What are the expectations of the users of audited private company financial statements?</i>
	Errors	
	Going concern	
	Good investment	
	Internal controls	
	Laws and regulations	
THEME 3: AUDIT VALUE PERCEPTIONS	Primary/Direct value	AND <i>To what extent do the expectations of users differ from what is required by relevant standards?</i>
	Secondary/Indirect value	
THEME 4: AUDITOR INDEPENDENCE	Relationships	
	Other services	

Source: Compiled by the researcher

A concurrent approach was followed in considering the second and third sub-questions, i.e. they were dealt with simultaneously within each code, category and theme. By firstly identifying participants' expectations and immediately comparing these expectations to applicable audit requirements, this enabled conclusions on whether the findings contribute to the audit expectation gap or not. These two sub-questions are, therefore, addressed in one section (cf. 5.2.2).

Finally, a comparison is presented between the contributors to the audit expectation gap in public, listed companies, versus private companies, to emphasise the unique nature of the audit expectation gap in private companies.

### **5.2.1. The users of audited private company financial statements**

In the literature review (cf. 2.4), the users of financial statements were explored. It was recognised that the users of private company financial statements would differ from public, listed companies, largely due to legislative requirements and the nature of these users.

It was important to ascertain that no relevant user group was excluded from this study on private companies, as the aim was to obtain a holistic understanding of the audit expectation gap phenomenon for private companies in the Free State province. Questions to participants, therefore, included those to confirm who the users of private company financial statements are. These users were confirmed as members of management, shareholders, providers of finance, and SARS, although the way in which these users make use of audited financial statements differed (cf. 4.3). These findings confirmed the appropriateness of the participants in this study.

It was, however, noteworthy that the perceptions of participants in the Management and Shareholders group regarding the use of audited financial statements when private companies applied for credit or submitted tax returns, differed from the reality depicted by banking institutions and SARS. Management and Shareholders believed that an unmodified auditor's report aids in obtaining higher facilities and better interest rates from banking institutions and that SARS would be less likely to query tax returns accompanied by audited financial statements. This expectation aligns with literature (cf. 2.4.3 and 2.4.4). Interviews with the participants in the External Stakeholder group, however, proved that this is not the case. SARS officials seldom look at the auditor's report, and perform tax compliance audits irrespective of whether a company is audited or not. Companies are also not less likely to be selected for a tax audit when they have been audited. There is therefore no real benefit to undergo an audit from a SARS perspective. The majority of banking institutions also do not provide higher facilities or better interest rates to audited clients as they argue that audited financial

statements are historical, while a company's credit rating should be based on forward-looking information, as well as the company's credit history. Audited financial statements do assist banking institutions in not having to verify certain information themselves, but it is unlikely that this will lead to better facilities or lower interest rates.

What became evident was that the background of users of financial statements often played an integral role in their perceptions of the audit service and their expectations from auditors (cf. 4.3.1). The views of individuals who previously worked at auditing firms and/or those who are currently employed in a finance role and, therefore, often interact with auditors, in some instances differed from those who had no background in finance.

Other possible users of audited financial statements, such as suppliers and labour unions were also identified, but it was confirmed that it is only in limited instances where these users would have access to private company financial statements, and often only extracts from the financial statements. Excluding these 'ad hoc' users of financial statements from this study is recognised as a limitation (cf. 5.5).

### **5.2.2. The expectations of users of audited private company financial statements and how these expectations align with the applicable audit requirements**

In this section, the findings that address the second and third research sub-questions are categorised according to their impact on the audit expectation gap, i.e. whether the findings contribute to the audit expectation gap or were found to have no impact thereon. Firstly, the various threats to auditor independence that were identified, and the impact that these have on the audit expectation gap, are explained. Thereafter, further comparisons are made between the expectations of participants and the applicable audit requirements (cf. 1.2 for the definition of this term).

Where participants' **expectations differed** from what is required/recommended in terms of applicable audit requirements as defined, these findings were considered to be contributors to the audit expectation gap. Where the participants' **expectations**

**aligned with** that which is prescribed/recommended by applicable audit requirements, no impact on the audit expectation gap was observed.

a. Participants' perceptions regarding auditor independence

ISQM 1 requires of audit firms to establish policies and procedures to ensure that its staff maintain independence where required (IAASB, 2022b). The first sentence of the Independence Standards included in the IESBA Code states: "It is in the public interest and required by the Code that professional accountants in public practice be independent when performing audit or review engagements." The heading of an auditor's report also clearly states "Independent Auditor's Report" (IESBA, 2022). Independence is undeniably central to the audit service – it is what gives audit value; it enhances trust. It also appears to impact the audit expectation gap as independence – or the lack of understanding thereof – has various implications in the context of the phenomenon.

**All participants** in this study emphasised the paramount significance of auditor independence. They agreed that independence enhances trust and is a vital quality of an auditor. In this regard, participants' expectations of auditors clearly align with applicable audit requirements. (Cf. 4.5.1.).

The **Management and Shareholders group**, however, seemed to be unaware that some of the circumstances cited by them created threats to the independence of auditors and further did not view these as factors impacting the audit expectation gap. The level of auditor independence that participants deem as appropriate, therefore seems to be much lower than what applicable audit requirements prescribe, creating an inverse expectation gap, i.e. participants expect less from auditors than what is prescribed by applicable audit requirements. The impact of this potential 'reduced independence' on the value that **External Stakeholders** place on auditor independence requires further consideration.

Independence is subjective and while independence standards do exist, they are not very prescriptive for non-public interest entities, which includes private companies. These standards guide auditors to evaluate threats to independence and respond

accordingly. Determining whether these threats are at an acceptable level is, however, completely left to the judgement of the auditor.

It would, however, be difficult to argue that independence is maintained by the auditor when management and shareholders of the companies which they audit refer to them as “brothers”, “business advisors”, “mentees” and “non-executive financial managers”. (Cf. 4.6.). Participants also value the positive and accommodating attitude of auditors. Various participants commented that they do not hesitate to “pick up the phone” to contact their auditor or that they have an “open line” to their auditor. While this is admirable service to clients, these discussions often involved more than a quick technical question and appeared to amount to business advice and decision-making, which could also create threats to auditor independence (cf. 4.5.2).

This study, however, focuses on the ‘Evolution Gap’ component of the audit expectation gap which only compared participants’ expectations/perceptions to applicable audit requirements and did not investigate how auditors responded to these threats to independence. Investigating auditor independence with a focus on the ‘Performance Gap’ is recommended as an area for future research (cf. 5.4).

#### b. Contributors to the audit expectation gap

Six overarching factors were identified as contributors to the audit expectation gap in private companies. These factors were all identified as areas where participants expected more from auditors than what is required in terms of applicable audit requirements.

Participants interpreted an unmodified auditor’s report as confirmation that the company under audit complied with all **laws and regulations** applicable to the company, and therefore, participants expect that testing compliance with all laws and regulations forms part of the scope of an external audit (cf. 4.4.6). This expectation contradicts what applicable audit requirements prescribe as auditors are only required to obtain sufficient and appropriate audit evidence regarding an entity’s compliance with laws and regulations that have a direct effect on the financial statements, while their duty regarding other laws and regulations is limited and confirming compliance thereto, is not required.

Participants also interpreted an unmodified auditor's report as confirmation that all **internal controls** within the company under audit were tested and found to be effective. They also expected auditors to report any/all internal control deficiencies to management. (Cf. 4.4.5). While applicable audit requirements do require of auditors to report to management on significant (not all) deficiencies in internal control that were detected throughout the audit, auditors have no requirement to test all internal controls, nor do they express an opinion on their effectiveness.

Participants differentiated between the recording of accounting transactions and transferring accounting records to a full set of financial statements (the financial statement preparation process). While participants were forgiving when it came to auditors not detecting all errors in underlying accounting records, they do expect that auditors should ensure that when financial statements are prepared from accounting data/the underlying records, there are **no errors in the presentation of the financial statements** (cf. 4.4.2). While applicable audit requirements prescribe that auditors must agree or reconcile the financial statements with the underlying accounting records (IAASB, 2022b), the financial statements include much more information that is not directly extracted from the underlying records, such as the selection and application of accounting policies, classification of accounts and narrative descriptions in the financial statement notes. Auditors are still only required to detect material misstatements and provide reasonable assurance on the financial statements as a whole, and therefore, complete accuracy cannot be guaranteed.

While participants do not expect auditors to prevent company failure and, thereby ensure a company is a **going concern**, they do expect auditors to play a role in preventing company failure by pointing out 'red lights' and **advise** management on the appropriate action to take to address the concerns (cf. 4.4.3). Applicable audit requirements do require of auditors to report to management and those charged with governance when they identify factors that could cast significant doubt on the entity's ability to continue as a going concern. However, there is no requirement of auditors to play an advisory role in this regard. In addition, should auditors take on such an advisory role, it may undermine their independence requirements.

In addition to providing advice to companies facing financial difficulty, participants also expected auditors to fulfil a **general advisory role** and share **business**

**opportunities.** Because auditors have wide exposure to various business and industries, this advice extends beyond guidance on tax and accounting treatments, but also includes advice on restructurings, areas for improvement, sharing insights gained from other businesses or best practices, and even pointing out investment or expansion opportunities (cf. 4.5.2 and 4.6.2). No such requirements of auditors exist in applicable audit requirements. On the contrary, these standards warn against external auditors providing such services as this may undermine auditor independence and, in some cases, could lead to breaching the principle of confidentiality.

Various other factors were identified as expectations of the Management and Shareholders group from auditors of private companies, which are not prescribed (or addressed at all) by applicable audit requirements. Many of these expectations are value that participants themselves derive from the audit process. While these perceived benefits happen naturally throughout the audit process, they are still not required of auditors or of the audit process, and therefore contribute to the audit expectation gap. These expectations included:

- Obtaining **reassurance** that the work they are doing is good and accurate, which provides Management and Shareholders with confidence and confirmation that what they are “on the right path”. Auditors often confirm what they already know, but they still value this reassurance (cf. 4.5.1).
- The audit serves as a **safety net** where Management and Shareholders may have missed something. The general attitude of participants was that they want their businesses and accounting to be accurate and appreciated that auditors assist in getting to this point – at least in all material respects (cf. 4.5.1).
- An **open line** to the auditor’s expertise and other business advice. Management and Shareholders want to be able to contact their auditors at any time to obtain their input (cf. 4.5.2).
- Resolving **agency conflict**. Where conflict arises, auditors are often brought in as mediators or the proverbial “trump card” (cf.4.5.2).

c. Factors found to have no impact on the audit expectation gap

The expectations of participants, in many cases, corresponded with the requirements of auditors according to applicable audit requirements. In these cases, no impact on the audit expectation gap was identified.

Contrary to literature on the audit expectation gap which identifies fraud detection as the number one contributor to the audit expectation gap, this was not the case in private companies. Participants' expectations from auditors regarding the detection of **fraud** corresponded with applicable audit requirements requiring auditors to design procedures to respond to the risk of fraud and that auditors are expected to detect material fraud through these procedures. Participants were not of the view that auditors should detect all fraud, regardless of its size and nature. They recognised that the prevention and detection of fraud is the responsibility of management, but expected of auditors to communicate any detected fraud (cf. 4.4.1). This expectation agrees with the requirements set out in auditing standards.

Participants also do not expect of auditors to detect all **errors in the underlying accounting records** of the companies which they audit (although they do expect the transfer of accounting records to financial statements to be without error). Participants recognised the limitations of an audit and therefore only expected auditors to detect material errors in the underlying accounting records, which is in line with the requirements of applicable audit requirements (cf. 4.4.2).

Participants recognised that it is management's responsibility to **prevent company failure** and to ensure that the company remains a going concern, while also expecting of auditors to communicate where they identify material uncertainty regarding the entity's ability to continue as a going concern. Regarding auditors' responsibility to determine whether a company is a **good investment**, participants also asserted that this should be the responsibility of financial analysts, rather than auditors (cf. 4.4.4). As applicable audit requirements do not expect of auditors to be responsible for either preventing company failure or determining whether a company is a good investment, no expectation gap is identified in these areas.

Participants attributed significant value to the high level of **assurance** that an audit provides. All participants in the Management and Shareholders group confirmed that they would opt for an audit regardless of the legislative requirement, citing 'assurance'

as the main reason. Those in the External Stakeholder group also valued the assurance provided by auditors. This finding aligns well with the purpose of an audit according to applicable audit requirements. (Cf. 4.5.1).

In enquiring from participants whether they expect to **influence the focus of the audit**, the audit team or other factors surrounding the audit, it was confirmed that no such expectations existed, which is also in line with applicable audit requirements. While participants indicated that they would point out areas where they would appreciate additional assurance, this was deemed appropriate and in line with applicable audit requirements as it would assist the auditor in performing a thorough risk assessment during the planning phase of an audit (cf. 4.6.2).

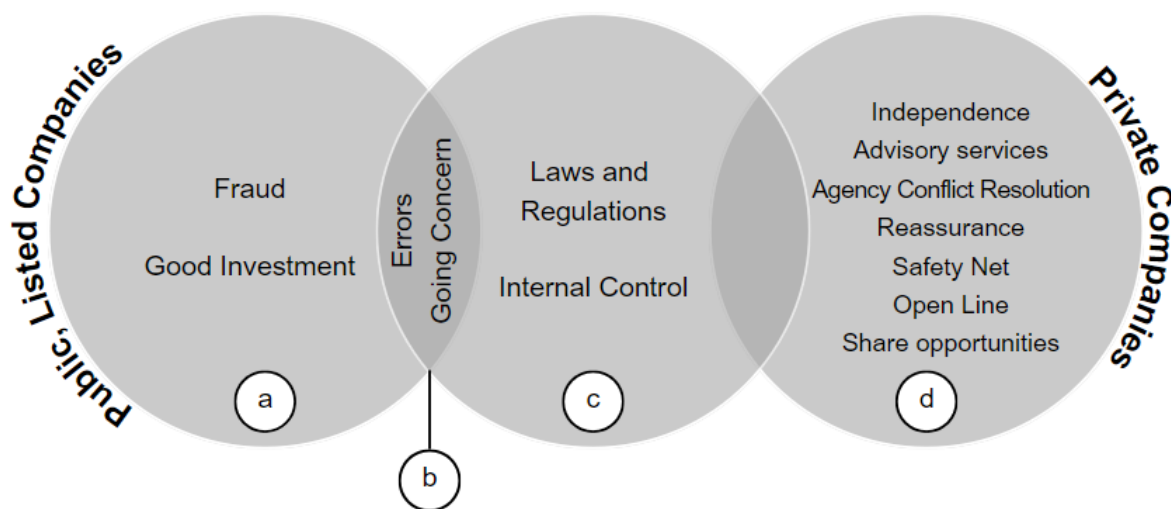
Lastly, the expectations regarding the **audit firms' size** were tested to determine whether expectations from Big 4 firm auditors differ from non-Big 4 firm auditors. It was found that in most cases, participants did not attach more or less value to an audit firm based on its classification as a Big 4 or non-Big 4 firm. Participants in the Management and Shareholders group were generally satisfied with the service they received from their auditors. Those who were audited by a Big 4 firm perceived certain benefits from this classification, while those audited by non-Big 4 firms also perceived benefits from being audited by a smaller firm. With the exception of one participant, it was particularly noteworthy that those in the External Stakeholders group also did not officially differentiate between Big 4 and non-Big 4. It was noted that participants in the External Stakeholders group who previously worked for a Big 4 firm did tend to rely more on financial statements audited by these firms, but this was not due to the organisation's policy, but rather personal bias. The reputation of firms was mostly regarded as an influencing factor in decision-making, rather than its classification of Big 4 or non-Big 4 (cf. 4.5.2c).

### **5.2.3. A comparison between public and private companies**

The audit expectation gap is well researched, and its existence confirmed in the context of public, listed companies (cf. 2.2). In this study, it was argued that the audit expectation gap in the private company context may differ from the public company context given that the users of audited financial statement users for private companies

are different (cf. 2.4) and the nature of the audit service differs to some extent (cf. 2.3). To emphasise the relevance of the study and to enable readers, particularly auditors of private companies, to adapt their approach to audit and to breach (or at least narrow) the audit expectation gap, this section presents a visual comparison between the contributors to the audit expectation gap in public, listed companies and private companies.

**Figure 7: Comparison of contributors to the audit expectation gap in public, listed companies versus private companies**



Source: Compiled by the researcher

a. Contributors to the audit expectation gap unique to public, listed companies

The expectation that auditors should detect all fraud is the most common contributor to the audit expectation gap in the context of public, listed companies. In addition to this, users of public, listed company financial statements interpret an unmodified auditor's report as a confirmation that the company is, in fact, a good investment. (Cf. 2.2.3). While auditors are required to assess and respond to the risk of fraud, these requirements recognise the limitations of an audit and, therefore, do not require of auditors to detect all fraud. There is also no requirement of auditors to confirm that a company is a good investment. Audited financial statements merely enable investors to make informed decisions.

The users of private company financial statements do not share these expectations,

as their expectations regarding fraud and whether a company is a good investment align with the requirements of auditors according to applicable audit requirements (cf. 4.4.1 and 4.4.4).

b. Contributors to the audit expectation gap common in public, listed companies which partially apply to private companies

Certain expectations known to be present in public, listed companies, partially applied to private companies as well, although not entirely. These expectations include the detection of all errors in the financial statements, and preventing company failure by confirming that an audited company is, in fact, a going concern.

In the public, listed company context, it is reported in the literature that users of financial statements expect of auditors to detect all errors in the financial statements (thereby providing absolute assurance), while applicable audit requirements only require of auditors to detect material errors in the financial statements, while recognising the limitations of an audit (requiring reasonable assurance) (cf. 2.2.3). Users of audited private company financial statements, however, differentiated between the underlying accounting records and the financial statement preparation process (the transferring of accounting data to the financial statements). These users recognise the limitations of an audit in that auditors cannot necessarily detect all errors in the underlying accounting records. In this area, their expectations align with applicable audit requirements as they only expect of auditors to detect material errors. However, these users expect of auditors to detect all errors in the transfer of accounting data to the final set of financial statements, which is not aligned with applicable audit requirements (still focusing only on material errors), thereby contributing to the audit expectation gap (cf. 4.4.2).

In addition, while users of public, listed company financial statements also expect of auditors to prevent company failure by confirming that the company is a going concern (cf. 2.2.3), this is not the expectation in the context of private companies. Users of audited private company financial statements do, however, expect of auditors to play an advisory role in how to prevent company failure when they detect indicators that the company may struggle to continue as a going concern (cf. 4.4.3). While applicable

audit requirements require of auditors to identify material uncertainty about a company's ability to continue as a going concern, there is no requirement of auditors to play an advisory role in such instances.

c. Contributors to the audit expectation gap in both public, listed companies and private companies

Users of both private and public, listed company financial statements interpret an unmodified auditor's report as confirmation that the company has complied with all laws and regulations applicable to the company and that all internal controls within the company are sufficient and effective (cf. 2.2.3, 4.4.5 and 4.4.6).

Both of these expectations exceed the requirements of auditors in accordance with applicable audit requirements. Auditors are required to confirm compliance with laws and regulations with a direct effect on the financial statements, while they are only required to perform limited procedures to detect possible non-compliance with other laws and regulations. Auditors have no requirement to confirm whether internal controls are sufficient and effective and are merely required to communicate deficiencies in the internal control environment should they elect to test certain controls and detect such deficiencies throughout the course of the audit. These areas therefore contribute to the audit expectation gap in both company categories.

d. Contributors to the audit expectation gap unique to private companies

The misunderstanding or lower expectation of auditor independence by users has not been proved in the context of public, listed companies. In addition, the following expectations were also identified in this study which are either unique to private companies or have not been tested/proven in the context of public, listed companies:

- Auditors should play an advisory role in various areas of private companies' business;
- Auditors should assist in resolving agency conflict within private companies;
- The audit process should provide reassurance to management that their work

is good and accurate;

- The audit should provide a safety net for those issues or misstatements that management may miss;
- Management and Shareholders should have an open line to the technical expertise and general advice of the auditor;
- Auditors should share opportunities and best practices with private companies to help them improve and grow.

The above expectations were addressed in detail in the previous section (cf. 5.2.2). While there is no literature available to support whether these expectations are also present in the public, listed company context, it is not claimed that these expectations may not, in fact, be present. As most research done on the audit expectation gap was of a quantitative nature, it may be that these factors were merely not tested, and it is therefore recommended as an area for future research.

In the following section, recommendations are provided on how to address the audit expectation gap in practice in the private company context.

### **5.3. Implications – recommendations for practice**

Humphrey, Moizer and Turley (1992) suggested two categories of responses to the audit expectation gap, aiming to reduce the gap. The first strategy is the defensive approach, which focuses on educating and reassuring users of financial statements, while the other is the constructive approach, which addresses the willingness of the auditing profession to adapt to public expectations or concerns. Although eliminating the audit expectation gap may not be possible, previous studies have shown that the answer might lie in narrowing the audit expectation gap from both sides – i.e. from both the auditor and the users of financial statements (Ruhnke and Schmidt, 2014). One of the primary roles of the auditor is to protect the public interest (South Africa, 2005). Accordingly, the audit profession needs to recognise that it also has a role to play in reducing the audit expectation gap and that it needs to adapt to changes in the economy and technology.

In 5.4, it is recommended that further research be conducted into the response strategies that can be employed to address the contributors to the audit expectation gap identified in this study. Several suggestions are provided in this section, addressing both recommendations for the defensive approach and the constructive approach.

### **5.3.1. Independence (including advisory services and resolving agency conflict)**

While users of audited private company financial statements value auditor independence, management and shareholders seem to not recognise when independence is compromised. This is often at the cost of external stakeholders, possibly relying on the 'independent' auditor's report for decision-making.

It is therefore important for auditors to have discussions with their clients on independence and, in particular, how their expectations of auditors to play various advisory roles and resolve agency conflict would compromise this independence.

Management and shareholders (and their knowledge gap) are, however, not the only ones to blame when auditors are not independent, as it is auditors who are bound by a code of ethics requiring them to be independent. When they are not independent of their audit clients, this is unlikely due to a lack of knowledge (in which case, incompetence could be argued), but rather a decision not to apply the guidance of their code of ethics (in which case a lack of integrity could be argued). This study did not focus on the 'Performance Gap' component of the audit expectation gap and therefore did not test how auditors responded to the threat to independence present in private companies. Independence, however, is subjective and auditors, who are directly influenced by the business decision of accepting or retaining audit clients, would naturally be inclined to lean towards their own favour when assessing their independence of an audit client in a borderline case.

The IESBA Code of Ethics and its Independence Standards, however, leave much of their **guidance** to the discretion of the auditor as most **requirements** of the Code are focused on Public Interest Entities alone. One of the recommended approaches to

respond to and address threats to independence, is the application of the ‘reasonable and informed third-party test’, whereby auditors consider whether another party (with a similar background and experience, having access to the same information) would be likely to reach the same conclusion as the auditor (IESBA, 2022).

A recommended constructive approach to address this challenge is to make guidance for non-Public Interest Entities in the code of ethics clearer in the form of **requirements**, rather than leaving most judgement calls to the auditor. Alternatively, audit firms could invest in an ‘independence advisor’ (as a reasonable and informed third party) who, independently of the firm, assesses whether the audit firm, the registered auditor and the audit team are, in fact, independent of every client.

### **5.3.2. Laws and regulations, Internal Control and Detection of Errors**

Auditors could have discussions with their clients on what their responsibility entails in terms of compliance with laws and regulations, effectiveness of internal controls and errors in the financial statements. This is, again, part of the defensive approach to narrow the audit expectation gap.

The following recommendations, which were identified during the interviews with participants, are presented for consideration in following a constructive approach:

- While not all laws and regulations are of audit importance, auditors could test and express an opinion on the controls in place to ensure compliance with laws and regulations. This will, however, require an adjustment to ISA 250 and would impact the size of the audit fee.
- Auditors could compile industry-specific lists of laws and regulations that their clients should comply with, and perform limited procedures on a sampling or rotation basis to test compliance, as recommended by one participant (cf. 4.4.6). This will, again, require an adjustment to ISA 250 and would impact the size of the audit fee.
- The IRBA as audit regulator in South Africa could consider implementing requirements similar to the Sarbanes Oxley Act in the United States of America, requiring auditors to express an opinion on the effectiveness of an entity’s internal control environment. This would require an amendment to the

auditing standards and/or the Auditing Profession Act and would impact the size of the audit fee.

- Auditors and standard-setters could differentiate between errors in the financial data versus errors in the transfer of financial data to the financial statements, requiring a higher level of assurance on the latter. This would, again, require adjustments to auditing standards and would impact the size of the audit fee.

It should, however, be noted that users of private company financial statements might alter their expectations in the above-mentioned areas when they are educated thereon and realise what the impact on audit fees would be, should changes be made to accommodate these expectations. It is therefore recommended that the defensive approach is adopted before the constructive recommendations are followed.

### **5.3.3. General**

During the interviews conducted in this study, it became evident that members of management and shareholders who do not have a finance background often felt excluded from discussions and left to their own fate in obtaining an understanding of the financial position, challenges and recommendations made by the auditor. While it may be assumed by auditors that these participants are not interested in the financial matters, this appeared not to be the case. These participants wanted to understand matters surrounding the company's finances and the audit, but often did not want to ask the questions out of fear of embarrassment and wasting others' time.

It is, therefore, recommended that auditors spend time with these individuals in particular to also educate them (as valid users of financial statements) in a pro-active attempt to narrow the audit expectation gap. Alternatively, companies themselves could invest in training for these individuals (either presented by their own finance staff or an outside professional). These individuals would be more likely to embrace and "buy into" an audit if they have a better understanding of its value and what it entails.

## 5.4. Recommendations for future research

The following recommendations are made for future research in the field of private company audits and/or the audit expectation gap:

- The study can be replicated in other South African provinces or other countries to provide data that is representative of a greater geographical area.
- A quantitative study on the audit expectation gap in private companies could be done, informed by the data in this study, to enable findings to be generalisable.
- Perform research on the 'Performance Gap' component of the audit expectation gap, with specific reference to auditor independence and how this is approached in the context of private companies. Auditors, in some cases, actually delivered on the higher expectations of participants by performing beyond what is required of them. These expectations still contribute to the 'Evolution Gap' component of the audit expectation gap (cf. Figure 3 in 1.1.1), which is the focus of this study. It is, however, possible that, because auditors often deliver on these expectations, their performance could reduce the audit expectation gap as a whole, and specifically the 'Performance Gap' component, but this could also negatively affect auditor independence. This questions the positioning of the 'Performance Gap' for private companies which can be further explored.
- Research the viability of the recommendations made by participants in this study on what they would like auditors to do differently or where the audit service can improve. These recommendations are presented in APPENDIX F: Recommendations from Participants.
- Replicate this qualitative study to public, listed companies as most studies in this context were of a quantitative nature. This could provide a deeper understanding of the expectations of users of public, listed company financial statements, while also providing insights on how results from quantitative and qualitative studies could compare.

## 5.5. Limitations of the study

The following limitations to the study were identified and should be considered when interpreting and utilising the findings made and conclusions reached:

- The study is conducted in the Free State province, of South Africa only and findings may not provide a representative view.
- The total population for the Management and Shareholder group could not be identified as it was not possible to obtain a complete list of audited private companies. It was, therefore, not possible to make use of purposive sampling to identify relevant participants in this group and convenience sampling was used as an alternative.
- Limited participants who are shareholders of audited private companies but not involved in the management of these companies could be identified. The number of Shareholder participants interviewed in this study is smaller than the recommended number of participants in each category of participants in qualitative studies. The data from interviews with Shareholders were, however, included in the findings from the Management and Shareholder group.
- Limited additional users of audited private company financial statements were identified, but not included in this study. These users included labour unions, core suppliers and issuers of tenders/contracts. It is argued that these users do not have frequent, legal access to private company financial statements, but views from these users could potentially provide valuable data.
- The nature of the study's findings is temporal. As the study tests the perceptions and expectations of financial statement users, it is recognised that these perceptions and expectations may change over time as participants' experience with auditors and the audit service, and their knowledge, change. The audit expectation gap phenomenon may also evolve as time progresses and it may, therefore, be necessary to continuously investigate the expectations of users of audited private company financial statements and the phenomenon itself.

## 5.6. Value of the study

In 2021, the IRBA submitted the following comment to the IAASB:

*“...each component – the “knowledge gap”, the “performance gap” and the “evolution gap” – contributes to the audit expectation gap in a significant manner.*

*The “evolution gap” is a common concern shared by regulators and those charged with governance. Concerns raised include whether the audit product and, consequently, the standards that support the audit product are evolving at the same pace as business; and whether they can keep up with the evolving business models, information systems and accounting standards that are more judgement- and estimation-based today than they were a few years ago.” (IAASB, 2021b)*

No doubt exists that the audit expectation gap remains a relevant and concerning phenomenon – especially the “evolution gap” component, which was the focus of this study. Standard setters, professional bodies, regulators and other researchers have, however, continued to investigate this phenomenon only in the context of public, listed companies, and understandably so. Public, listed companies are of significant public interest and the consequences of the audit expectation gap in this context are far-reaching.

This study argued that, although private companies may be of lesser public interest, the impact that private companies have on the economy, not only in South Africa, but also globally, is significant. Data obtained from the CIPC (2020) indicated that 3.6 million of 4 million companies (excluding close corporations) in South Africa are private companies. Detailed statistics on private companies, as well as their impact on the South African economy, are however not available. However, the International Finance Corporation (2021) issued a report stating that smaller enterprises in South Africa contribute approximately 35 percent to the country’s GDP and constitute over 90 percent of all formalised businesses, while they employ between 50 and 60 percent of the country’s workforce.

It is recognised that many of these small and medium-sized entities are not necessarily audited private companies, but it would be reasonable to submit that it includes many

of them. In South Africa, to be categorised as a medium-sized entity, an entity can employ up to 250 employees and record a turnover of up to R220 million (Connect Space, 2023); companies of this size are undoubtedly mandated to be audited. There are also multiple private companies that exceed the threshold to be classified as medium-sized entities, arguing that the impact of private companies on the South African economy could be much more than the statistics provided on small and medium-sized entities alone.

Internationally, the World Bank (2023) reports that small and medium-sized companies contribute more than 50 percent to employment and represent more than 90 percent of all businesses. In emerging economies, like South Africa, they often contribute more than 40 percent to the country's gross domestic product.

The collective impact of private companies on the South African economy and globally is not only notable, but substantial, and not investigating the audit expectation gap in a private company context would be an oversight.

It was established in this study that the audit expectation gap in the private company context differs substantially from public, listed companies, primarily due to the difference in the nature of its financial statement users and the nature of the audit service itself. It, therefore, emphasised that findings from studies investigating the audit expectation gap in the public, listed company context cannot be generalised to private companies.

This study provides valuable data to registered auditors, professional accountancy bodies and audit regulators on the contributors to the audit expectation gap in private companies, enabling them to form an appropriate response strategy.

The audit profession has been under scrutiny for a number of years with various contributing factors. In response to the introduction of the Auditing Profession Amendment Act, 2021, South Africa finance minister at the time, Tito Mboweni, commented: "At the core, the centre of the bill is a need for us to restore the ethical, moral, and integrity levels of the accounting and auditing profession... Once doubt is cast on the accounting and auditing profession, then you know we are in serious trouble" (Davis, 2020).

While this study may not address, or even come close to solving all the difficulties faced by the auditing profession, it aims to provide one step in the right direction by better understanding the differences between users' expectations and what is required from auditors.

***“It’s worth remembering that it is often the small steps, not the giant leaps, that bring about the most lasting change.”***

**The late Queen Elizabeth II**

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## **APPENDIX A**

### ***Ethics Committee Approval Letter***

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**GENERAL/HUMAN RESEARCH ETHICS COMMITTEE (GHREC)**

03-Aug-2022

Dear Mrs Ane Church

**Application Approved**

Research Project Title:

**The Audit Expectation Gap: A Private Company Perspective**

Ethical Clearance number:

**UFS-HSD2022/0210/22**

We are pleased to inform you that your application for ethical clearance has been approved. Your ethical clearance is valid for twelve (12) months from the date of issue. We request that any changes that may take place during the course of your study/research project be submitted to the ethics office to ensure ethical transparency. Furthermore, you are requested to submit the final report of your study/research project to the ethics office. Should you require more time to complete this research, please apply for an extension. Thank you for submitting your proposal for ethical clearance; we wish you the best of luck and success with your research.

Yours sincerely

**Dr Adri Du Plessis**

**Chairperson: General/Human Research Ethics Committee**

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**APPENDIX B**  
*Interview Guides*

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## Research Project to be submitted in fulfilment of the degree of Master of Accounting with Specialisation in Auditing

# THE AUDIT EXPECTATION GAP: A PRIVATE COMPANY PERSPECTIVE

University of the Free State Ethical Clearance Approval Number: UFS-HSD2022/0210/22

### *Interview Questions (Shareholders): Researcher's Copy*

## SECTION A: Introduction

Good morning/afternoon Sir/Madam

Thank you very much for your time and effort to participate in this study. I am Ané Church and I am currently enrolled for a Master's degree in Accounting with Specialisation in Auditing under the supervision of Prof Frans Prinsloo.

As you would have seen from the information provided to you prior to this interview, the objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs). The purpose of this interview is therefore to gather as much information as possible in order to obtain a deep understanding of your perceptions and experiences regarding the audit of your company. This information will be useful in determining whether an audit expectation gap exists in the private company sphere, and if so, what the extent thereof is.

Please be as open and honest as possible, taking comfort in the fact that your information will remain anonymous and confidential. Your participation remains voluntary, and you may withdraw at any time should you wish to do so. Should you agree thereto, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes will be made during the interview. Please refer to the *Research Study Information Leaflet and Consent Form* which was provided to you prior to our meeting. [*Point out the Confidentiality and Voluntary Participation sections within the form, as well as the section indicating that the interview will be recorded.*]

Thank you for completing the biographical and company information prior to this interview. This will assist greatly in analysing the data gathered during this study.

[*Start the recording the interview, if approved*]



## SECTION B: Interview Questions

The following interview questions serve to provide an understanding of the research participant's expectations from the auditors of private companies, without prompting certain topics or themes. Where responses are unclear, follow-up questions will be asked to clarify what the participant has said.

<b>SECTION B 1</b>	
1. Tell me more about your company structure and who the shareholders of your company are. <i>(Confirm the company on which the interview is based.)</i>	
2. Do you read the company's auditor's report, or do you just take comfort in the fact that an audit is done for the company?	
3. Who, in your view, are the users of the company's financial statements?	3.1 What would you say each of the identified users use the company's audited financial statements for?
4. What, in your view, is the purpose of an external audit of your company's financial statements?	
5. Rate your level of satisfaction with the service from the company's external auditor on a scale of 1 to 5 (with 1 being 'extremely dissatisfied' and 5 being 'extremely satisfied').  Please elaborate on your rating.	5.1 For ratings 1 to 4: Would you like your auditors to do more or less work than what they are currently doing? Or are you satisfied with the nature of the work that they currently perform?  <ul style="list-style-type: none"> <li>• If more: What would you like for your auditors to do in addition to their current service offering?</li> <li>• If less: What aspects of the auditor's current service offering do you think should not be undertaken? And why is this?</li> </ul>
6. Does your company get more from your auditors than just an Auditor's Report, i.e. are there other benefits/services obtained from your external auditors? If yes, please elaborate.	6.1 What would you regard as the biggest benefit of having the audit done?
7. In the Biographical and Company Information, you indicated that the company's audit is mandatory/voluntary. <sup>1</sup>	7.1 If mandatory: If the company was not mandated to be audited, would you have supported the need for an audit? Please elaborate.  7.2 If voluntary: Why does your company choose to have an audit done?
8. In the Biographical and Company Information, you indicated that the company auditors are [insert firm name].	8.1 If it is a Big4 audit firm: Why did your company choose a Big4 audit firm? Do you think that there are additional benefits to appointing a Big 4 audit firm? Please elaborate.  8.2 If it is a non-Big4 audit firm: Why did you choose [insert firm name] (which is a mid-tier/smaller audit firm)? Do you think that there are additional benefits to appointing a mid-tier/smaller audit firm?

<sup>1</sup> Delete which option is not applicable.



9. As far as you know, does management/shareholders have any say/input in where the external auditor focuses their testing, who forms part of the audit team, etc.?	9.1 If yes: Please elaborate on the areas/factors of the audit that management/shareholders may influence.
	9.2 If no: Would you like to have input in these matters? Please elaborate.

The interview questions and statements in Sections B 2 and 3 and C were informed by the literature and relate to areas typically identified as ones contributing to the audit expectation gap in general.

<b>SECTION B 2</b>				
<b>For each of the following statements, please indicate whether you agree or disagree, by making use of the following 4-point scale:</b>				
	1 Completely Disagree	2 Somewhat Disagree	3 Somewhat Agree	4 Completely Agree
1. Auditors are responsible for detecting all <b>fraud</b> that is perpetrated within the companies which they audit.				
1.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
1.2 Do you think that auditors should be responsible for detecting all fraud? Please elaborate.				
1.3 If yes: Would you be willing to pay more for auditors taking on this responsibility for detecting <b>all</b> fraud?				
2. Auditors are responsible for detecting all <b>errors</b> in the financial statements of the companies which they audit.				
2.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
2.2 Do you think that auditors should be responsible for detecting all errors in the financial statements? Please elaborate.				
2.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of detecting <b>all</b> errors in the financial statements?				
3. Auditors are responsible for preventing company failure (i.e. ensuring that the company is a <b>going concern</b> ).				
3.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
3.2 Do you think that auditors <b>should be</b> responsible for preventing company failure? Please elaborate.				
3.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of preventing company failure?				
4. Auditors are responsible for determining whether the companies which they audit are <b>good investments</b> .				
4.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				



4.2 Do you think that auditors should be responsible for determining whether your company is a good investment? Please elaborate.				
4.3 If yes: Would you be willing to pay more for auditors taking on this responsibility to determine whether your company is a good investment?				
5. Auditors are responsible for confirming whether <b>all internal controls</b> within the companies which they audit are effective.				
5.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
5.2 Do you think that auditors should be responsible for determining whether all internal controls within your company are effective? Please elaborate.				
5.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of determining whether all internal controls are effective?				
6. Auditors are responsible for confirming that the companies which they audit are complying with <b>all laws and regulations</b> applicable to those companies.				
6.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
6.2 Do you think that auditors should be responsible for confirming that your company is complying with all laws and regulations relevant to your company? Please elaborate.				
6.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of confirming compliance with all laws and regulations relevant to your company?				

<b>SECTION B 3</b>	
1. Does an audit help to minimize disagreements/conflict between different stakeholder groups in your company (i.e. agency conflict)? Please elaborate.	
2. Do you have any insights as to whether having an external audit done leads to fewer tax queries from SARS and therefore to greater tax credibility for your company? Please elaborate.	
3. Do you have any insights as to whether your company obtains finance from banks or other providers of finance (other than shareholders)?	3.1 If banks: <ul style="list-style-type: none"> <li>• Which bank is your company's primary bank?</li> <li>• Does your bank require your company to submit its audited financial statements from time to time?</li> <li>• Does your company get easier access to finance/better interest rates by submitting an unmodified/clean auditor's report to the bank?</li> </ul>
	3.2 If other providers of finance: <ul style="list-style-type: none"> <li>• Where does your company obtain finance from?</li> <li>• Is your company required to provide audited financial statements to the finance provider from time to time?</li> <li>• Does your company get easier access to finance/better interest rates by submitting an unmodified/clean auditor's report to the finance provider?</li> </ul>



4. Do you have any insights as to whether the company's management gains access to expertise and good business advice by having an audit done?

### **SECTION C**

Is there anything else that you would like to comment on in relation to the audit services provided to private companies?

Thank you for your time and willingness to participate in this study; it would not be possible without your contribution.

Would you like a report of key findings from this study?

Yes

No

You are welcome to contact me for any reason related to this study at [ChurchA2@ufs.ac.za](mailto:ChurchA2@ufs.ac.za) or 082 772 6373.





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## Research Project to be submitted in fulfilment of the degree of Master of Accounting with Specialisation in Auditing

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# THE AUDIT EXPECTATION GAP: A PRIVATE COMPANY PERSPECTIVE

University of the Free State Ethical Clearance Approval Number: UFS-HSD2022/0210

### *Interview Questions (Management): Researcher's Copy*

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## SECTION A: Introduction

Good morning/afternoon Sir/Madam

Thank you very much for your time and effort to participate in this study. I am Ané Church and I am currently enrolled for a Master's degree in Accounting with Specialisation in Auditing under the supervision of Prof Frans Prinsloo.

As you would have seen from the information provided to you prior to this interview, the objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs). The purpose of this interview is therefore to gather as much information as possible in order to obtain a deep understanding of your perceptions and experiences regarding the audit of your employing company. This information will be useful in determining whether an audit expectation gap exists in the private company sphere, and if so, what the extent thereof is.

Please be as open and honest as possible, taking comfort in the fact that your information will remain anonymous and confidential. Your participation remains voluntary, and you may withdraw at any time should you wish to do so. Should you agree thereto, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes will be made during the interview. Please refer to the *Research Study Information Leaflet and Consent Form* which was provided to you prior to our meeting. [*Point out the Confidentiality and Voluntary Participation sections within the form, as well as the section indicating that the interview will be recorded*]

Thank you for completing the biographical and company information prior to this interview. This will assist greatly in analysing the data gathered during this study.

[*Start the recording the interview, if approved*]



## SECTION B: Interview Questions

The following interview questions serve to provide an understanding of the research participant's expectations from the auditors of private companies, without prompting certain topics or themes. Where responses are unclear, follow-up questions will be asked to clarify what the participant has said.

<b>SECTION B 1</b>	
1. Tell me more about your company structure and who the shareholders of your company are. <i>(Confirm the company on which the interview is based.)</i>	
2. Do you read the company's auditor's report, or do you just take comfort in the fact that an audit is done for the company?	
3. Who are the users of the company's financial statements?	3.1 What would you say each of the identified users use the company's audited financial statements for?
4. What, in your view, is the purpose of an external audit of your company's financial statements?	
5. Rate your level of satisfaction with the service from your external auditor on a scale of 1 to 5 (with 1 being 'extremely dissatisfied' and 5 being 'extremely satisfied').  Please elaborate on your rating.	5.1 For ratings 1 to 4: Would you like your auditors to do more or less work than what they are currently doing? Or are you satisfied with the nature of the work that they currently perform? <ul style="list-style-type: none"> <li>• If more: What would you like your auditors to do in addition to their current service offering?</li> <li>• If less: What aspects of the auditor's current service offering do you think should not be undertaken? And why is this?</li> </ul>
6. Do you get more from your auditors than just an Auditor's Report, i.e. are there other benefits/services obtained from your external auditors? If yes, please elaborate.	6.1 What would you regard as the biggest benefit of having the audit done? 6.2 Do you receive, and make use of, a management report with detailed findings from your auditors?
7. In the Biographical and Company Information, you indicated that the company's audit is mandatory/voluntary <sup>1</sup> .	7.1 If mandatory: If the company was not mandated to be audited, would you have supported the need for an audit? Please elaborate. 7.2 If voluntary: Why does your company choose to have an audit done?
8. In the Biographical and Company Information, you indicated that the company auditors are [insert firm name].	8.1 If it is a Big 4 audit firm: Why did your company choose a Big 4 audit firm? Do you think that there are additional benefits to appointing a Big 4 audit firm? Please elaborate. 8.2 If it is a non-Big 4 audit firm: Why did you choose [insert firm name] (which is a mid-tier/smaller audit firm)? Do you think that there are additional benefits to appointing a mid-tier/smaller audit firm?

<sup>1</sup> Delete which option is not applicable.



9. Does management have any say/input in where the external auditor focuses their testing, who forms part of the audit team, etc.?	9.1 If yes: Please elaborate on the areas/factors of the audit that management may influence.
	9.2 If no: Would you like to have input in these matters? Please elaborate.

The interview questions and statements in Sections B 2 and 3 and C were informed by the literature and relate to areas typically identified as ones contributing to the audit expectation gap in general.

<b>SECTION B 2</b>				
<b>For each of the following statements, please indicate whether you agree or disagree, by making use of the following 4-point scale:</b>				
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1. Auditors are responsible for detecting all <b>fraud</b> that is perpetrated within the companies which they audit.				
1.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
1.2 Do you think that auditors <b>should be</b> responsible for detecting all fraud? Please elaborate.				
1.3 If yes: Would you be willing to pay more for auditors taking on this responsibility for detecting <b>all</b> fraud?				
(Repeat rating scale)				
2. Auditors are responsible for detecting all <b>errors</b> in the financial statements of the companies which they audit.				
2.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
2.2 Do you think that auditors should be responsible for detecting all errors in the financial statements? Please elaborate.				
2.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of detecting <b>all</b> errors in the financial statements?				
3. Auditors are responsible for preventing company failure (i.e. ensuring that the company is a <b>going concern</b> ).				
3.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
3.2 Do you think that auditors <b>should be</b> responsible for preventing company failure? Please elaborate.				
3.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of preventing company failure?				
4. Auditors are responsible for determining whether the companies which they audit are <b>good investments</b> .				
4.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				



4.2 Do you think that auditors should be responsible for determining whether your company is a good investment? Please elaborate.				
4.3 If yes: Would you be willing to pay more for auditors taking on this responsibility to determine whether your company is a good investment?				
5. Auditors are responsible for confirming whether <b>all internal controls</b> within the companies which they audit are effective.				
5.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
5.2 Do you think that auditors should be responsible for determining whether all internal controls within your company are effective? Please elaborate.				
5.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of determining whether all internal controls are effective?				
6. Auditors are responsible for confirming that the companies which they audit are complying with <b>all laws and regulations</b> applicable to those companies.				
6.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
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6.3 If yes: Would you be willing to pay more for auditors taking on this responsibility of confirming compliance with all laws and regulations relevant to your company?				

<b>SECTION B 3</b>	
1. Does an audit help to minimize disagreements/conflict between different stakeholder groups in your company (i.e. agency conflict)? Please elaborate.	
2. Does having an external audit done in your view lead to fewer tax queries by SARS and therefore to greater tax credibility for your company? Please elaborate.	
3. Does your company obtain finance from banks and/or other providers of finance (other than shareholders)?	3.1 If banks: <ul style="list-style-type: none"> <li>• Which bank is your company's primary banker?</li> <li>• Does your bank require your company to submit its audited financial statements from time to time?</li> <li>• Does your company get easier access to finance/better interest rates by submitting an unmodified/clean auditor's report to the bank?</li> </ul>
	3.2 If other providers of finance: <ul style="list-style-type: none"> <li>• Where does your company obtain finance from?</li> <li>• Is your company required to provide audited financial statements to the finance provider from time to time?</li> <li>• Does your company get easier access to finance/better interest rates by submitting an unmodified/clean auditor's report to the finance provider?</li> </ul>



4. Do you / your company gain access to expertise and good business advice by having an audit done?

### **SECTION C**

Is there anything else that you would like to comment on in relation to the audit services provided to private companies?

Thank you for your time and willingness to participate in this study; it would not be possible without your contribution.

Would you like a report of key findings from this study?

Yes

No

You are welcome to contact me for any reason related to this study at [ChurchA2@ufs.ac.za](mailto:ChurchA2@ufs.ac.za) or 082 772 6373.





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## Research Project to be submitted in fulfilment of the degree of Master of Accounting with Specialisation in Auditing

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# THE AUDIT EXPECTATION GAP: A PRIVATE COMPANY PERSPECTIVE

University of the Free State Ethical Clearance Approval Number: UFS-HSD2022/0210/22

### *Interview Questions (Banking Institutions): Researcher's Copy*

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## SECTION A: Introduction

Good morning/afternoon Sir/Madam

Thank you very much for your time and effort to participate in this study. I am Ané Church and I am currently enrolled for a Master's degree in Accounting with Specialisation in Auditing under the supervision of Prof Frans Prinsloo.

As you would have seen from the information provided to you prior to this interview, the objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs). The purpose of this interview is therefore to gather as much information as possible in order to obtain a deep understanding of your perceptions and experiences regarding the use/value of auditor reports accompanying financial statements. This information will be useful in determining whether an audit expectation gap exists in the private company sphere, and if so, what the extent thereof is.

Please be as open and honest as possible, taking comfort in the fact that your information will remain anonymous and confidential. Your participation remains voluntary, and you may withdraw at any time should you wish to do so. Should you agree thereto, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes will be made during the interview. Please refer to the *Research Study Information Leaflet and Consent Form* which was provided to you prior to our meeting. *[Point out the Confidentiality and Voluntary Participation sections within the form, as well as the section indicating that the interview will be recorded.]*

Thank you for completing the biographical and company information prior to this interview. This will assist greatly in analysing the data gathered during this study.

*[Start the recording the interview, if approved]*



## SECTION B: Interview Questions

The following interview questions serve to provide an understanding of the research participant's expectations from the auditors of private companies, without prompting certain topics or themes. Where responses are unclear, follow-up questions will be asked to clarify what the participant has said.

<b>SECTION B 1</b>	
In the personal and company information provided prior to today's interview, you indicated that your company [ <i>requires/does not require/sometimes require</i> ] <sup>1</sup> private companies to submit audited financial statements when applying for finance.	
<b>If audited financial statements are always required:</b>	
1. What, in your view, is the purpose of an external audit of a private company's financial statements?	
2. Why do you require private companies to submit audited financial statements?	
3. Do you read the auditor's report, or do you just take comfort in the fact that an audit is done?	3.1 Read the report: What is the consequence if a private company applies for finance and the audit opinion is modified (i.e. it is not a 'clean' audit report)?  3.2 Take comfort: Would you agree or disagree with the following statement: "The auditor's opinion does not matter as long as an audit is performed."
4. Would you like for auditors to disclose more information in the auditor's report than what it currently contains?	4.1 If yes: What type of information would you like for auditors to disclose?  4.2 If no: <i>Continue to next question.</i>
5. What is the consequence if a private company applies for finance, and it does not submit <b>audited</b> annual financial statements?	
6. If a private company applies for finance and submits audited financial statements with an unmodified auditor's report (i.e. a 'clean' auditor's report), would this aid in your company approving any of the following: <ul style="list-style-type: none"> <li>• Lower interest rates AND/OR</li> <li>• Higher credit limits AND/OR</li> <li>• Higher loan amounts?</li> </ul>	
7. Does it matter who the auditor of the private company applying for finance is? Do you differentiate between Big4 audit firms and non-Big4 firms for purposes of granting finance based on audited financial statements?	7.1 If Big4 matters: Why does it matter whether the company's auditor is a Big 4 audit firm? Do you think that there is an additional benefit? Please elaborate.  7.2 If Big4 does not matter: <i>Continue to next question.</i>

<sup>1</sup> Delete whichever is not applicable.



<b>If audited financial statements are sometimes required:</b>	
1. What, in your view, is the purpose of an external audit of a private company's financial statements?	
2. When do you require private companies to submit audited financial statements?	
3. Why do you require certain private companies to submit audited financial statements?	
4. When/in what instances do you require private companies to submit financial statements?	4.1 When/in what instance do you require these financial statements to be audited?
5. Do you read the auditor's report, or do you just take comfort in the fact that an audit is done?	5.1 Read the report: What is the consequence if a private company applies for finance and the audit opinion is modified (i.e. it is not a 'clean' audit report)?
	5.2 Take comfort: Would you agree or disagree with the following statement: "The auditor's opinion does not matter as long as an audit is performed."
6. Would you like for auditors to disclose more information in the auditor's report than what it currently contains?	6.1 If yes: What type of information would you like for auditors to disclose?
	6.2 If no: <i>Continue to next question.</i>
7. What is the consequence if a private company applies for finance, and it does not submit <b>audited</b> annual financial statements when you would typically require them to do so?	
8. If a private company applies for finance and submits audited financial statements with an unmodified auditor's report (i.e. a 'clean' auditor's report), would this aid in your company approving any of the following: <ul style="list-style-type: none"> <li>• Lower interest rates AND/OR</li> <li>• Higher credit limits AND/OR</li> <li>• Higher loan amounts?</li> </ul>	
9. Does it matter who the auditor of the private companies applying for finance is? Do you differentiate between Big4 firms and non-Big4 firms?	9.1 If Big4 matters: Why does it matter whether the company's auditor is a Big 4 firm? Do you think that there is an additional benefit? Please elaborate.
	9.2 If Big4 does not matter: <i>Continue to next question.</i>



If audited financial statements are not required:	
1. What, in your view, is the purpose of an external audit of a private company's financial statements?	
2. Why do you not require private companies to submit audited financial statements?	
3. Do you require private companies to submit financial statements, even if it is unaudited? Why?	
4. If auditors were to disclose more information in their auditor's reports than what they currently report, would you then require companies that you finance to submit audited financial statements?	4.1 If yes: What type of information would you like auditors to disclose in their auditors' reports?
	4.2 If no: <i>Continue to next question.</i>
5. If a private company applies for finance and submits <b>audited</b> financial statements with an unmodified auditor's report (i.e. a 'clean' auditor's report) even though this is not required, would this aid in your company considering any of the following (please elaborate):	
<ul style="list-style-type: none"> <li>• Lower interest rates AND/OR</li> <li>• Higher credit limits AND/OR</li> <li>• Higher loan amounts?</li> </ul>	

The interview questions and statements in Section B 2 were informed by the literature and relate to areas typically identified as ones contributing to the audit expectation gap in general.

<b>SECTION B 2</b>				
For each of the following statements, please indicate whether you agree or disagree, by making use of the following 4-point scale:				
	1 Completely Disagree	2 Somewhat Disagree	3 Somewhat Agree	4 Completely Agree
1. Auditors are responsible for detecting all <b>fraud</b> .				
1.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
1.2 Do you think that auditors should be responsible for detecting all fraud? Please elaborate.				
2. Auditors are responsible for detecting all <b>errors</b> in the financial statements.				
2.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
2.2 Do you think that auditors should be responsible for detecting all errors in the financial statements? Please elaborate.				
3. Auditors are responsible for determining whether the company is financially sound (a <b>going concern</b> ).				
3.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
3.2 Do you think that auditors should be responsible for determining whether a private company is financially sound? Please elaborate.				



4. Auditors are responsible for determining whether the company is a <b>good investment</b> .				
4.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
4.2 Do you think that auditors should be responsible for determining whether a private company is a good investment? Please elaborate.				
5. Auditors are responsible for confirming whether the company's <b>internal controls</b> are effective.				
5.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
5.2 Do you think that auditors should be responsible for determining whether a private company's internal controls are effective? Please elaborate.				
6. Auditors are responsible for confirming that the company is complying with all <b>laws and regulations</b> .				
6.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
6.2 Do you think that auditors should be responsible for confirming that a private company is complying with all laws and regulations? Please elaborate.				

### **SECTION C**

Is there anything else that you would like to comment on in relation to the audit services provided to private companies?

Thank you for your time and willingness to participate in this study; it would not be possible without your contribution.

Would you like a report of key findings from this study?

Yes	No
-----	----

You are welcome to contact me for any reason related to this study at [ChurchA2@ufs.ac.za](mailto:ChurchA2@ufs.ac.za) or 082 772 6373.





## Research Project to be submitted in fulfilment of the degree of Master of Accounting with Specialisation in Auditing

# THE AUDIT EXPECTATION GAP: A PRIVATE COMPANY PERSPECTIVE

University of the Free State Ethical Clearance Approval Number: UFS-HSD2022/0210

### *Interview Questions (SARS): Researcher's Copy*

## SECTION A: Introduction

Good morning/afternoon Sir/Madam

Thank you very much for your time and effort to participate in this study. I am Ané Church and I am currently enrolled for a Master's degree in Accounting with Specialisation in Auditing under the supervision of Prof Frans Prinsloo.

As you would have seen from the information provided to you prior to this interview, the objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs). The purpose of this interview is therefore to gather as much information as possible in order to obtain a deep understanding of your perceptions and experiences regarding the use/value of auditor reports accompanying financial statements. This information will be useful in determining whether an audit expectation gap exists in the private company sphere, and if so, what the extent thereof is.

Please be as open and honest as possible, taking comfort in the fact that your information will remain anonymous and confidential. Your participation remains voluntary, and you may withdraw at any time should you wish to do so. Should you agree thereto, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes will be made during the interview. Please refer to the *Research Study Information Leaflet and Consent Form* which was provided to you prior to our meeting. [*Point out the Confidentiality and Voluntary Participation sections within the form, as well as the section indicating that the interview will be recorded.*]

Thank you for completing the biographical and institutional information prior to this interview. This will assist greatly in analysing the data gathered during this study.

[*Start the recording the interview, if approved*]



## SECTION B: Interview Questions

The following interview questions serve to provide an understanding of the research participant's expectations from the auditors of private companies, without prompting certain topics or themes. Where responses are unclear, follow-up questions will be asked to clarify what the participant has said.

<b>SECTION B 1</b>													
In the <i>Personal and Institution Information</i> completed prior to this study, you indicated that SARS [requires/does not require/sometimes require] <sup>1</sup> private companies to submit audited financial statements.													
<b>If audited financial statements are required in all instances:</b>													
1. What, in your view, is the purpose of an external audit of a private company's financial statements?													
2. Why does SARS require private companies to submit audited financial statements?													
3. Do you read the auditor's report, or do you just take comfort in the fact that an audit is done?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px;">3.1 Read the report: What is the consequence if a private company submits financial statements with a modified audit opinion (i.e. it is not a 'clean' audit report)?</td> </tr> <tr> <td style="padding: 5px;">3.2 Take comfort: Would you agree or disagree with the following statement: "The auditor's opinion does not matter as long as an audit is performed."</td> </tr> </table>	3.1 Read the report: What is the consequence if a private company submits financial statements with a modified audit opinion (i.e. it is not a 'clean' audit report)?	3.2 Take comfort: Would you agree or disagree with the following statement: "The auditor's opinion does not matter as long as an audit is performed."										
3.1 Read the report: What is the consequence if a private company submits financial statements with a modified audit opinion (i.e. it is not a 'clean' audit report)?													
3.2 Take comfort: Would you agree or disagree with the following statement: "The auditor's opinion does not matter as long as an audit is performed."													
4. Would you like auditors to disclose more information in the auditor's report than what it currently contains?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px;">4.1 If yes: What type of information would you like auditors to disclose?</td> </tr> <tr> <td style="padding: 5px;">4.2 If no: <i>Continue to next question.</i></td> </tr> </table>	4.1 If yes: What type of information would you like auditors to disclose?	4.2 If no: <i>Continue to next question.</i>										
4.1 If yes: What type of information would you like auditors to disclose?													
4.2 If no: <i>Continue to next question.</i>													
5. What is the consequence if private companies do not submit <b>audited</b> financial statements?													
6. If a private company submits audited financial statements with an unmodified auditor's report (i.e. a 'clean' auditor's report), would this lead to any of the following:	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px;">6.1 Fewer tax adjustments?</td> <td style="padding: 5px;"> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px; text-align: center;">All instances</td> <td style="padding: 5px; text-align: center;">Some instances</td> <td style="padding: 5px; text-align: center;">No instances</td> </tr> </table> </td> </tr> <tr> <td style="padding: 5px;">6.2 Lower chance of being selected for a tax audit?</td> <td style="padding: 5px;"> <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px; text-align: center;">All instances</td> <td style="padding: 5px; text-align: center;">Some instances</td> <td style="padding: 5px; text-align: center;">No instances</td> </tr> </table> </td> </tr> <tr> <td style="padding: 5px;">6.3 Any other benefits to the taxpayer (please elaborate)?</td> <td></td> </tr> </table>	6.1 Fewer tax adjustments?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px; text-align: center;">All instances</td> <td style="padding: 5px; text-align: center;">Some instances</td> <td style="padding: 5px; text-align: center;">No instances</td> </tr> </table>	All instances	Some instances	No instances	6.2 Lower chance of being selected for a tax audit?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px; text-align: center;">All instances</td> <td style="padding: 5px; text-align: center;">Some instances</td> <td style="padding: 5px; text-align: center;">No instances</td> </tr> </table>	All instances	Some instances	No instances	6.3 Any other benefits to the taxpayer (please elaborate)?	
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All instances	Some instances	No instances											
6.3 Any other benefits to the taxpayer (please elaborate)?													
7. Does it matter who the auditor of the private company taxpayer is? Do you differentiate between Big4 firms and non-Big4 audit firms in your evaluation?	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="padding: 5px;">7.1 If Big4 matters: Why does it matter whether the company's auditor is a Big 4 audit firm? Do you think that there are additional benefits? Please elaborate.</td> </tr> <tr> <td style="padding: 5px;">7.2 If Big4 does not matter: <i>Continue to next question.</i></td> </tr> </table>	7.1 If Big4 matters: Why does it matter whether the company's auditor is a Big 4 audit firm? Do you think that there are additional benefits? Please elaborate.	7.2 If Big4 does not matter: <i>Continue to next question.</i>										
7.1 If Big4 matters: Why does it matter whether the company's auditor is a Big 4 audit firm? Do you think that there are additional benefits? Please elaborate.													
7.2 If Big4 does not matter: <i>Continue to next question.</i>													

<sup>1</sup> Delete which is not applicable.



If audited financial statements are sometimes required:				
1. What, in your view, is the purpose of an external audit of a private company's financial statements?				
2. When do you require private companies to submit audited financial statements?				
3. Why do you require certain private companies to submit audited financial statements?				
4. When/in what instances do you require private companies to submit financial statements?	4.1 When/in what instance do you require these financial statements to be audited?			
5. Do you read the auditor's report, or do you just take comfort in the fact that an audit is done?	5.1 Read the report: What is the consequence if a private company submits financial statements with a modified audit opinion (i.e. it is not a 'clean' audit report) to SARS?			
	5.2 Take comfort: Would you agree or disagree with the following statement: "The auditor's opinion does not matter as long as an audit is performed." Explain your view.			
6. Would you like auditors to disclose more information in the auditor's report than what it currently contains?	6.1 If yes: What type of information would you like auditors to disclose?			
	6.2 If no: <i>Continue to next question.</i>			
7. What is the consequence if private companies do not submit <b>audited</b> financial statements when SARS would typically require them to do so?				
8. If a private company submits audited financial statements with an unmodified auditor's report (i.e. a 'clean' auditor's report), would this lead to any of the following:	8.1 Fewer tax adjustments?			
	<table border="1"> <tr> <td>All instances</td> <td>Some instances</td> <td>No instances</td> </tr> </table>	All instances	Some instances	No instances
	All instances	Some instances	No instances	
8.2 Lower chance of being selected for a tax audit?				
	<table border="1"> <tr> <td>All instances</td> <td>Some instances</td> <td>No instances</td> </tr> </table>	All instances	Some instances	No instances
All instances	Some instances	No instances		
	8.3 Any other benefits to the taxpayer (please elaborate)?			
9. Does it matter who the auditor of the private company taxpayer is? Do you differentiate between Big4 firms and other audit firms in your evaluation?	9.1 If Big4 matters: Why does it matter whether the company's auditor is a Big 4 audit firm? Do you think that there are additional benefits? Please elaborate.			
	9.2 If Big4 does not matter: <i>Continue to next question.</i>			



If audited financial statements are never required:			
1. What, in your view, is the purpose of an external audit of a private company's financial statements?			
2. Why does SARS not require private companies to submit audited financial statements? Does SARS require them to submit financial statements, even if these are unaudited?			
3. If auditors were to disclose more information in their auditor's reports than what these reports currently contain, would you require them to submit audited financial statements?	3.1 If yes: What type of information would you like auditors to disclose?		
	3.2 If no: <i>Continue to next question.</i>		
4. If a private company submits audited financial statements with an unmodified auditor's report (i.e. a 'clean' auditor's report) even though it is not required, would this lead to any of the following:	4.1 Fewer tax adjustments?		
	All instances	Some instances	No instances
	4.2 Lower chance of being selected for a tax audit?		
	All instances	Some instances	No instances
	4.3 Any other benefits to the taxpayer (please elaborate)?		

The interview questions and statements in Section B 2 were informed by the literature and relate to areas typically identified as ones contributing to the audit expectation gap in general.

SECTION B 2				
For each of the following statements, please indicate whether you agree or disagree, by making use of the following 4-point scale:				
	1 Completely Disagree	2 Somewhat Disagree	3 Somewhat Agree	4 Completely Agree
1. Auditors are responsible for detecting all <b>fraud</b> that is perpetrated within the companies which they audit.				
1.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
1.2 Do you think that auditors should be responsible for detecting all fraud? Please elaborate.				
2. Auditors are responsible for detecting all <b>errors</b> in the financial statements of the companies which they audit.				
2.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
2.2 Do you think that auditors should be responsible for detecting all errors in the financial statements? Please elaborate.				



3. Auditors are responsible for preventing company failure (i.e. ensuring that the company is a <b>going concern</b> ).				
3.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
3.2 Do you think that auditors should be responsible for preventing company failure? Please elaborate.				
4. Auditors are responsible for determining whether the companies which they audit are <b>good investments</b> .				
4.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
4.2 Do you think that auditors should be responsible for determining whether a private company is a good investment? Please elaborate.				
5. Auditors are responsible for confirming whether <b>all internal controls</b> within the companies which they audit are effective.				
5.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
5.2 Do you think that auditors should be responsible for determining whether a private company's internal controls are effective? Please elaborate.				
6. Auditors are responsible for confirming that the companies which they audit are complying with <b>all laws and regulations</b> applicable to those companies.				
6.1 Please elaborate on your rating.				
<b>For ratings 1 – 3:</b>				
6.2 Do you think that auditors should be responsible for confirming that a private company is complying with all laws and regulations relevant to the companies which they audit? Please elaborate.				

### **SECTION C**

Is there anything else that you would like to comment on in relation to the audit services provided to private companies?

Thank you for your time and willingness to participate in this study; it would not be possible without your contribution.

Would you like a report of key findings from this study?

 Yes

 No

You are welcome to contact me for any reason related to this study at [ChurchA2@ufs.ac.za](mailto:ChurchA2@ufs.ac.za) or 082 772 6373.



## **APPENDIX C**

### ***Gatekeeper's Permission***

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## REQUEST FOR PERMISSION TO CONDUCT RESEARCH FROM GATEKEEPERS

[INSERT DATE]

Dear [INSERT NAME OF GATEKEEPER]

I am doing research and would like to request permission to conduct my research at [INSERT PRIVATE COMPANY NAME WHERE MEMBER OF MANAGEMENT IS EMPLOYED] by interviewing [PARTICIPANT'S NAME].

### TITLE OF THE RESEARCH PROJECT

The Audit Expectation Gap: A Private Company Perspective.

### PRINCIPAL INVESTIGATOR / RESEARCHER NAME AND CONTACT NUMBER(S):

Student: Ané Church

Student number: 2006029553

Contact number: 082 772 6373

### FACULTY AND DEPARTMENT:

Faculty of Economic and Management Sciences

School of Accountancy

### STUDY LEADER'S NAME AND CONTACT NUMBER:

Prof Frans Prinsloo (Supervisor)

083 676 2052

### WHAT IS THE AIM / PURPOSE OF THE STUDY?

The objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs).

In recent times, the audit profession has come under scrutiny. Not only were many audit failures encountered, but the audit profession has also been accused of being unresponsive to the changing world as well as to the needs of audit report users. Through this study, a positive contribution can be made to the audit profession, as identifying the expectations of these users could enable the audit profession to become more responsive, which highlights the importance of this study.

## WHO IS DOING THE RESEARCH?

I am Ané Church and I am currently employed as a lecturer in Auditing at the School of Accountancy, University of the Free State. I am also registered with the South African Institute of Chartered Accountants (SAICA) as a Chartered Accountant (SA), where I also serve on various committees/councils. I am enrolled for my Master's degree in Accounting, with specialisation in Auditing, which this study will enable me to complete.

## HAS THE STUDY RECEIVED ETHICAL APPROVAL?

This study has received approval from the Research Ethics Committee of the UFS. A copy of the approval letter can be obtained from the researcher.

**Approval number:** UFS-HSD2022/0210

## WHY IS YOUR COMPANY INVITED TO TAKE PART IN THIS RESEARCH PROJECT?

In order to determine whether an audit expectation gap exists in the private company sector, I need to determine what the expectations of the users of annual financial statements, and consequently auditor reports, are. Your company is an audited private company and your company's management would consequently be a rich source of information as a result of their experience with and expectations from auditors. I received your contact details from [INSERT NAME] in order to ask for your permission to interview [HIM/HER] as a part of management. Should you grant me permission to conduct this interview, [INSERT PARTICIPANT NAME] will be one of approximately 28 individuals interviewed for this study.

## WHAT IS THE NATURE OF PARTICIPATION IN THIS STUDY?

This study requires me to interview research participants by conducting semi-structured interviews. These interviews may take place online (by making use of MS Teams or Zoom) or in person, whichever the participant prefers. Should the research participant agree, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes of the interview will be made, although it should be noted that this may extend the duration of the interview. Prior to the interview, the research participant will be required to complete a digital form with biographical and company information which will enable me to categorise and analyse the data. The interview questions will relate to the research participant's experience with and expectations from auditors, as well as questions to determine who the users of the financial statements are. It is anticipated that the duration of the interview will be 45 to 60 minutes.

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

The audit profession has come under scrutiny over the past few years, with various role players questioning its value and whether the external audit of financial statements has evolved sufficiently to

address the needs of the users of financial statements. Most studies have, however, focussed on public and/or listed companies, but the findings of these studies are not necessarily generalisable to private companies. This study aims to determine what the expectations of private company financial statement users, and consequently auditor report users, are, with the hope that when these findings are shared, the external audit service to private companies will adapt where necessary. In the long run, it is hoped that this study will make the audits of private companies more fit for purpose.

### **WHAT ARE THE POTENTIAL RISKS TAKING PART IN THIS STUDY?**

The only risk identified for participants in this study is that the time spent during the interview may impose on work time and productivity. Should the participant or gatekeeper prefer, the interview could be scheduled during lunchtime or after hours to limit the interference caused.

### **WILL THE INFORMATION BE KEPT CONFIDENTIAL?**

The names of gatekeepers, research participants and companies will not be recorded anywhere in the research report and no one will be able to connect a person or company to the answers provided before or during the interview. Responses will be given a fictitious code number, or a pseudonym and your company will be referred to in this way in the data, any publications, or other research reporting methods such as conference proceedings. Therefore, a report of the study may also be submitted for publication, but individual participants will not be identifiable in such a report. Apart from the researcher/student, supervisor and co-supervisor mentioned in this document, the services of a professional company will be contracted to transcribe the recorded interview and an external co-coder will be used to analyse and code these transcripts. All of these parties will be required to sign confidentiality agreements to ensure that information remains confidential. Your answers may also be reviewed by people responsible for making sure that research is done properly, such as members of the Research Ethics Committee. Otherwise, records that identify you will be available only to people working on the study, unless you give permission for other people to see the records.

### **HOW WILL THE INFORMATION BE STORED AND ULTIMATELY DESTROYED?**

Any hard-copy written notes will be scanned and stored digitally and hard-copies will be destroyed immediately thereafter. All digital information, including recordings and transcripts will be stored on a password protected computer to which the password is known only by the researcher/student. All information will be kept on a password protected computer for a minimum period of five years for future research or academic purposes. Future use of the stored data will be subject to further Research Ethics Review and approval if applicable.

### **WILL THERE BE PAYMENT OR ANY INCENTIVES FOR PARTICIPATING IN THIS STUDY?**

No research participants will be remunerated in any way for participating in this study. The study is completely voluntary, and participants may withdraw from the study at any time.

## HOW WILL THE COMPANY BE INFORMED OF THE FINDINGS / RESULTS OF THE STUDY?

If you would like to be informed of the final research findings, please contact Ané Church on 082 772 6373 or ChurchA2@ufs.ac.za. The findings are accessible for 12 months after completion of the study. Should you require any further information or want to contact the researcher about any aspect of this study, you are also welcome to contact me at the above-mentioned contact details. Should you have concerns about the way in which the research has been conducted, you may contact Prof Frans Prinsloo (Supervisor) at 083 676 2052/PrinslooFE@ufs.ac.za.

If you are comfortable with the above arrangements and willing to provide your permission for me to interview [INSERT PARTICIPANT'S NAME], kindly complete and sign the *Gatekeeper's Permission* section below.

Yours sincerely

Ané Church

### Gatekeeper's Permission

I, [NAME OF GATEKEEPER] (the undersigned), hereby grant permission to Mrs Ané Church to interview [NAME OF INTERVIEW PARTICIPANT] in his capacity as an employee of [COMPANY NAME], as part of the research project as stipulated above.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Designation

\_\_\_\_\_  
Date

## REQUEST FOR PERMISSION TO CONDUCT RESEARCH FROM GATEKEEPERS

[INSERT DATE]

To whom it may concern

I am doing research and would like to request permission to conduct my research at [INSERT NAME OF  
**BANKING INSTITUTION**].

### TITLE OF THE RESEARCH PROJECT

The Audit Expectation Gap: A Private Company Perspective.

### PRINCIPAL INVESTIGATOR / RESEARCHER NAME AND CONTACT NUMBER(S):

Student: Ané Church

Student number: 2006029553

Contact number: 082 772 6373

### FACULTY AND DEPARTMENT:

Faculty of Economic and Management Sciences

School of Accountancy

### STUDY LEADER'S NAME AND CONTACT NUMBER:

Prof Frans Prinsloo (Supervisor)

083 676 2052

### WHAT IS THE AIM / PURPOSE OF THE STUDY?

The objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs).

In recent times, the audit profession has come under scrutiny. Not only were many audit failures encountered, but the audit profession has also been accused of being unresponsive to the changing world as well as to the needs of audit report users. Through this study, a positive contribution can be made to the audit profession, as in identifying the expectations of these users could enable the audit profession to become more responsive, which highlights the importance of this study.

## WHO IS DOING THE RESEARCH?

I am Ané Church and I am currently employed as a lecturer in Auditing at the School of Accountancy, University of the Free State. I am also registered with the South African Institute of Chartered Accountants (SAICA) as a Chartered Accountant (SA), where I also serve on various committees/councils. I am enrolled for my Master's degree in Accounting, with specialisation in Auditing, which this study will enable me to complete.

## HAS THE STUDY RECEIVED ETHICAL APPROVAL?

This study has received approval from the Research Ethics Committee of the UFS. A copy of the approval letter can be obtained from the researcher.

**Approval number:** UFS-HSD2022/0210

## WHY IS YOUR COMPANY INVITED TO TAKE PART IN THIS RESEARCH PROJECT?

In order to determine whether an audit expectation gap exists in the private company sector, I need to determine what the expectations of the users of annual financial statements, and consequently auditor reports, are. Providers of finance, typically Banking Institutions, have been identified in literature as a user of audited financial statements and the staff in your credit division would consequently be a rich source of information as a result of their experience with analysing your clients' audited financial statements. I received your contact details from [INSERT NAME] in order to ask for your permission to interview [HIM/HER] as an employee working in your credit division. Should you grant me permission to conduct this interview, [INSERT NAME OF PARTICIPANT] will be one of approximately 28 individuals interviewed for this study.

## WHAT IS THE NATURE OF PARTICIPATION IN THIS STUDY?

This study requires me to interview research participants by conducting semi-structured interviews. These interviews may take place online (by making use of MS Teams or Zoom) or in person, whichever the participant prefers. Should the research participant agree, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes of the interview will be made, although it should be noted that this may extend the duration of the interview. Prior to the interview, the research participant will be required to complete a digital form with biographical and company information which will enable me to categorise and analyse the data. The interview questions will relate to the research participant's experience with and processes for analysing your clients' audited financial statements, as well as questions to determine what you use these financial statements for. Note that the research participant will not be required to disclose any client specific information. It is anticipated that the duration of the interview will be approximately 45 minutes.

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

The audit profession has come under scrutiny over the past few years, with various role players questioning its value and whether the external audit of financial statements has evolved sufficiently to address the needs of the users of financial statements. Most studies have, however, focussed on public and/or listed companies, but the findings of these studies are not necessarily generalisable to private companies. This study aims to determine what the expectations of private company financial statement users, and consequently auditor report users, are, with the hope that when these findings are shared, the external audit service to private companies will adapt where necessary, benefitting its various users, including Banking Institutions. In the long run, it is hoped that this study will make the audits of private companies more fit for purpose.

## WHAT ARE THE POTENTIAL RISKS TAKING PART IN THIS STUDY?

The only risk identified for participants in this study is that the time spent during the interview may impose on work time and productivity. Should the participant or gatekeeper prefer, the interview could be scheduled during lunchtime or after hours to limit the interference caused.

## WILL THE INFORMATION BE KEPT CONFIDENTIAL?

The names of gatekeepers, research participants and companies will not be recorded anywhere in the research report and no one will be able to connect a person, company or client to the answers provided before or during the interview. Responses will be given a fictitious code number, or a pseudonym and you will be referred to in this way in the data, any publications, or other research reporting methods such as conference proceedings. Therefore, a report of the study may also be submitted for publication, but individual participants will not be identifiable in such a report. Apart from the researcher/student, supervisor and co-supervisor mentioned in this document, the services of a professional company will be contracted to transcribe the recorded interview and an external co-coder will be used to analyse and code these transcripts. All of these parties will be required to sign confidentiality agreements to ensure that information remains confidential. Your answers may also be reviewed by people responsible for making sure that research is done properly, such as members of the Research Ethics Committee. Otherwise, records that identify you will be available only to people working on the study, unless you give permission for other people to see the records.

## HOW WILL THE INFORMATION BE STORED AND ULTIMATELY DESTROYED?

Any hard-copy written notes will be scanned and stored digitally and hard-copies will be destroyed immediately thereafter. All digital information, including recordings and transcripts will be stored on a password protected computer to which the password is known only by the researcher/student. All information will be kept on a password protected computer for a minimum period of five years for future research or academic purposes. Future use of the stored data will be subject to further Research Ethics Review and approval if applicable.

## WILL THERE BE PAYMENT OR ANY INCENTIVES FOR PARTICIPATING IN THIS STUDY?

No research participants will be remunerated in any way for participating in this study. The study is completely voluntary, and participants may withdraw from the study at any time.

## HOW WILL THE COMPANY BE INFORMED OF THE FINDINGS / RESULTS OF THE STUDY?

If you would like to be informed of the final research findings, please contact Ané Church on 082 772 6373 or ChurchA2@ufs.ac.za. The findings are accessible for 12 months after completion of the study. Should you require any further information or want to contact the researcher about any aspect of this study, you are also welcome to contact me at the above-mentioned contact details. Should you have concerns about the way in which the research has been conducted, you may contact Prof Frans Prinsloo (Supervisor) at 083 676 2052/PrinslooFE@ufs.ac.za.

Yours sincerely

Ané Church

### Gatekeeper's Permission

I, \_\_\_\_\_(the undersigned), hereby grant permission to Mrs Ané Church to interview [NAME OF INTERVIEW PARTICIPANT] in her capacity as an employee of [NAME OF BANKING INSTITUTION], as part of the research project as stipulated above.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Designation

\_\_\_\_\_  
Date

Office: Enterprise Research  
and Knowledge Management

Enquiries  
Nozuko Twala  
Dr Rebone Gcabo

Telephone  
012 4227374

E-mail  
\_SecretariatRC@sars.gov.za

Reference  
Request to use SARS data

Date: 01 July 2022

**Ane Church**



Pretoria Head Office  
299 Bronkhorst Street,  
Nieuw Muckleneuk, 0181  
Private Bag X923,  
Pretoria, 0001

## **COMMUNICATION FROM THE SARS RESEARCH COMMITTEE**

Dear A Church

### **REQUEST FOR ACCESS AND UTILISATION OF TAXPAYER INFORMATION FOR ACADEMIC RESEARCH PURPOSES**

Thank you for submitting your research request to SARS for consideration, title: "The Audit Expectation Gap: A Private Company Perspective".

The application was submitted to the SARS Research Committee for consideration and has been approved. The approval is conditional to adherence of the following:

#### **Data requirements:**

A qualitative study requesting interviews with 3 SARS staff working with private companies' tax affairs because of their experience with analysing private companies audited financial statements within the Free State Province. The 3 SARS will be part of the 28 individuals interviewed for the study.

#### **Data handling & security management:**

- The researcher will be responsible for ensuring that the research process is handled appropriately as guided by Research Ethics Committee of the University of the Free State.
- All research data files will be stored securely in secure university systems to ensure that there is no-unauthorised access to the research data;
- To ensure confidentiality and no personal information can be collected while ensuring informed consent from participants;

- To ensure confidentiality & privacy of the organisation and participants during the research process including the report;
- The researcher undertakes to comply and process personal information of data subjects in accordance with the relevant provisions of the Protection of Personal Information Act, Act No. 4 of 2013; and
- To ensure that the final report is shared with SARS through the Research Committee (EnterpriseResearch@sars.gov.za).

Our best wishes with your research.

Sincerely

A handwritten signature in black ink, appearing to read 'Mamiky Leolo', written in a cursive style.

Approved

Mamiky Leolo

SARS Research Committee

Date: 01 July 2022

## **APPENDIX D**

### ***Information Leaflets and Informed Consent***

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# RESEARCH STUDY INFORMATION LEAFLET AND CONSENT FORM

[INSERT DATE]

## TITLE OF THE RESEARCH PROJECT

The Audit Expectation Gap: A Private Company Perspective.

## PRINCIPLE INVESTIGATOR / RESEARCHER NAME AND CONTACT NUMBER:

Student: Ané Church

Student number: 2006029553

Contact number: 082 772 6373

## FACULTY AND DEPARTMENT:

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School of Accountancy

## STUDY LEADER'S NAME AND CONTACT NUMBER:

Prof Frans Prinsloo (Supervisor)

083 676 2052

## WHAT IS THE AIM / PURPOSE OF THE STUDY?

The objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs).

In recent times, the audit profession has come under scrutiny. Not only were many audit failures encountered, but the audit profession has also been accused of being unresponsive to the changing world as well as to the needs of audit report users. Through this study, a positive contribution can be made to the audit profession, as identifying the expectations of these users could enable the audit profession to become more responsive, which highlights the importance of this study.

## WHO IS DOING THE RESEARCH?

I am Ané Church and I am currently employed as a lecturer in Auditing at the School of Accountancy, University of the Free State. I am also registered with the South African Institute of Chartered Accountants (SAICA) as a Chartered Accountant (SA), where I also serve on various

committees/councils. I am enrolled for my Master's degree in Accounting, with specialisation in Auditing, which this study will enable me to complete.

### **HAS THE STUDY RECEIVED ETHICAL APPROVAL?**

This study has received approval from the Research Ethics Committee of UFS. A copy of the approval letter can be obtained from the researcher.

**Approval number:** UFS-HSD2022/0210

### **WHY ARE YOU INVITED TO TAKE PART IN THIS RESEARCH PROJECT?**

In order to determine whether an audit expectation gap exists in the private company sector, I need to determine what the expectations of the users of annual financial statements, and consequently auditor reports, are. The company, OVK Beherend (Pty) Ltd, is an audited private company and you, being a shareholder of the company, would consequently be a rich source of information as a result of your experience with and expectations from auditors. I received your contact details from Gerhard Theorn in order to reach out to you as a potential interview participant in this study. Should you agree to participate in this study, you will be one of approximately 28 individuals interviewed for this study.

### **WHAT IS THE NATURE OF PARTICIPATION IN THIS STUDY?**

This study requires me to interview research participants by conducting semi-structured interviews. These interviews may take place online (by making use of MS Teams or Zoom) or in person, whichever you prefer. Should you agree, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes of the interview will be made, although it should be noted that this may extend the duration of the interview. Prior to the interview, you will be required to complete a digital form with biographical and company information which will enable me to categorise and analyse the data. The interview questions will relate to your experience with and expectations from auditors. It is anticipated that the duration of the interview will be approximately 45 minutes.

### **CAN THE PARTICIPANT WITHDRAW FROM THE STUDY?**

Participating in this study is entirely voluntary, and you are under no obligation to consent to participation. If you do decide to take part, you will be given this information sheet to keep and be asked to sign a written consent form. You are free to withdraw as a participant in this study at any time and without giving a reason.

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

The audit profession has come under scrutiny over the past few years, with various role-players questioning its value and whether the external audit of financial statements has evolved sufficiently to address the needs of the users of financial statements. Most studies have, however, focussed on public and/or listed companies, but the findings of these studies are not necessarily generalisable to private

companies. This study aims to determine what the expectations of private company financial statement users, and consequently auditor report users, are, with the hope that when these findings are shared, the external audit service to private companies will adapt where necessary. In the long run, it is hoped that this study will be making the audits of private companies more fit for purpose.

### **WHAT IS THE ANTICIPATED INCONVENIENCE OF TAKING PART IN THIS STUDY?**

The only risk or anticipated inconvenience identified for participants in this study is that the time spent during the interview may impose on personal or work time and productivity. Should you prefer, the interview could be scheduled during lunchtime or after hours to limit the interference caused.

### **WILL WHAT I SAY BE KEPT CONFIDENTIAL?**

Your name and your company's name will not be recorded anywhere in the research report and no one will be able to connect a person or company to the answers provided before or during the interview. Your answers will be given a fictitious code number, or a pseudonym and you will be referred to in this way in the data, any publications, or other research reporting methods such as conference proceedings. Therefore, a report of the study may also be submitted for publication, but individual participants will not be identifiable in such a report. Apart from the researcher/student, supervisor and co-supervisor mentioned in this document, the services of a professional company will be contracted to transcribe the recorded interview and an external co-coder will be used to analyse and code these transcripts. All of these parties will be required to sign confidentiality agreements to ensure that information remains confidential. Your answers may also be reviewed by people responsible for making sure that research is done properly, such as members of the Research Ethics Committee. Otherwise, records that identify you will be available only to people working on the study, unless you give permission for other people to see the records.

### **HOW WILL THE INFORMATION BE STORED AND ULTIMATELY DESTROYED?**

Any hard-copy written notes will be scanned and stored digitally and hard copies will be destroyed immediately thereafter. All digital information, including recordings and transcripts, will be stored on a password-protected computer to which the password is known only by the researcher/student. All information will be kept on a password-protected computer for a minimum period of five years for future research or academic purposes. Future use of the stored data will be subject to further Research Ethics Review and approval if applicable.

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

You will not be remunerated in any way for participating in this study. The study is completely voluntary, and participants may withdraw from the study at any time.

## HOW WILL THE PARTICIPANT BE INFORMED OF THE FINDINGS / RESULTS OF THE STUDY?

If you would like to be informed of the final research findings, please indicate this to Ané Church on the day of the interview or contact her on 082 772 6373 or ChurchA2@ufs.ac.za thereafter. The findings are accessible for 12 months after completion of the study. Should you require any further information or want to contact the researcher about any aspect of this study, you are also welcome to contact me at the above-mentioned contact details. Should you have concerns about the way in which the research has been conducted, you may contact Prof Frans Prinsloo (Supervisor) at 083 676 2052/PrinslooFE@ufs.ac.za.

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

## CONSENT TO PARTICIPATE IN THIS STUDY

You will be requested to complete an online survey prior to the interview. As part of this survey, you will be requested to express your consent to participate in this study. By agreeing, you confirm the following:

I (the “**Participant**”) confirm that I voluntarily agree to participate in the research study referred to as the Audit Expectation Gap: A Private Company Perspective (the “**Study**”) in relation to determining the extent to which the expectations of the users of auditor’s reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs) and which Study is being conducted by Ané Church (the “**Researcher**”).

I, the Participant, further confirm that–

1. the Researcher has explained the nature, procedure, potential benefits and anticipated inconvenience of my participation in the Study;
2. I have read (or had explained to me) and understood the Study as explained in the attached information sheet;
3. I have had sufficient opportunity to ask questions and am prepared to participate in the Study;
4. I understand that my participation in the Study is entirely voluntary and that I am free to withdraw at any time without penalty (if applicable);
5. I voluntarily provide the UFS and the Researcher with my personal information and consent to the UFS and the Researcher collecting, disclosing and processing my personal information in order to conduct the Study and any related activities in relation thereto;
6. I hereby acknowledge and confirm that I understand the purpose for which the UFS and the Researcher may collect, store, use, delete, destroy, outsource, transfer or otherwise process, as the context and circumstances may require and as contemplated in terms of POPIA, my personal information as set out herein;
7. I am aware that the findings of the Study will be anonymously processed into a research report, journal publications and/or conference proceedings and that my personal information will be aggregated and deidentified at such stage;
8. I also give the UFS permission to share, without notification, the collected data with other researchers at the UFS or other Higher Education Institutions. This permission is dependent on the same principles of ethical research practices, anonymity/confidentiality, safekeeping of information, and other issues listed above applying.

evasys	The Audit Expectation Gap: A Private Company Perspective - Biographical and Company	
University of the Free State	Mrs Ané Church	
School of Accountancy	towards completion of the M.Acc (Auditing) degree	

Mark as shown:      Please use a ball-point pen or a thin felt tip. This form will be processed automatically.

Correction:      Please follow the examples shown on the left hand side to help optimize the reading results.

## 1. Informed Consent

**Thank you for your willingness to participate in this study.**

**You were provided with an *Information Leaflet and Informed Consent* document. Please ensure that you read this document before you continue with this survey.**

Please note the following terminology used throughout the questionnaire and interview: 'Company' refers to the private company in which you own shares (as identified by the researcher/student); and 'Audit' refers to the external audit of a company's annual financial statements

**If you are employed by the company as part of the company's board or management, please inform the researcher/student immediately, as a different set of questions is applicable in such a case.**

- 1.1 Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?  Yes  No
- 1.2 Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.  Yes  No

## 2. Biographical and Company Information: Personal Information

- 2.1 Interview participant number (as provided in the email)
- 2.2 Industry in which the Company operates
- 2.3 Name of audit firm responsible for auditing the company's financial statements (i.e. the company's registered auditor)
- 2.4 What is your level of qualification? 
 Matric/Grade 12     Diploma     Bachelor's Degree  
 Honours Degree     Master's Degree     Other
- 2.5 Please specify:
- 2.6 Did you study in the field of 'Accountancy' or 'other' after school? 
 Accountancy     Other     N/A - Did not study after school
- 2.7 If you are registered with a professional body, please state the professional body you are a member of (otherwise, continue to the next question).
- 2.8 Please specify your field of study:
- 2.9 Have you ever worked in public practice (for an audit firm)?  Yes  No

## 3. Biographical and Company Information: Company Information

- 3.1 Confirm whether the Company is a Private Company (i.e. a (Pty) Ltd).  Yes  No

### 3. Biographical and Company Information: Company Information [Continue]

- 3.2 Confirm whether the Company is registered within the Free State Province.  Yes  No
- 3.3 Please indicate the size of your company in terms of annual turnover/revenue.  Less than R10 000 000  Between R10 000 000 and R50 000 000  More than R50 000 000
- 3.4 What is the company's Public Interest Score (according to the Companies Act of South Africa, 2008)?  Unsure  Less than 100  Between 100 and 350  Above 350
- 3.5 Are the company's annual financial statements compiled in-house or by an external service provider?  Unsure/Not available  Financial Statements are prepared in-house (i.e. by employees of the company)  Financial Statements are prepared by an external service provider (e.g. an accounting firm)  Unsure
- 3.6 Why are the company's annual financial statements audited?
- An audit is required in terms of the Companies Act of South Africa, 2008 (i.e. Public Interest Score above 350 or above 100 and the financial statements are internally compiled)  The company is a subsidiary of a holding company, which requires it to be audited.  The company's Memorandum of Incorporation requires it to be audited
- The company's shareholders or management requested an audit, i.e. a voluntary audit  Unsure  Other
- 3.7 Please specify:

Thank you for taking the time to complete this survey. I look forward to our interview as per our scheduled appointment.

# RESEARCH STUDY INFORMATION LEAFLET AND CONSENT FORM

## DATE

*[INSERT DATE]*

## TITLE OF THE RESEARCH PROJECT

The Audit Expectation Gap: A Private Company Perspective.

## PRINCIPLE INVESTIGATOR / RESEARCHER NAME AND CONTACT NUMBER:

Student: Ané Church

Student number: 2006029553

Contact number: 082 772 6373

## FACULTY AND DEPARTMENT:

Faculty of Economic and Management Sciences

School of Accountancy

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## **HAS THE STUDY RECEIVED ETHICAL APPROVAL?**

This study has received approval from the Research Ethics Committee of UFS. A copy of the approval letter can be obtained from the researcher.

**Approval number:** UFS-HSD2022/0210

## **WHY ARE YOU INVITED TO TAKE PART IN THIS RESEARCH PROJECT?**

In order to determine whether an audit expectation gap exists in the private company sector, I need to determine what the expectations of the users of annual financial statements, and consequently auditor reports, are. Your employing company is an audited private company and you, being part of management, would consequently be a rich source of information as a result of your experience with and expectations from auditors. Should you agree to participate in this study, you will be one of approximately 28 individuals interviewed for this study.

## **WHAT IS THE NATURE OF PARTICIPATION IN THIS STUDY?**

This study requires me to interview research participants by conducting semi-structured interviews. These interviews may take place online (by making use of MS Teams or Zoom) or in person, whichever you prefer. Should you agree, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes of the interview will be made, although it should be noted that this may extend the duration of the interview. Prior to the interview, you will be required to complete a digital form with biographical and company information which will enable me to categorise and analyse the data. The interview questions will relate to your experience with and expectations from auditors, as well as questions to determine who the users of the financial statements are. It is anticipated that the duration of the interview will be approximately 45 minutes.

## **CAN THE PARTICIPANT WITHDRAW FROM THE STUDY?**

Participating in this study is entirely voluntary, and you are under no obligation to consent to participation. If you do decide to take part, you will be given this information sheet to keep and be asked to sign a written consent form. You are free to withdraw as a participant in this study at any time and without giving a reason.

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

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The only risk or anticipated inconvenience identified for participants in this study is that the time spent during the interview may impose on work time and productivity. Should you or your gatekeeper prefer, the interview could be scheduled during lunchtime or after hours to limit the interference caused.

## **WILL WHAT I SAY BE KEPT CONFIDENTIAL?**

Your name and your employing company's name will not be recorded anywhere in the research report and no one will be able to connect a person or company to the answers provided before or during the interview. Your answers will be given a fictitious code number, or a pseudonym and you will be referred to in this way in the data, any publications, or other research reporting methods such as conference proceedings. Therefore, a report of the study may also be submitted for publication, but individual participants will not be identifiable in such a report. Apart from the researcher/student, supervisor and co-supervisor mentioned in this document, the services of a professional company will be contracted to transcribe the recorded interview and an external co-coder will be used to analyse and code these transcripts. All of these parties will be required to sign confidentiality agreements to ensure that information remains confidential. Your answers may also be reviewed by people responsible for making sure that research is done properly, such as members of the Research Ethics Committee. Otherwise, records that identify you will be available only to people working on the study, unless you give permission for other people to see the records.

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

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I, the Participant, further confirm that–

1. the Researcher has explained the nature, procedure, potential benefits and anticipated inconvenience of my participation in the Study;
2. I have read (or had explained to me) and understood the Study as explained in the attached information sheet;
3. I have had sufficient opportunity to ask questions and am prepared to participate in the Study;
4. I understand that my participation in the Study is entirely voluntary and that I am free to withdraw at any time without penalty (if applicable);
5. I voluntarily provide the UFS and the Researcher with my personal information and consent to the UFS and the Researcher collecting, disclosing and processing my personal information in order to conduct the Study and any related activities in relation thereto;
6. I hereby acknowledge and confirm that I understand the purpose for which the UFS and the Researcher may collect, store, use, delete, destroy, outsource, transfer or otherwise process, as the context and circumstances may require and as contemplated in terms of POPIA, my personal information as set out herein;
7. I am aware that the findings of the Study will be anonymously processed into a research report, journal publications and/or conference proceedings and that my personal information will be aggregated and deidentified at such stage;
8. I also give the UFS permission to share, without notification, the collected data with other researchers at the UFS or other Higher Education Institutions. This permission is dependent on the same principles of ethical research practices, anonymity/confidentiality, safekeeping of information, and other issues listed above applying.

evasys	The Audit Expectation Gap: A Private Company Perspective - Biographical and Company	
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## 1. Informed Consent

**Thank you for your willingness to participate in this study.**

**You were provided with an *Information Leaflet and Informed Consent* document. Please ensure that you read this document before you continue with this survey.**

Please note the following terminology used throughout the questionnaire and interview: 'Company' refers to your employing company; and 'Audit' refers to the external audit of a company's annual financial statements

- 1.1 Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?  Yes  No
- 1.2 Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.  Yes  No

## 2. Biographical and Company Information: Personal Information

- 2.1 Interview participant number (as provided in the email)
- 2.2 Industry in which your employing company operates
- 2.3 Your role/position at the employing company
- 2.4 Name of audit firm responsible for auditing the company's financial statements (i.e. the company's registered auditor)
- 2.5 For how long have you been employed in your current role at the company?  Less than 1 year  1 - 5 years  6 - 10 years  
 11 - 20 years  More than 20 years
- 2.6 Do you own shares in your employing company?  Yes  No
- 2.7 What is your level of qualification?  Matric/Grade 12  Diploma  Bachelor's Degree  
 Honours Degree  Master's Degree  Other
- 2.8 Please specify:
- 2.9 Did you study in the field of 'Accountancy' or 'other' after school?  Accountancy  Other  N/A - Did not study after school
- 2.10 If you are registered with a professional body, please state the professional body you are a member of (otherwise, continue to the next question).
- 2.11 Please specify your field of study:
- 2.12 Have you ever worked in public practice (for an audit firm)?  Yes  No

### 3. Biographical and Company Information: Company Information

- 3.1 Confirm whether your company is a Private Company (i.e. a (Pty) Ltd).  Yes  No
- 3.2 Confirm whether your company is registered within the Free State Province.  Yes  No
- 3.3 Please indicate the size of your company in terms of annual turnover/revenue.  Less than R10 000 000  Between R10 000 000 and R50 000 000  More than R50 000 000
- 3.4 What is the company's Public Interest Score (according to the Companies Act of South Africa, 2008)?  Less than 100  Between 100 and 350  Above 350  
 Unsure/Not available
- 3.5 Are the company's annual financial statements compiled in-house or by an external service provider?  Financial Statements are prepared in-house (i.e. by employees of the company)  Financial Statements are prepared by an external service provider (e.g. an accounting firm)  Unsure
- 3.6 Why are the company's annual financial statements audited?  
 An audit is required in terms of the Companies Act of South Africa, 2008 (i.e. Public Interest Score above 350 or above 100 and the financial statements are internally compiled)  The company is a subsidiary of a holding company, which requires it to be audited.  The company's Memorandum of Incorporation requires it to be audited  
 The company's shareholders or management requested an audit, i.e. a voluntary audit  Unsure  Other
- 3.7 Please specify:

Thank you for taking the time to complete this survey. I look forward to our interview as per our scheduled appointment.

# RESEARCH STUDY INFORMATION LEAFLET AND CONSENT FORM

[INSERT DATE]

## TITLE OF THE RESEARCH PROJECT

The Audit Expectation Gap: A Private Company Perspective.

## PRINCIPLE INVESTIGATOR / RESEARCHER NAME AND CONTACT NUMBER:

Student: Ané Church

Student number: 2006029553

Contact number: 082 772 6373

## FACULTY AND DEPARTMENT:

Faculty of Economic and Management Sciences  
School of Accountancy

## STUDY LEADER(S) NAME AND CONTACT NUMBER:

Prof Frans Prinsloo (Supervisor)

083 676 2052

## WHAT IS THE AIM / PURPOSE OF THE STUDY?

The objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs).

In recent times, the audit profession has come under scrutiny. Not only were many audit failures encountered, but the audit profession has also been accused of being unresponsive to the changing world as well as to the needs of audit report users. Through this study, a positive contribution can be made to the audit profession, as in identifying the expectations of these users could enable the audit profession to become more responsive, which highlights the importance of this study.

## WHO IS DOING THE RESEARCH?

I am Ané Church and I am currently employed as a lecturer in Auditing at the School of Accountancy, University of the Free State. I am also registered with the South African Institute of Chartered Accountants (SAICA) as a Chartered Accountant (SA), where I also serve on various committees/councils. I am enrolled for my Master's degree in Accounting, with specialisation in Auditing, which this study will enable me to complete.

## **HAS THE STUDY RECEIVED ETHICAL APPROVAL?**

This study has received approval from the Research Ethics Committee of UFS. A copy of the approval letter can be obtained from the researcher.

**Approval number:** UFS-HSD2022/0210

## **WHY ARE YOU INVITED TO TAKE PART IN THIS RESEARCH PROJECT?**

In order to determine whether an audit expectation gap exists in the private company sector, I need to determine what the expectations of the users of annual financial statements, and consequently auditor reports, are. Your employing company is a banking institution providing finance to audited private companies and you, being employed in the credit division, would consequently be a rich source of information as a result of your experience with analysing and using audited financial statements. I received your contact details from Kobus Barnard. Should you agree to participate in this study, you will be one of approximately 28 individuals interviewed for this study.

## **WHAT IS THE NATURE OF PARTICIPATION IN THIS STUDY?**

This study requires me to interview research participants by conducting semi-structured interviews. These interviews may take place online (by making use of MS Teams or Zoom) or in person, whichever you prefer. Should you agree, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes of the interview will be made, although it should be noted that this may extend the duration of the interview. Prior to the interview, you will be required to complete a digital form with biographical and company information which will enable me to categorise and analyse the data. The interview questions will relate to your experience with and process for analysing your company's clients' audited financial statements, as well as questions to determine what you use these financial statements for. Note that you will not be required to disclose any client-specific information. It is anticipated that the duration of the interview will be approximately 45 minutes.

## **CAN THE PARTICIPANT WITHDRAW FROM THE STUDY?**

Participating in this study is entirely voluntary, and you are under no obligation to consent to participation. If you do decide to take part, you will be given this information sheet to keep and be asked to sign a written consent form. You are free to withdraw as a participant in this study at any time and without giving a reason.

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

The audit profession has come under scrutiny over the past few years, with various role-players questioning its value and whether the external audit of financial statements has evolved sufficiently to address the needs of the users of financial statements. Most studies have, however, focussed on public and/or listed companies, but the findings of these studies are not necessarily generalisable to private companies. This study aims to determine what the expectations of private company financial statement users, and consequently auditor report users, are, with the hope that when these findings are shared, the external audit service to private companies will adapt where necessary, benefitting its various users,

including Banking Institutions. In the long run, it is hoped that this study will make the audits of private companies more fit for purpose.

### **WHAT IS THE ANTICIPATED INCONVENIENCE OF TAKING PART IN THIS STUDY?**

The only risk or anticipated inconvenience identified for participants in this study is that the time spent during the interview may impose on work time and productivity. Should you or your gatekeeper prefer, the interview could be scheduled during lunchtime or after hours to limit the interference caused.

### **WILL WHAT I SAY BE KEPT CONFIDENTIAL?**

Your name and your employing company's name will not be recorded anywhere in the research report and no one will be able to connect a person, company or client to the answers provided before or during the interview. Your answers will be given a fictitious code number, or a pseudonym and you will be referred to in this way in the data, any publications, or other research reporting methods such as conference proceedings. Therefore, a report of the study may also be submitted for publication, but individual participants will not be identifiable in such a report. Apart from the researcher/student, supervisor and co-supervisor mentioned in this document, the services of a professional company will be contracted to transcribe the recorded interview and an external co-coder will be used to analyse and code these transcripts. All of these parties will be required to sign confidentiality agreements to ensure that information remains confidential. Your answers may also be reviewed by people responsible for making sure that research is done properly, such as members of the Research Ethics Committee. Otherwise, records that identify you will be available only to people working on the study, unless you give permission for other people to see the records.

### **HOW WILL THE INFORMATION BE STORED AND ULTIMATELY DESTROYED?**

Any hard-copy written notes will be scanned and stored digitally and hard-copies will be destroyed immediately thereafter. All digital information, including recordings and transcripts, will be stored on a password-protected computer to which the password is known only by the researcher/student. All information will be kept on a password-protected computer for a minimum period of five years for future research or academic purposes. Future use of the stored data will be subject to further Research Ethics Review and approval if applicable.

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

You will not be remunerated in any way for participating in this study. The study is completely voluntary, and participants may withdraw from the study at any time.

### **HOW WILL THE PARTICIPANT BE INFORMED OF THE FINDINGS / RESULTS OF THE STUDY?**

If you would like to be informed of the final research findings, please indicate this to Ané Church on the day of the interview or contact her on 082 772 6373 or ChurchA2@ufs.ac.za thereafter. The findings are accessible for 12 months after completion of the study. Should you require any further information or want to contact the researcher about any aspect of this study, you are also welcome to contact me at the above-mentioned contact details. Should you have concerns about the way in which the research

has been conducted, you may contact Prof Frans Prinsloo (Supervisor) at 083 676 2052/PrinslooFE@ufs.ac.za.

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

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## CONSENT TO PARTICIPATE IN THIS STUDY

You will be requested to complete an online survey prior to the interview. As part of this survey, you will be requested to express your consent to participate in this study. By agreeing, you confirm the following:

I (the “**Participant**”) confirm that I voluntarily agree to participate in the research study referred to as the Audit Expectation Gap: A Private Company Perspective (the “**Study**”) in relation to determining the extent to which the expectations of the users of auditor’s reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs) and which Study is being conducted by Ané Church (the “**Researcher**”).

I, the Participant, further confirm that—

1. the Researcher has explained the nature, procedure, potential benefits and anticipated inconvenience of my participation in the Study;
2. I have read (or had explained to me) and understood the Study as explained in the attached information sheet;
3. I have had sufficient opportunity to ask questions and am prepared to participate in the Study;
4. I understand that my participation in the Study is entirely voluntary and that I am free to withdraw at any time without penalty (if applicable);
5. I voluntarily provide the UFS and the Researcher with my personal information and consent to the UFS and the Researcher collecting, disclosing and processing my personal information in order to conduct the Study and any related activities in relation thereto;
6. I hereby acknowledge and confirm that I understand the purpose for which the UFS and the Researcher may collect, store, use, delete, destroy, outsource, transfer or otherwise process, as the context and circumstances may require and as contemplated in terms of POPIA, my personal information as set out herein;
7. I am aware that the findings of the Study will be anonymously processed into a research report, journal publications and/or conference proceedings and that my personal information will be aggregated and deidentified at such stage;
8. I also give the UFS permission to share, without notification, the collected data with other researchers at the UFS or other Higher Education Institutions. This permission is dependent on the same principles of ethical research practices, anonymity/confidentiality, safekeeping of information, and other issues listed above applying.

University of the Free State

Mrs Ané Church

School of Accountancy

towards completion of the M.Acc (Auditing) degree

Mark as shown:      Please use a ball-point pen or a thin felt tip. This form will be processed automatically.Correction:      Please follow the examples shown on the left hand side to help optimize the reading results.

## 1. Informed Consent

**Thank you for your willingness to participate in this study.**

**You were provided with an *Information Leaflet and Informed Consent* document. Please ensure that you read this document before you continue with this survey.**

Please note the following terminology used throughout the questionnaire and interview: 'Company' refers to your employing company; and 'Audit' refers to the external audit of a company's annual financial statements

1.1 Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?  Yes  No

1.2 Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.  Yes  No

## 2. Biographical and Company Information: Personal Information

2.1 Interview participant number (as provided in the email)

2.2 Your role/position at the employing company

2.3 Size/type of clients/companies that you service in your role

2.4 For how long have you been employed in your current role at the company?  Less than 1 year  1 - 5 years  6 - 10 years  
 11 - 20 years  More than 20 years

2.5 What is your level of qualification?  Matric/Grade 12  Diploma  Bachelor's Degree  
 Honours Degree  Master's Degree  Other

2.6 Please specify:

2.7 Did you study in the field of 'Accountancy' or 'other' after school?  Accountancy  Other  N/A - Did not study after school

2.8 If you are registered with a professional body, please state the professional body you are a member of (otherwise, continue to the next question).

2.9 Please specify your field of study:

2.10 Have you ever worked in public practice (for an audit firm)?  Yes  No

2.11 Does your company require all private companies to submit audited financial statements when applying for finance?  Yes  No  Sometimes

## 2. Biographical and Company Information: Personal Information [Continue]

**Thank you for taking the time to complete this survey. I look forward to our interview as per our scheduled appointment.**

# RESEARCH STUDY INFORMATION LEAFLET AND CONSENT FORM

[INSERT DATE]

## TITLE OF THE RESEARCH PROJECT

The Audit Expectation Gap: A Private Company Perspective.

## PRINCIPLE INVESTIGATOR / RESEARCHER NAME AND CONTACT NUMBER:

Student: Ané Church

Student number: 2006029553

Contact number: 082 772 6373

## FACULTY AND DEPARTMENT:

Faculty of Economic and Management Sciences  
School of Accountancy

## STUDY LEADER(S) NAME AND CONTACT NUMBER:

Prof Frans Prinsloo (Supervisor)  
083 676 2052

## WHAT IS THE AIM / PURPOSE OF THE STUDY?

The objective of this study is to determine to what extent the expectations of the users of auditor's reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs).

In recent times, the audit profession has come under scrutiny. Not only were many audit failures encountered, but the audit profession has also been accused of being unresponsive to the changing world as well as to the needs of audit report users. Through this study, a positive contribution can be made to the audit profession, as in identifying the expectations of these users could enable the audit profession to become more responsive, which highlights the importance of this study.

## WHO IS DOING THE RESEARCH?

I am Ané Church and I am currently employed as a lecturer in Auditing at the School of Accountancy, University of the Free State. I am also registered with the South African Institute of Chartered Accountants (SAICA) as a Chartered Accountant (SA), where I also serve on various committees/councils. I am enrolled for my Master's degree in Accounting, with specialisation in Auditing, which this study will enable me to complete.

## HAS THE STUDY RECEIVED ETHICAL APPROVAL?

This study has received approval from the Research Ethics Committee of UFS. A copy of the approval letter can be obtained from the researcher.

**Approval number:** UFS-HSD2022/0210

## WHY ARE YOU INVITED TO TAKE PART IN THIS RESEARCH PROJECT?

In order to determine whether an audit expectation gap exists in the private company sector, I need to determine what the expectations of the users of annual financial statements, and consequently auditor reports, are. As private companies are often required to submit audited financial statements to SARS, and you, having experience with analysing and using these financial statements, would consequently be a rich source of information. Should you agree to participate in this study, you will be one of approximately 28 individuals interviewed for this study.

## WHAT IS THE NATURE OF PARTICIPATION IN THIS STUDY?

This study requires me to interview research participants by conducting semi-structured interviews. These interviews may take place online (by making use of MS Teams or Zoom) or in person, whichever you prefer. Should you agree, the interview will be recorded to enable me to refer back to our discussion and reflect data as accurately as possible. Alternatively, detailed notes of the interview will be made, although it should be noted that this may extend the duration of the interview. Prior to the interview, you will be required to complete a digital form with biographical and institutional information which will enable me to categorise and analyse the data. The interview questions will relate to your experience with and process for analysing private companies' audited financial statements, as well as questions to determine what you use these financial statements for. Note that you will not be required to disclose any taxpayers' specific information. It is anticipated that the duration of the interview will be 45 to 60 minutes.

## CAN THE PARTICIPANT WITHDRAW FROM THE STUDY?

Participating in this study is entirely voluntary, and you are under no obligation to consent to participation. If you do decide to take part, you will be given this information sheet to keep and be asked to sign a written consent form. You are free to withdraw as a participant in this study at any time and without giving a reason.

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

The audit profession has come under scrutiny over the past few years, with various role players questioning its value and whether the external audit of financial statements has evolved sufficiently to address the needs of the users of financial statements. Most studies have, however, focussed on public and/or listed companies, but the findings of these studies are not necessarily generalisable to private companies. This study aims to determine what the expectations of private company financial statement users, and consequently auditor report users, are, with the hope that when these findings are shared, the external audit service to private companies will adapt where necessary, benefitting its various users, including SARS. In the long run, it is hoped that this study will make the audits of private companies more fit for purpose.

## WHAT IS THE ANTICIPATED INCONVENIENCE OF TAKING PART IN THIS STUDY?

The only risk or anticipated inconvenience identified for participants in this study is that the time spent during the interview may impose on work time and productivity. Should you or your gatekeeper prefer, the interview could be scheduled during lunchtime or after hours to limit the interference caused.

## WILL WHAT I SAY BE KEPT CONFIDENTIAL?

As SARS is the only revenue service in South Africa it will be identifiable in the study. Your name will, however, not be recorded anywhere in the research report and no one will be able to connect a person or taxpayer/company to the answers provided before or during the interview. Your answers will be given a fictitious code number or a pseudonym and you will be referred to in this way in the data, any publications, or other research reporting methods such as conference proceedings. Therefore, a report of the study may also be submitted for publication, but individual participants will not be identifiable in such a report. Apart from the researcher/student, supervisor and co-supervisor mentioned in this document, the services of a professional company will be contracted to transcribe the recorded interview and an external co-coder will be used to analyse and code these transcripts. All of these parties will be required to sign confidentiality agreements to ensure that information remains confidential. Your answers may also be reviewed by people responsible for making sure that research is done properly, such as members of the Research Ethics Committee. Otherwise, records that identify you will be available only to people working on the study, unless you give permission for other people to see the records.

## HOW WILL THE INFORMATION BE STORED AND ULTIMATELY DESTROYED?

Any hard-copy written notes will be scanned and stored digitally and hard-copies will be destroyed immediately thereafter. All digital information, including recordings and transcripts, will be stored on a password-protected computer to which the password is known only by the researcher/student. All information will be kept on a password-protected computer for a minimum period of five years for future research or academic purposes. Future use of the stored data will be subject to further Research Ethics Review and approval if applicable.

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

You will not be remunerated in any way for participating in this study. The study is completely voluntary, and participants may withdraw from the study at any time.

### **HOW WILL THE PARTICIPANT BE INFORMED OF THE FINDINGS / RESULTS OF THE STUDY?**

If you would like to be informed of the final research findings, please indicate this to Ané Church on the day of the interview or contact her on 082 772 6373 or ChurchA2@ufs.ac.za thereafter. The findings are accessible for 12 months after completion of the study. Should you require any further information or want to contact the researcher about any aspect of this study, you are also welcome to contact me at the above-mentioned contact details. Should you have concerns about the way in which the research has been conducted, you may contact Prof Frans Prinsloo (Supervisor) at 083 676 2052/PrinslooFE@ufs.ac.za.

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

## CONSENT TO PARTICIPATE IN THIS STUDY

You will be requested to complete an online survey prior to the interview. As part of this survey, you will be requested to express your consent to participate in this study. By agreeing, you confirm the following:

I (the “**Participant**”) confirm that I voluntarily agree to participate in the research study referred to as the Audit Expectation Gap: A Private Company Perspective (the “**Study**”) in relation to determining the extent to which the expectations of the users of auditor’s reports of audited private companies differ from what is delivered by the audit in terms of the International Standards on Auditing (ISAs) and which Study is being conducted by Ané Church (the “**Researcher**”).

I, the Participant, further confirm that–

1. the Researcher has explained the nature, procedure, potential benefits and anticipated inconvenience of my participation in the Study;
2. I have read (or had explained to me) and understood the Study as explained in the attached information sheet;
3. I have had sufficient opportunity to ask questions and am prepared to participate in the Study;
4. I understand that my participation in the Study is entirely voluntary and that I am free to withdraw at any time without penalty (if applicable);
5. I voluntarily provide the UFS and the Researcher with my personal information and consent to the UFS and the Researcher collecting, disclosing and processing my personal information in order to conduct the Study and any related activities in relation thereto;
6. I hereby acknowledge and confirm that I understand the purpose for which the UFS and the Researcher may collect, store, use, delete, destroy, outsource, transfer or otherwise process, as the context and circumstances may require and as contemplated in terms of POPIA, my personal information as set out herein;
7. I am aware that the findings of the Study will be anonymously processed into a research report, journal publications and/or conference proceedings and that my personal information will be aggregated and deidentified at such stage;
8. I also give the UFS permission to share, without notification, the collected data with other researchers at the UFS or other Higher Education Institutions. This permission is dependent on the same principles of ethical research practices, anonymity/confidentiality, safekeeping of information, and other issues listed above applying.



## 2. Biographical and Institution Information: Personal Information [Continue]

**Thank you for taking the time to complete this survey. I look forward to our interview as per our scheduled appointment.**

## **APPENDIX E**

### ***Evasys Survey Results***

---

# Ané Church

Shareholders ()  
No. of responses = 5



## Survey Results

### 1. Informed Consent

1.1) Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?

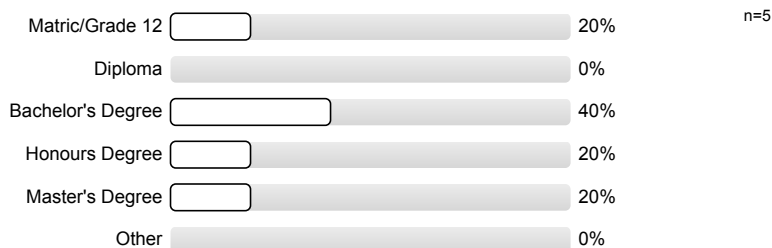


1.2) Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.

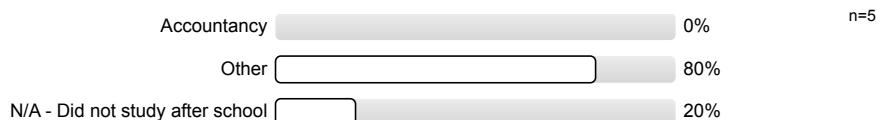


### 2. Biographical and Company Information: Personal Information

2.4) What is your level of qualification?



2.6) Did you study in the field of 'Accountancy' or 'other' after school?



2.9) Have you ever worked in public practice (for an audit firm)?



### 3. Biographical and Company Information: Company Information

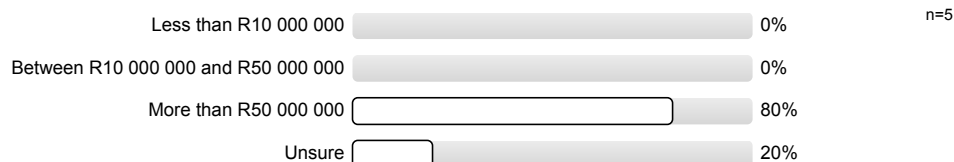
3.1) Confirm whether the Company is a Private Company (i.e. a (Pty) Ltd).



3.2) Confirm whether the Company is registered within the Free State Province.

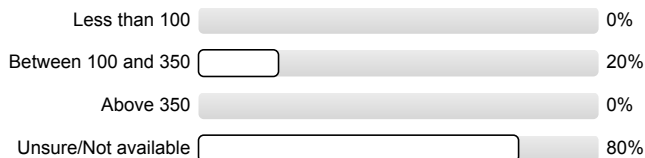


3.3) Please indicate the size of your company in terms of annual turnover/revenue.



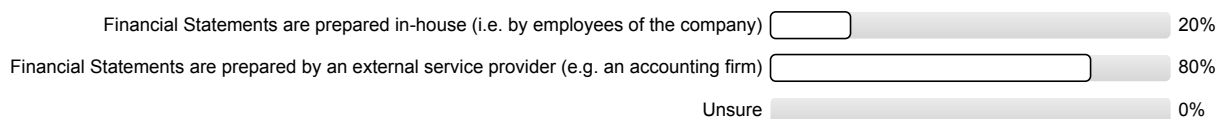
n=5

3.4) What is the company's Public Interest Score (according to the Companies Act of South Africa, 2008)?



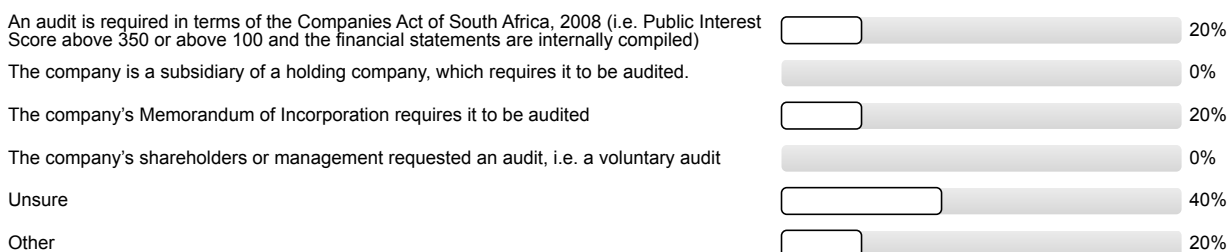
n=5

3.5) Are the company's annual financial statements compiled in-house or by an external service provider?



n=5

3.6) Why are the company's annual financial statements audited?



n=5

# Comments Report

## 2. Biographical and Company Information: Personal Information

2.1) Interview participant number (as provided in the email)

■ UFS-HSD2022/0210

■ 6

■ 14

■ 15

■ 16

2.2) Industry in which the Company operates

■ Agriculture

■ Bethlehem

■ Farming

■ Investment

■ Retail

2.3) Name of audit firm responsible for auditing the company's financial statements (i.e. the company's registered auditor)

■

■

■

Removed due to confidentiality requirements.

■

■

2.8) Please specify your field of study:

■ Architecture

■ B-Agric

■ B.Sc Civil Engineering (UCT), B.com Accounting (UCT), M.Phil in Management Studies (Oxon)

■ corporate communication

## 3. Biographical and Company Information: Company Information

# Ané Church

Management ()  
No. of responses = 11



## Survey Results

### 1. Informed Consent

1.1) Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?

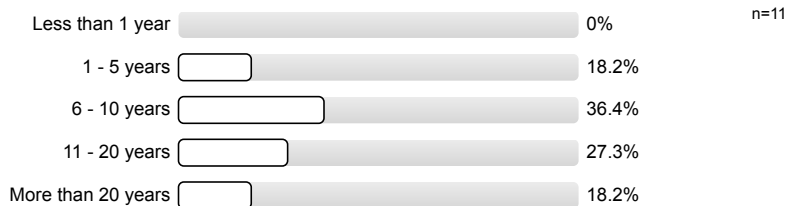


1.2) Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.



### 2. Biographical and Company Information: Personal Information

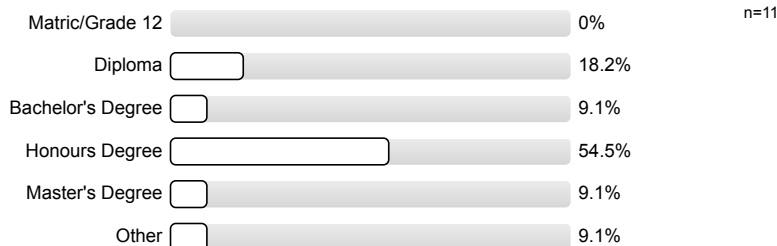
2.5) For how long have you been employed in your current role at the company?



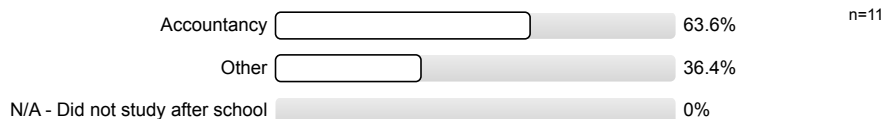
2.6) Do you own shares in your employing company?



2.7) What is your level of qualification?



2.9) Did you study in the field of 'Accountancy' or 'other' after school?



2.12) Have you ever worked in public practice (for an audit firm)?



3. Biographical and Company Information: Company Information

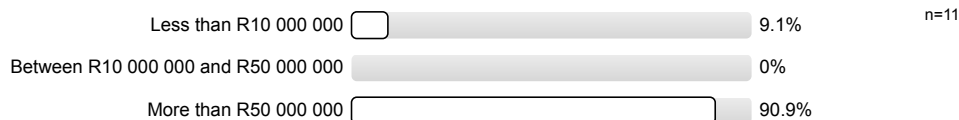
3.1) Confirm whether your company is a Private Company (i.e. a (Pty) Ltd).



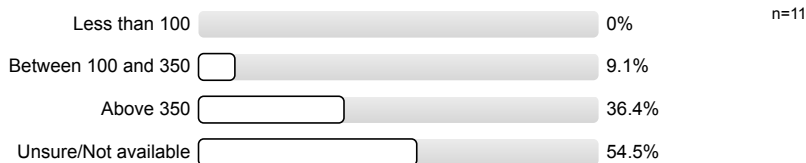
3.2) Confirm whether your company is registered within the Free State Province.



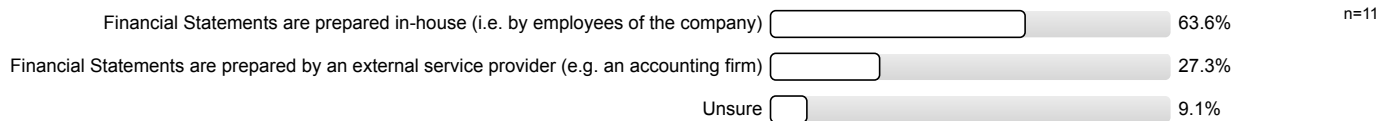
3.3) Please indicate the size of your company in terms of annual turnover/revenue.



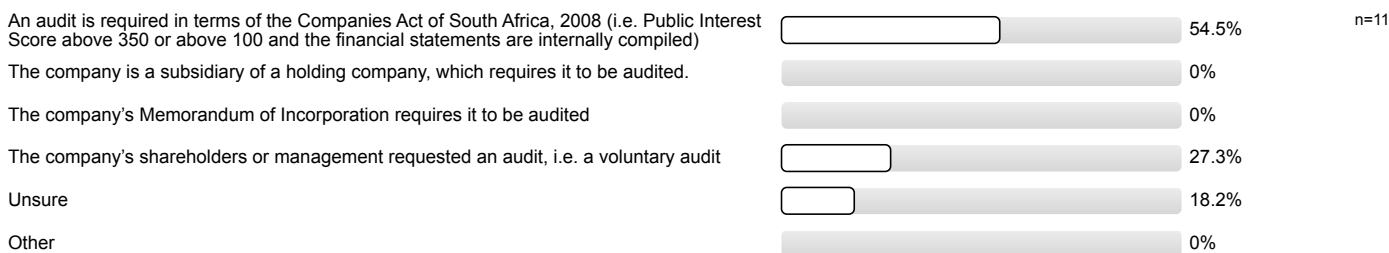
3.4) What is the company's Public Interest Score (according to the Companies Act of South Africa, 2008)?



3.5) Are the company's annual financial statements compiled in-house or by an external service provider?



3.6) Why are the company's annual financial statements audited?



# Comments Report

## 2. Biographical and Company Information: Personal Information

2.1) Interview participant number (as provided in the email)

- 1
- 2
- 4
- 5
- 7
- 8
- 13
- 16
- 17
- 19
- 21

2.2) Industry in which your employing company operates

- Agriculture
- Bus Transport
- Financial Services
- Liquor retail / wholesale
- Manufacturing
- Open Cast Contract Mining
- Poultry Farming
- RETAIL
- Sports
- Transport
- Wholesale and retail of Food

2.3) Your role/position at the employing company

- CFO
- Chief Financial Officer
- Commercial Manager
- Compliance, Risk and Sustainability Manager
- DIRECTOR
- Director
- Financial Director
- Financial Manager
- General Manager
- General Manger

- Group Finance Manager

2.4) Name of audit firm responsible for auditing the company's financial statements (i.e. the company's registered auditor)

- 
- 
- 
- 
- Removed for purposes of confidentiality
- 
- 
- 
- 
- 
- 

2.8) Please specify:

- Chartered Accountant

2.10) If you are registered with a professional body, please state the professional body you are a member of (otherwise, continue to the next question).

- CA(SA)
- SAICA (4 Counts)
- SAIPA

2.11) Please specify your field of study:

- B. AGRIC
- Business Management and Marketing
- Diploma in civil engineering
- Information Technology

### 3. Biographical and Company Information: Company Information

## Ané Church

Banking Institutions ()  
No. of responses = 6



### Survey Results

#### 1. Informed Consent

1.1) Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?

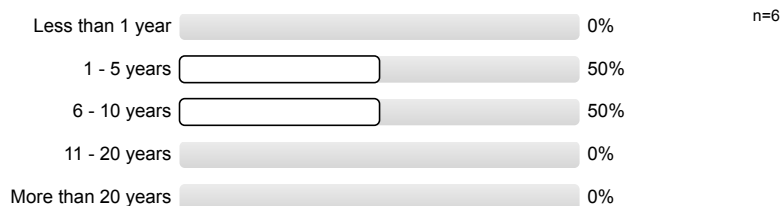


1.2) Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.

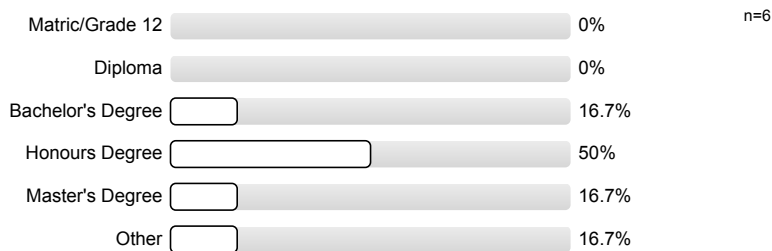


#### 2. Biographical and Company Information: Personal Information

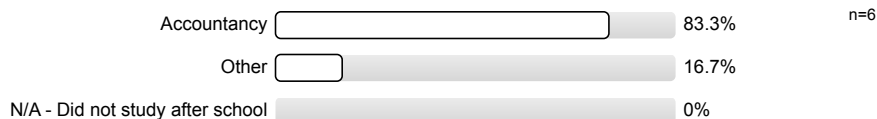
2.4) For how long have you been employed in your current role at the company?



2.5) What is your level of qualification?



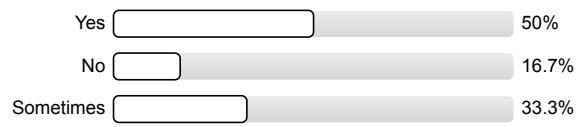
2.7) Did you study in the field of 'Accountancy' or 'other' after school?



2.10) Have you ever worked in public practice (for an audit firm)?



2.11) Does your company require all private companies to submit audited financial statements when applying for finance?



n=6

# Comments Report

## 2. Biographical and Company Information: Personal Information

2.1) Interview participant number (as provided in the email)

- 3
- 10
- 11
- 12
- 20
- 23

2.2) Your role/position at the employing company

- Catchment Credit Evaluatoin Manager
- Credit Analyst
- Credit Evaluation Manager
- Credit manager
- Senior Commercial Credit Manager
- Senior Credit Manager

2.3) Size/type of clients/companies that you service in your role

- Agric and Business client's up turnover of R300m
- All clients that qualify to bank with Investec Private Bank
- Business and Agriculture Clients in the Eastern Free State Area
- Clients with annual turnover of R60m and above. Commercial clients and a mix between agriculture and business.
- Mid-Corporate & Public Sector, TSL R100m
- Small and large (Commercial and Agricultural entities)

2.6) Please specify:

- Bachelors in Accounting Honours
- Bcom Acocunting
- Honours and qualified CA(SA)
- Honours in Investment Management
- MBA
- PGDip (University of Free State)

2.8) If you are registered with a professional body, please state the professional body you are a member of (otherwise, continue to the next question).

- SAICA (2 Counts)
- n/a

2.9) Please specify your field of study:

- Accounting (3 Counts)

- Auditing and Accounting
- B Com Financial Management with Honours in investment management
- Bcom Accounting and PGDip (Business Administration)

# Ané Church

SARS ()  
No. of responses = 3



## Survey Results

### 1. Informed Consent

1.1) Do you provide your consent to participate in this study (as per page 5 of the *Information Leaflet and Informed Consent* document)?

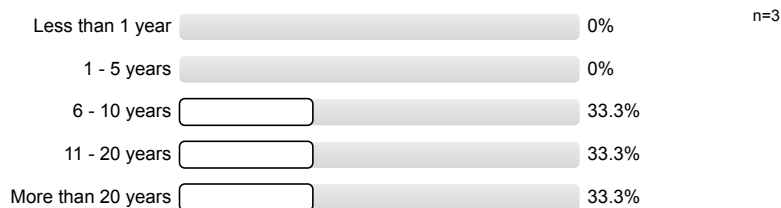


1.2) Do you agree to the recording of the interview? As explained in the *Information Leaflet and Informed Consent* document, the recording and transcript of the recording will be kept confidential.

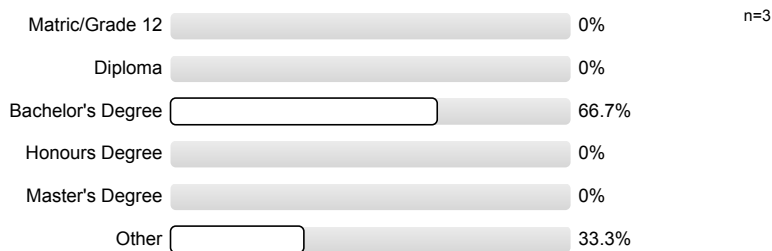


### 2. Biographical and Institution Information: Personal Information

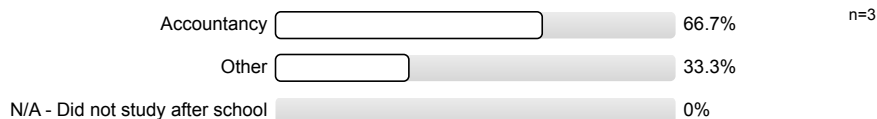
2.4) For how long have you been employed in your current role at SARS?



2.5) What is your level of qualification?



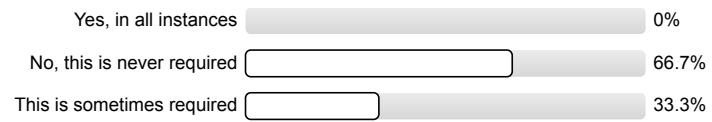
2.7) Did you study in the field of 'Accountancy' or 'other' after school?



2.10) Have you ever worked in public practice (for an audit firm)?



2.11) Does SARS require private companies to submit audited financial statements when applying for finance?



n=3

# Comments Report

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## 2. Biographical and Institution Information: Personal Information

2.1) Interview participant number (as provided in the email)

- 24
- 25
- 26

2.2) Your role/position at SARS

- Auditor - Corporate Tax
- Compliance Auditor (corporate income tax)
- Compliance auditor

2.3) Size/type of taxpayers/companies that you service in your role at SARS

- Micro, small and medium to large based on SARS's classification
- Small companies, sometimes medium to large.
- Various types and sizes of companies from micro to large focusing on Income Tax

2.6) Please specify:

- B. Com (1996 - UFS), Adv. Cert. Taxation (1999 - RAU), H. Dip. SA and International Taxation (2005 - UNW)
- Cost and Management accounting B - Tech Degree.
- Postgraduate diploma in Tax

2.8) If you are registered with a professional body, please state the professional body you are a member of (otherwise, continue to the next question).

- N/A
- No registered.

2.9) Please specify your field of study:

- Accounting and Tax
- Cost and Management accounting B - Tech Degree
- Statistics

## APPENDIX F

### *Recommendations from Participants*

During the interviews with the various participants, they were asked to provide recommendations on what they would like auditors to do differently or where they felt the audit service could improve. While these recommendations are not specific expectations from auditors nor are they requirements in terms of international auditing standards, they could assist auditors in improving their services to clients and were therefore regarded as valuable data collected in this study and worth documenting.

In the theme of *Recommendations*, three categories emerged: *Audit Team* and *Approach to Audit* contain recommendations by participants in the Management and Shareholders group, while the third category, *Additional Information*, contains recommendations by participants in the External Stakeholders group. In these categories, a brief description is provided on what participants shared, as well as some literature or secondary data supporting these findings. The data in this theme could also form the basis for further research on how to improve audit client satisfaction.

Theme	Categories	Codes
<b>Recommendations</b>	1. Audit team	a. Continuity b. Experience
	2. Approach to audit	a. Consideration of different methods b. Limiting interruptions to business flow c. Limiting tick boxes and paperwork d. Explanatory communication to non-financial staff
	3. Auditor's report	a. Qualitative aspects b. Terminology

#### 1. Audit Team

Theme	Category	Code
Recommendations	Audit Team	a. Continuity b. Experience

The category of *Audit Team* emerged from recommendations that participants made on how the composition of the audit team could improve to ensure a more effective and higher quality audit. Continuity of audit teams and experience of audit team members are addressed in this category.

a. Continuity

Participants shared some frustrations with regards to the frequent, year-on-year changes to the audit team. They did not want to re-explain information every year and expressed the desire for improved continuity of audit team members. This finding was expressed as follows:

---

<i>...the audit team doesn't understand the client's business and because they don't understand the client's business, they waste a lot of your time.</i>	<i>...die ouditeur span verstaan nie die kliënt se besigheid nie en omdat hulle nie die kliënt se besigheid verstaan nie, mors hulle baie van jou tyd.</i>
<i>...it is someone else who comes every year.</i>	<i>... dit is elke jaar iemand anders wat kom.</i>
(P21)	(P21)

---

Continuity of the audit team does seem to be something that large audit firms aim to achieve, as it was found as part of client satisfaction surveys/evaluations of audit effectiveness of two Big 4 firms (Deloitte, 2013; KPMG, 2019). As most audit firms are also training offices for professional accountants, it is understandable that many trainees leave firms after their training contracts have been completed. However, South African audit firms are experiencing particularly high staff turnover at more senior levels, as published by the IRBA's Report on Audit Quality Indicators (IRBA, 2022), increasing the difficulty of enhancing audit team continuity. The reasons for the high staff turnover and possible solutions to improve continuity could be explored as a future area of study.

b. Experience

The need for more senior, experienced staff members to serve on the audit team was also raised by some participants. This links closely to the previous finding where

participants wanted more continuity, as in both these cases, it would lead to more effective and higher quality audits.

Opinions were, however, somewhat divergent, as participants who had previously worked at audit firms did seem to have a better understanding that the more senior the audit team, the more expensive the audit would be.

One participant articulated this finding as follows:

---

<i>...when I look at the people who come to audit and sit here, it is always interesting to me to wonder how much do they know about the industry or the business that you are in. You know, they are also rather, I usually assume, rather fresh out of university. (P16)</i>	<i>...as ek na die mense kyk wat kom oudit en hier sit, is dit altyd vir my interessant om te wonder hoeveel weet hulle van die industrie of die besigheid, waarin jy is. Jy weet, hulle is ook redelik, ek aanvaar gewoonlik redelik rou uit universiteit uit. (P16)</i>
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The International Standards on Quality Management (ISQM) require audit firms to assign staff members to audit teams who have sufficient competence, capabilities and experience to conduct the audit at the required quality standards (IAASB, 2022a). The IESBA Code of Ethics also requires auditors to consider whether the firm has sufficient experienced individuals available for an audit, when considering accepting a new appointment (IESBA, 2022).

While this seems to be the aim of audit firms and the requirement from the relevant codes/standards, the challenge faced by audit firms to retain experience is noticeable, considering the previous finding. ISQM 1 also requires audit firms to have measures in place to develop and retain competence and capabilities of staff. How to practically do this, would be an interesting research area to explore.

## 2. Approach to Audit

Theme	Category	Code
Recommendations	Approach to audit	a. Consideration for automation b. Limiting interruptions to business flow c. Limiting tick boxes and paperwork d. Explanatory communication to non-financial staff

Participants made practical and procedural recommendations on how the audit could improve effectiveness, resulting in the category of *Approach to audit*. While many of these recommendations are aspects audit firms aim to address, participants perceived room for improvement.

### a. Consideration for automation

Some participants, especially those employed in a finance role, believed that audits could be more effective and provide greater coverage by focusing more on automated tools and techniques, as opposed to traditional sampling methods. Participants also anticipated that changing some of the procedures to be more automated could reduce the audit fee, which, naturally, they would welcome. It was also interesting to note that younger participants mainly made these recommendations, perhaps because they are more familiar with the concepts of automation and big data.

The following quotation supports this finding:

---

<p><i>It just makes sense that if you have a system that can move through the books with the goal of seeing whether there is something funny, then you are going to pick up something funny much quicker than when you just sample ten because you want to finish your work. So, especially when you work with a million transactions, I cannot see how that is very effective. So rather do more data review and, based on that, dig deep and</i></p>	<p><i>Dit maak net sin dat as jy 'n system het wat deur die boeke kan beweeg met die doel om te sien of daar iets snaaks is, dan gaan jy baie vinniger iets snaaks optel as wat jy net tien sample want jy wil jou werk net klaarmaak. So, veral as jy werk met 'n miljoen transaksies, ek kan nie sien hoe daardie baie effektief is nie. So, doen lieverste meer data review en, gebaseer op dit, dig deep en vra vrae. En ek dink jy</i></p>
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*ask questions. And I think you will get many more worms that will come out. (P7)*      *gaan baie meer wurms kry wat uitkom. (P7)*

---

The IAASB, SAICA and other institutions are continuously publishing guidance and providing training to auditors on the use of automated tools and techniques in planning and performing an audit, but these are guidelines and not requirements (IAASB, 2020; SAICA, 2023a). For many auditors, this is unknown terrain, which may lead to reluctance in implementing these technologies. The cost involved in developing and implementing such technologies may also be a challenge for smaller firms. The practical implementation of these technologies could be explored in future research projects.

b. Limiting interruptions to business flow

It is commonly known that finance staff in business dread audit time as it causes a lot of additional work on top of their regular daily duties that continue regardless of the audit. One participant explained this by referring to the audit as a ‘necessary irritation’. With this in mind, many participants suggested ways in which interruptions to the normal business flow could be reduced. These recommendations ranged from requesting supporting evidence in advance and communicating the timelines for when which sections will be tested, to using digital platforms to upload and monitor requested documentation. One of these suggestions was articulated as follows:

---

*In the audit, in that week they are with us, the type of things that they ask, often times you are busy with other things, so then it is inconvenient, but they have to ask it to get the result that we want...What they can do is they can tell us in advance exactly what they will need. (P4)*      *In die oudit, in daai week wat hulle by ons is, die tipe goed wat hulle vra, baie keer is jy besig met ander goed so dan is dit ongeleë, maar hulle moet dit vra om die uitslag te kry wat ons wil hê...Wat hulle kan doen is hulle kan vooraf kan hulle presies sê wat hulle alles gaan nodig hê. (P4)*

---

Reports published by some firms indicated that these firms request their clients to complete surveys to evaluate their experience of the audit. These firms appear to aim to be proactive in their approach to the audit. One of the ways in which they do this is by communicating the audit plan in advance (Deloitte, 2013; KPMG, 2019). However, this was only available for certain Big 4 firms and does not guarantee that these firms

achieve these outcomes. Smaller firms could consider implementing a similar process/auditor evaluation to identify further client needs in this regard.

c. Limiting tick boxes and paperwork

In some instances, participants experience the audit as a generic rather than a value-adding process. Participants shared frustrations with the perceived tick-box exercises and piles of paperwork that accompany the audit, noting that these are factors that do not necessarily add value but take time and, therefore, increase the audit cost.

This finding was articulated as follows:

---

<i>I think a lot of the work that [THE AUDITORS] do is to tick paperwork that is actually unnecessary. So I think they do too much work, the answer will not change if they do more work. (P1)</i>	<i>Ek dink baie werk wat [DIE OUDITEURE] doen is om papierwerk te tiek wat eintlik onnodig is. So ek dink hulle doen te veel werk, die antwoord sal nie verander as hulle meer werk doen nie. (P1)</i>
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One of the key drivers behind the tick boxes and paperwork is the regulation of the profession, which many auditors view as overregulation. Overregulation has been a discussion point for many years in the auditing profession in South Africa (and abroad), to such an extent that SAICA has built audit reform, which also addresses overregulation, as an initiative into its strategy (SAICA, 2023b). Not only is meeting the regulatory requirements costly, but it also unintentionally encourages a tick-box process, discouraging creative and abstract thinking, which are essential in conducting an effective audit (Moroney, 2015). Audit partners have also indicated the threat that, due to overregulation, audits are designed to minimise inspection risk rather than improve audit quality (Dowling, Knechel and Moroney, 2018).

Auditors and clients seem to agree on this finding and that regulators are seemingly to blame for the shared frustration.

d. Explanatory communication to non-financial staff

Participants in a non-finance management role and shareholders who did not have an accountancy background expressed the need for additional communication and

explanations from auditors. These participants perceived the language of auditors and finance staff to be somewhat exclusive. Although these participants are often included in feedback meetings or discussions with auditors, they believe that it could be of more value to them if auditors use simpler terminology and provide a high-level overview of the financial statements, audit findings and other relevant matters in lay terms. This finding was articulated as follows:

---

<p><i>...for me who didn't study this, who doesn't always understand everything, ...[THE AUDITORS] just assume that you understand everything. And I don't always. So, I sometimes just wish it was easier to grasp all of these things and understand the financial statements, but for someone who knows how to read financial statements, it is easy. (P6)</i></p>	<p><i>...vir my wat dit nie geswot het nie, wat nie altyd alle goeters verstaan nie, ...DIE OUDITEURE] neem maar net aan jy verstaan alles. En ek doen nie altyd nie. So, ek wens partykeer dat dit makliker was om al hierdie goeters te begryp en die finansiële state te verstaan, maar vir iemand wat weet hoe om finansiële state te lees is dit maklik. (P6)</i></p>
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Communication between auditors and client staff or shareholders with no finance background seems to be an under-researched topic. While various books and courses are available for non-financially literate individuals to upskill themselves, it would perhaps be wise for auditors to particularly cater for these individuals as part of their audience when providing feedback to the client, thereby adding value and building professional relationships beyond the company owners and finance staff.

### 3. Auditor's Report

Theme	Category	Code
Recommendations	Auditor's report	a. Qualitative aspects b. Terminology

The recommendations in the 'Auditor's Report' category resulted from suggestions made by participants in the External Stakeholders group, particularly Banking Institutions. These participants seldom have the opportunity to engage with the auditor directly and depend on the auditor's report and financial statements as their primary source of information. The suggestions in this category are, once again, not

expectations from auditors but rather ways in which auditors could enhance the value of their service beyond the value perceived by the audit client.

a. Qualitative aspects

Participants believed that auditors have access to much more information than what is contained in the financial statements and auditor's report, which, if known to them, could assist them in making better decisions when evaluating private companies. While all the figures and quantitative information are available, the qualitative aspects of the business are largely kept secret by the auditors.

Examples of the qualitative aspects that banking institutions would appreciate information on from the auditors of private companies include more disclosures relating to the control environment of the company, detail regarding the condition of physical assets, and a deeper analysis of the industry-specific risks and details regarding companies' ownership (who the shareholders are, etc.). While participants acknowledged that disclosing this information was not the auditor's duty, they believed it would increase the value of the auditor's report and financial statements and place them in a better position to make informed decisions on credit applications from private companies.

The following quotations support this finding:

---

*...I think the auditors have access to much more information than us... I mean, we have the asset, but is the asset well looked after? We have the farm, but are the fields clean? (P3)*

*...ek dink ouditeure het toegang tot baie meer inligting as ons... Ek meen, ons het die bate, maar is die bate opgepas? Ons het die plaas, maar is die landerye skoon? (P3)*

---

*Interviewer: Would you like for auditors to disclose more information in the auditor's report than what's currently in there?*

*Participant: I think maybe around some of the industry-specific risks ... for how long do you see that going on; do you think it's something that somebody assessing the financial statements should really consider or base a lot of their decision on, et cetera. So, I think maybe a deeper analysis of the risks that they identify. (P20)*

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The IFAC has listed greater transparency as contributing to achieving high-quality, value-adding audits, listing the introduction of ISA 701 on Key Audit Matters as an example of enhancing transparency (IFAC, 2022). The disclosure of Key Audit Matters

is, however, not compulsory for private companies (IAASB, 2022b) and the users of private company financial statements, therefore, miss out on the benefits brought about by ISA 701. The IRBA is actively exploring how disclosures in auditor reports could be enhanced, considering disclosures on the scope of the audit, materiality and auditor effort related to going concern and fraud (IRBA, 2021). The question remains whether these changes, if implemented, would apply to private companies as they do to public, listed companies.

These recommendations should not only be considered by auditors, but perhaps also by regulators, such as the IRBA. The IFAC notes the following: “Audit and assurance services have evolved—and they must continue to do so—in order to meet the ever-changing needs of stakeholders.” (IFAC, 2022).

#### b. Terminology

Some participants perceived the language used in the auditor’s report to be somewhat confusing, not only for themselves but also for their colleagues. Participants in the External Stakeholders group who have never worked in an auditing environment before, have misinterpreted audit opinions, and misunderstood the difference between an audit, a review and a compilation report. Participants expressed the need for a more understandable, simplified auditor’s report. This finding was articulated as follows:

---

<i>Many of the [BANK STAFF] just look at what the opinion is. It is qualified and then they think it is fine. And then they proceed... perhaps the auditor’s report could be discussed in more “layman’s terms”. There really is confusion between what is an emphasis of matter and what is a disclaimer of opinion and such things. (P23)</i>	<i>Baie van die [BANK PERSONEEL] kyk net wat is die opinion. Dit is qualified, en dan dink hulle dit is fine. En dan gaan hulle voort... dalk kan die oudit verslag meer in “layman’s terms” bespreek word. Daar is regtig confusion tussen wat is ’n emphasis of matter en wat is ’n disclaimer of opinion en sulke goed. (P23)</i>
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Research has indicated that users of public, listed company auditor reports often confuse the concepts of reasonable versus absolute assurance (Epstein and Geiger, 1994; Ruhnke and Schmidt, 2014; Brydon, 2019a), which seems to also be the case for participants in the External Stakeholders group. From the finding above, it is

however, evident that this is not the only concept in the auditor's report that users misunderstand or misinterpret.

Prior to 2015, the IAASB launched the Auditor Reporting Project, which included 'enhancing the communicative value of the auditor's report' as one of its objectives. The changes brought about by this project were effective for audits of financial statements ending on or after 15 December 2016 and included enhanced communications between auditors and investors, moving the auditor's opinion to be presented first in the auditor's report, enhancing presentation of the auditor's responsibilities, etc. While these changes may have been necessary and added value to the auditor's report, they do not address the terminology and financial concepts used in the auditor's report directly and further refinements or explanatory information may be necessary to address the need presented in within this finding.

#### **4. Summary**

Audit firms, audit standards, ethics codes and participants all agree that an effective and high-quality audit benefits all stakeholders. Audit team continuity and experience seem to play a pivotal role in achieving this. However, the feasibility of attaining audit team continuity and, by implication, retaining experienced staff, seems problematic within the auditing profession.

Various suggestions from participants to improve the auditor's approach were also made. The practicality of these suggestions should be considered in the context of each firm and each client and could be considered as a future area of research.

Participants in the External Stakeholders group, specifically those of banking institutions, also provided recommendations to the auditor's report. These participants expressed the need for more qualitative information to be presented in the auditor's report to assist in making informed decisions when credit applications are evaluated. While this has been addressed to some extent for public interest entities, similar changes have not been enforced for private companies. Further thereto, these participants also indicated that they, and colleagues who report to them, struggle with

understanding the terminology used in the auditor's report and, therefore, indicated a need for simpler terms or explanatory information to accompany the auditor's report.