How External Financial Audit Services are selected by Dutch Listed OOBs and how this Selection Process affects Perceived Auditor Independence and Perceived Audit Quality

Does a turkey vote for Christmas?
NYENRODE BUSINESS UNIVERSITEIT

How External Financial Audit Services are selected by Dutch Listed OOBs and how this Selection Process affects Perceived Auditor Independence and Perceived Audit Quality

Does a turkey vote for Christmas?

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by

J.C.A. Tros MBA

born on 2 November 1969

in Bergen (N-H) the Netherlands.
Doctorate Committee:

Supervisor
Prof. dr. L. Paape RA RO CIA

Co-Supervisor
Dr. ing. J.J.A.M Reijniers MBA

Other members:
Prof. dr. P.W.A. Eimers RA
Prof. dr. E.A.G. Groenland
Prof. dr. W. van Rhenen
Prof. dr. J. Telgen
Prof. dr. J.A.A. van der Veen
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Acknowledgements

I thought, as a business consultant and as a seasoned buying expert, that conducting research on a buying-related topic would be a walk in the park. Well, I was wrong and the past four years have been a process with many ups and downs which have impacted me in both a personal as well as a business context. Conducting research in parallel to my professional life meant that I had to redirect time that I would normally have used for family, friends or sports, to other items such as writing, reading and listening. This did not always make me very popular, especially as I was following a strict schedule to ensure I made steady progress.

On the other hand my knowledge of purchasing, performance-based purchasing, external financial audits as well as the way objectives can influence behavior has increased. This knowledge will enable me to be a better professional, both with my clients as well as with my colleagues. In particular, the knowledge I have gained of the methods used to conduct an analysis is something that I will continue to use in both my personal and business life. I have learned over time that every analysis method has its limitations and that understanding these limitations is crucial, especially when you become aware that some methods are not always used in the right way.

The biggest challenge I had during this research was to understand what researchers were writing sometimes. I have learned that reading and understanding academic papers is an art in itself!! Sometimes I wondered why so many words had to be used to write a conclusion and sometimes I had to read a paper several times before I really understood what the respective researcher wanted to say. I believe that this way of writing is one of the main reasons why a gap exists between business and academia. So I would urge every academic and professional to take a look into each other’s kitchens to increase the effectiveness of both professions.

Having said that, this has been an exciting trip and I really believe that I could not have reached my destination without the support, cooperation and guidance of some people who have been very close to me during this research.

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Luckily it is all over now, so I will have more time for my family, friends and sports.

Thank you.

John Tros

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1. Introduction

1.1 Introduction
The objective of an external financial auditor is, according to The International Standards on Auditing\(^1\) no. 200.11 (ISA 200 (2009)), to “(a) obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and (b) report on the financial statements, and communicate as required by the ISAs, in accordance with the auditor’s findings.” According to Ashbaugh and Warfield (2003) “Audits serve to reduce asymmetric information risks by attesting to the reliability of a company’s published financial information, thereby allowing current and prospective equity stakeholders i.e. investors, to assess a company’s profitability and performance and to develop expectations for the distribution of its profits.”

From this starting point I was asked, as director of business development, to support a team of my employer at that time in winning an external financial audit tender. My employer’s team had received from the Procurement team of a large non-listed company owned by a private equity firm\(^2\), a request for proposal (RFP) to purchase the services of an external financial auditor. At the time of the RFP, my employer, who was the incumbent supplier of the external financial audit, was charging the following number of hours at the following rates: 2,000 hours * EUR 190 = EUR 380,000 to perform the external financial audit of this company.

I asked the partner in charge of our team how this number of hours was determined. The partner explained that the number of hours was based on the scope of the external financial audit that needed to be performed and the efficiency with which the team could perform the audit.

The scope of the external audit, according to this partner, could be based on the concept of materiality, the number of entities that needed to be audited and strategic risks that were identified. In this case materiality means, according to the International Standard on Auditing no. 320.9 (ISA 320), “the amount or amounts set by the auditor at less than materiality for the financial statements as a whole, for the purpose of reducing to an appropriate level the probability that the aggregate of unadjusted and undetected misstatements will exceed

\(^{1}\) In the Netherlands the NVCOS (in Dutch: Nader Voorschriften controle- en overige standaarden) are applicable but these are a translation of the ISA.

\(^{2}\) The name of this Dutch company, which was not listed, and the actual hours spent cannot be revealed due to client confidentiality.
materiality (i.e. relative significance), for the financial statements as a whole”. As such, I understood that materiality can be compared with the distance between the teeth of the rake and that the greater the distance between the teeth of a rake the greater the chance that small misstatements could be overlooked by the external financial auditor. I also learned that, according to ISA 320, the assessment of materiality is a matter of professional judgment. This means that an external financial auditor can vary, based on his or her professional judgement, the materiality used in the external financial audit.

At the same time, the audit partner in my company explained that the effectiveness of the external financial audit is also determined by the professionalism and effectiveness of the control systems within the company that will undergo an external financial audit; the effectiveness of the Enterprise Resource Planning (ERP) system (a company with one ERP system is easier to audit than a company with several ERP systems); and the availability of a professional Internal Audit Department with whom the auditor can co-operate and share tasks, and on whom it can rely.

I noticed, once I read the proposal the team had prepared, that the number of hours required to conduct the external financial audit of this company had changed from the 2,000 hours currently needed to approximately 1,600 hours in the future. At the same time, I noticed that the average rate was lowered by EUR 22.50 per hour. I asked the audit partner what had caused this decrease of 400 hours because obviously both the materiality and effectiveness of the control systems of the company had not changed overnight. The audit partner explained that this difference arose for the following reasons:

- The CFO and the Audit Committee of the client company had put a RFP on the market which did not present the actual state of the professionalism and effectiveness of the company’s control systems. At the same time, a certain number of entities, which were currently included in the scope of the external financial audit, were excluded from the new one. As a result the audit partner expected that he would need 300 fewer hours to perform the external financial audit requested;
- New audit software developed by the external financial audit firm meant that the audit partner could conduct the analysis needed for the external financial audit more effectively. As a result, the audit partner expected that he would need another 100 fewer hours to perform the external financial audit requested.

Finally, he explained that if he wanted to win the proposal, he would need to offer a discount on rates.

I did understand that the new audit software could present efficiency gains and I did understand that he wanted to retain this client. However, I did not understand why the audit partner complied with the revised scope from the client when he knew that the actual scope
would be different because of the work already performed. He explained that, although he knew that the scope presented by the client was not correct, if he did not meet the scope requested by the client his proposal would be far off the proposal presented by competitors. The competitors would use the scope presented by the company as the starting point for their calculation while he, if he stuck to the actual scope, would present an audit fee which could be higher than that of the competitors and he could therefore lose the client’s business on this basis.

The RFP process of this company and the proposal process of the external financial auditor identified the following three gaps (see figure 1) which in this case led to a lower proposed audit fee received by the company:

- **Scope gap**: The difference between the hours needed for the previous scope of the external financial audit of the company and the hours needed for the scope presented (the new scope) of the external financial audit;
- **Efficiency gap**: The difference between the hours needed to perform the external financial audit on the presented scope in the current situation and the hours needed to perform the external financial audit in the future situation (i.e. new systems, processes, shared services);
- **Commercial gap**: The difference between the rates previously charged and the rates that will be charged in the future.

![Figure 1: Gaps identified in a selection process.](image)

Later I was invited, after the respective partner had presented the proposal to a group of representatives of the client, to be present at the final negotiations. The client’s Procurement department had invited two shortlisted companies to participate in a competition for the external financial audit of the company. The Procurement department presented a slide (see figure 2) in which they showed anonymously the quotes from the four different external financial auditors that had participated in the tender. The quotes were split into the number of hours per entity and the average hourly rates quoted by the external financial auditors. The
Procurement department had used the lowest of each of the hours and rates to calculate and present a target price as shown in figure 2.

<table>
<thead>
<tr>
<th></th>
<th>Entity A</th>
<th>Entity B</th>
<th>Entity C</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong># Hours</strong></td>
<td># Hours</td>
<td># Hours</td>
<td># Hours</td>
<td># Hours</td>
</tr>
<tr>
<td>External financial auditor A</td>
<td>750</td>
<td>600</td>
<td>250</td>
<td>1600</td>
</tr>
<tr>
<td>External financial auditor B</td>
<td>700</td>
<td>450</td>
<td>300</td>
<td>1450</td>
</tr>
<tr>
<td>External financial auditor C</td>
<td>800</td>
<td>700</td>
<td>225</td>
<td>1825</td>
</tr>
<tr>
<td>External financial auditor D</td>
<td>625</td>
<td>450</td>
<td>250</td>
<td>1225</td>
</tr>
<tr>
<td><strong>Target price</strong></td>
<td>625</td>
<td>450</td>
<td>250</td>
<td>1225</td>
</tr>
<tr>
<td><strong>Average rates</strong></td>
<td>EUR 160.00</td>
<td>EUR 170.00</td>
<td>EUR 160.00</td>
<td>EUR 167.50</td>
</tr>
<tr>
<td><strong>Total fee</strong></td>
<td>EUR 268,000</td>
<td>EUR 225,500</td>
<td>EUR 366,000</td>
<td>EUR 268,000</td>
</tr>
<tr>
<td><strong>Average rates</strong></td>
<td>EUR 167.50</td>
<td>EUR 157.59</td>
<td>EUR 157.81</td>
<td>EUR 150.87</td>
</tr>
</tbody>
</table>

The lowest of each of the hours and rates offered per entity.

Figure 2: Example of table with target price as presented by the client’s Procurement department.

A representative of the Procurement department (purchaser), in the presence of the company’s CFO, explained that the external financial audit would be awarded to the external financial auditor with the lowest price. It explained that both external financial auditors provided the same services, which were in any case determined by legislation. It also expected the price of the external audit to be in the range of EUR 194,500, which it had calculated as the target price.

The purchaser and the CFO asked the partner to absorb this information and present a final proposal by close of business the next day. This proposal would be sent to the client’s Audit Committee for final decision.

The partner decided, based on the information received, to provide an additional discount on our rates to win this proposal. They did not want to reduce the number of hours because that was perceived as a drop in the quality of the audit.

After a week, the partner received information that he had lost the tender to another external auditor. The Procurement representative explained that the competitor had agreed to perform the external financial audit at the target price given and that they had agreed to apply and charge the given hours and rates for the defined scope. This was later confirmed by the CFO of the client company.

I was amazed when I received this information because I had been taught that the number of hours, according to the management of my then employer, was a measure of quality. However, according to the CFO of the client another external financial auditor seemed to be willing to reduce the number of hours when put under commercial pressure, which could in my mind lead to a decrease in the quality of the audit.
I had recognised, as former CPO of an insurance company and Global Category Manager for buying professional services for a financial institution, the selection process and the buying behaviour initiated by the purchasers and CFO of this company. I had seen similar approaches in tenders for services like cleaning and IT software. I had learned from these tenders, as confirmed by the learnings from Reijniers and Ledder (2011), that squeezing on price and minimising scope often results in different services of lower quality than the services which were previously received by a client.

This made me wonder what could happen to the external financial audit of listed companies if the external financial auditor was put under commercial pressure.

From this starting point my research began and I learned that the quality of the services provided by the external financial auditor (audit quality), according to DeAngelo (1981), can be defined “as the probability that a given external financial auditor will discover a breach in the client’s accounting system”. However, DeAngelo combines audit quality with auditor independence, which is defined as “the fact that the external financial auditor will report this breach in the client’s accounting system once discovered”.

I learned that Baker (2005) analysed the impact of increased competition amongst external financial audit firms in the United States. Baker concluded that competitive bidding for contracts has put pressure on audit fees (i.e. lowering audit fees). Baker also concluded that this increased competition has led to the reduction of auditor engagement hours. As such, Baker concluded that this reduction in hours “may compromise the quality of the audit, which could lower the standard of the audit performed and therefore mislead shareholders”.

A study by Causholli, Knechel, Lin and Sappington (2012) stated that auditing services can be seen as a credence good due to the limited information the buyer has. Darby and Karni (1973) defined credence goods as “goods which cannot be evaluated on their quality after the purchase of the goods or where the evaluation of the quality of the bought good is very expensive”. Due to the credence character of the auditing services, the buyer will always choose the external financial auditor with the lowest fees because this is the only information that the buyer has. Causholli et al. (2012) stated that, “the buyer’s limited information could lead to under-auditing, less effort than is appropriate for the client needs, because of the credence character of auditing services”. Under-auditing, according to Causholli et al. (2012), “can lead to a decrease in the quality of the audit and limits the incentives for external financial auditors to improve their technologies”.

I also learned that Dart (2011) had studied the factors that affect auditor independence and found that, in the UK market, “economic dependence” (the external financial auditor is financially dependent on the fees paid by the company that is audited) and “the provision of
non-audit services” are perceived as “greater threats to the independence of the external financial auditor than long-term relationships between the auditor and the client”. Research by Paape and Van Buuren (2012) concluded that in the Dutch market, a long-term client relationship has a significant positive effect on the adjustments made in the annual report after the external financial auditor identified audit differences. Therefore, a long-term relationship, according to Paape et al. (2012), may increase the quality of the audit because the auditor will have a greater understanding of the client, helping to detect breaches in the accounting system.

A study by Van Buuren, Majoor, Paape and Wright (2014) also showed that audit effort, defined for the purposes of this research as an increase in the number of hours, has a positive effort on audit quality. However at the same time this research demonstrated that “economic bonding may undo the benefits of high audit effort in detecting errors and may even lead to overstated earnings”.

A study that did focus on the buying process of financial audits was initiated by Abdul and Mahmud (2011). They suggested that in a buyer-seller relationship, the providers of services cannot be independent from the receivers of services, as providers are compensated by receivers. As “the nature of audit firms’ activities is highly characterised by this same buyer-seller relationship, the same may hold for external financial auditors”.

A common factor in papers studying audit quality and auditor independence is that limited attention was paid to the purchasing process used by companies, which leads to the appointment of an external financial auditor. As the outcome of this purchasing process determines who will be appointed as the new external financial auditor, the question can be raised as to the way in which a purchasing process can contribute to the independence of the external financial auditor and/or the quality of the financial audit.

However, other researchers, for instance Vanstraelen (2000), Wooten (2003) and Balsam, Krishnan and Yang (2003) have concluded that audit quality is impossible to measure.

It should be noted that during my research, which started in 2010, new legislation was introduced in the Netherlands. This legislation determines that, from 1 January 2016 onwards,
an OOB\(^3\) has to select a new external financial auditor every eight\(^4\) years or less. The goal of this new legislation, together with several other proposals, is to enhance the quality of financial audits (i.e. audit quality) and to improve the independence of the external financial auditor (i.e. auditor independence), as explained in Plasterk, Irrgang and Braakhuis (2012) and Vliet (2012) legislative motion (in Dutch: *Initiatiewet “De accountancy na de crisis”*).

Due to this new legislation, companies will be forced to switch auditors at least every eight\(^5\) years and external financial auditors are not allowed to provide non-audit services, including tax services, to audit clients. This research will show that, due to this new legislation, based on the OOBs that were listed on the Dutch stock markets (AEX, AMX or AScX)\(^6\) in December 2012, 61\(^7\) OOBs will have to change their external financial auditor sometime between 2013 and January 2016. In contrast, only nine OOBs listed on the AEX, AMX or AScX changed their external financial auditor between 2008 and 2012. This will probably mean that the number of tenders will increase.

In addition to this, there is another need to investigate the quality of the purchasing process that leads to the appointment of an external financial auditor. In their book *Buying Business Services*, Wynstra and Axelsson (2002) argue that the professionalism of the procurement of industrial products is higher than the professionalism in buying business services (external financial audit services are a business service).

In light of the importance of the purchasing process in the selection of a new external financial auditor; the conclusions by Wynstra *et al.* (2002), Causholli *et al.* (2012); and suggestions made by Abdul *et al.* (2011); this research aims to obtain knowledge and insight into how the services of external financial auditors are selected by OOBs in the Netherlands, and how this selection

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\(^3\) An “*Organisatie van Openbaar Belang*” (OOB) is, according to the Wta, an entity which due to its size or activities can have a large impact on the public domain. To clarify, an OOB is normally a PIE but a PIE is not always an OOB.

\(^4\) In December 2013 the European Parliament agreed that a mandatory tender will have to take place every 10 years and that a company has an option to continue the engagement with the same external financial auditor for another 10 years.

\(^5\) It is expected that this will now change to 10 years, due to the agreement of the European Parliament.

\(^6\) In December 2012, a total of 75 PIEs (70 OOBs + 5 other PIEs) were listed on the AEX, AMX or AScX. See Appendix A for more details.

\(^7\) Of the 70 OOBs listed, only nine changed external financial audit firm between January 2008 and January 2012, which means that 61 OOBs will have to change auditor by January 2016.
process affects the perceived auditor independence and the perceived audit quality as perceived by Shareholders.

From this starting point, section 1.2 will give a further background on the role of the external financial auditor. Section 1.3 formulates the questions that this research tries to answer. Section 1.4 describes the relevance of this research and section 1.5 will provide an overview of the content of the research.

**1.2 The external financial auditor**

### 1.2.1 The role of the external financial auditor

The purpose of an external financial audit is, according to the International Standards on Auditing 200.3 (ISA 200.3), “to enhance the degree of confidence of intended users in the financial statements”. Benston (1985) takes a narrower view because he defines users of the external financial audit as “investors” which are defined as “present and potential shareholders, creditors, customers and employees”.

The services provided by an external financial auditor seem to gain importance when OOBs need to be audited. An OOB, as stated in article 1 of the law for supervision by external financial audit firms (In Dutch: *Wet Toezicht Accountantsorganisaties*) concerning OOBs, has to meet one of the following characteristics:

1) “A legal entity based in the Netherlands and comply with Dutch laws and regulations and be listed on a stock exchange (also called a regulated market)”;
2) “A bank based in the Netherlands, which received a licence in accordance with the law for supervision of financial institutions (in Dutch: *WFT, Wet Financieel Toezicht*)”;
3) “A central credit institution based in the Netherlands which received a licence in accordance with the WFT”;
4) “A life or damage insurer based in the Netherlands which received a licence in accordance with the WFT”;
5) “An organisation, institution or body of which the size or position in society is such that a defective execution of an external financial audit can have a significant influence on public confidence in the entity itself and in the role of the external financial auditor”.

### 1.2.2 Changing external financial auditor market

Greenwood, Li, Prakash and Deephouse (2005) define professional service firms as “organisations of which the primary assets are a highly educated (professional) workforce and whose outputs are intangible services encoded with complex knowledge”.

Axelsson and Wynstra (2002) identified two types of business services: routine services and professional services. Fitzsimmons, Noh and Thies (1998) identify six types of different business
services, which are facility support, equipment support, employee support, employee development, facilitation and professional. As such, an external financial auditor may be seen as a professional service provider.

According to Plasier (2012), the market for these professional services has changed dramatically over recent years. Plasier (2012) states that clients have become more demanding and as result professional service providers have to show results more quickly. At the same time, clients have become less loyal which means that professional service providers have to differentiate more effectively.

According to Offeren, Verdoes and Witjes (2010), external financial auditors also operate in a changing market with two potential causes identified. Firstly, clients ask external financial auditors to participate in RFP processes more often and secondly OOBs, since mid-2008, are obliged to state audit fees paid in their annual report, which has made the public and companies more aware of the fees paid to external financial auditors.

This obligation to report audit fees triggered a survey performed by the Dutch newspaper Het Financieele Dagblad (the Dutch equivalent of the Financial Times) and consultancy firm Alfa Delta Compendium in June 2009. This survey links the fees paid to their external financial auditors by the companies listed on the AEX and AMX in 2008 to the revenue of those companies in the same year. The survey shows that 0.1% of a company’s revenue is spent on its external financial audit.

The same survey provided possible explanations why external financial auditor fees may be higher or lower than 0.1% of company revenues. In addition to incidental differences which may arise for example as a result of a large merger and/or economies of scale, experts mention that the following factors play a role in the fees paid to the external financial auditor:

- The company has not/has an internal audit department (the consequence being that the external financial auditor has to perform more/less work);
- The company has internal reporting challenges (the consequence being that the external financial auditor has to put more effort into testing and repairing the balance sheet);
- The company has a lot of patents (with the consequence that the external financial auditor has to perform alternatives testing to value the patents);
- The organisation has a great number of subsidiaries, all of which must be audited and all of which have their own individual systems instead of being part of one global system (the consequence being that the external financial auditor has to put more effort into testing the different systems).

In May of 2010, the Dutch newspaper Het Financieele Dagblad and consultancy firm Alfa Delta Compendium initiated a similar survey. This survey stated that the fees for the external financial auditor were under pressure due to clients’ cost reduction initiatives. According to the
survey, these cost reduction initiatives directly translated into hourly rates being reduced and an optimisation of the activities performed by the external financial auditor, which led to a decrease in external financial audit fees. A similar survey performed in July 2011 showed that negotiating with and/or changing the external financial auditor could lead to lower audit fees.

However, the composition of the AEX has subsequently changed and not all companies listed on the AEX in 2008 were listed in 2011. At the same time, as explained in §1.1, not all AEX listed companies are Dutch OOBs. Therefore, as part of this research, the annual reports of companies that were listed on the AEX in each of the years 2008, 2009, 2010 and 2011 were collected. Based on these annual reports, a similar analysis to the one done by *Het Financieele Dagblad* and the consultancy firm Alfa Delta Compendium was done to provide a view on how audit fees as a percentage of revenues have developed over time for companies that were listed continuously on the AEX in 2008, 2009, 2010 and 2011.

![Figure 3: Audit fees of listed companies on the AEX and Dutch Listed OOBs on the AEX as a percentage of revenues of these companies & OOBs 2008 – 2011.](image)

Figure 3 shows the trend in the average audit fees of listed companies on the AEX as a percentage of revenue changed from 0.0336% in 2008, 0.0422% in 2009, 0.0352% in 2010 to 0.0294% in 2011. The average audit fees of the OOBs listed on the AEX as a percentage of revenue changed from 0.0566% in 2008 to 0.0564% in 2009, 0.0520% in 2010 and 0.0532% in 2011. At the same time, figure 3 shows that the fees of Dutch Listed OOBs on the AEX seem to develop differently than the fees of all companies listed on the AEX.

As stated previously (see §1.1) new legislation has been introduced which means that approximately 61 OOBs have to change external financial auditor between 2013 and 2016.

This research shows (see §7.5.1.13) that listed companies would like to work with one of the Big4 firms. However, the new legislation will decrease the number of suppliers from which the OOBs can select, and the current external financial auditor cannot longer be selected of course,

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8 The Big4 firms consists of the external financial audit firms: EY, Deloitte, KPMG and PwC.
due to the mandatory rotation. In addition, if a company wants to maintain its current Tax Advisor, which is often another Big4 firm, the Big4 firms from which the OOB can select an external financial auditor will be reduced to two of the four Big4 firms.

### 1.3 Aim and research question

The introduction of this research shows that:

- Listed OOBs, due to new legislation, have to rotate their external financial auditor at least every eight years from January 2016;
- It is not common to change external financial auditor since out of the 70 Listed OOBs only nine changed external financial auditor between January 2008 and December 2012. As such, 61 OOBs have to change external financial auditor by January 2016 and it is expected that these companies will use some kind of a selection process to select a new external financial auditor;
- The new legislation might bring about a reduction in the size of the potential pool from which the companies can select an external financial auditor, given the perceived preference of companies for using one of the Big4 firms (see §1.2.2). The selection processes used for other services have shown that squeezing on price and minimising scope often results in different services, which are of lower quality than the services previously received by a client. As such, it might be that the selection process for a new external financial auditor could have an impact on audit quality and/or auditor independence as perceived by the Shareholders.
- Measuring audit quality and auditor independence is impossible and therefore only the effect on audit quality and auditor independence, as perceived by the stakeholders in the selection process, can be tested (called perceived audit quality and perceived auditor quality).

Given this development and the impact of the services provided by an external financial auditor on society, the overall objective/aim of this research is:

**To obtain knowledge and insight into how the services of external financial auditors are selected by Listed OOBs in the Netherlands and how this selection process affects, according to the stakeholders\(^9\), the auditor independence and the audit quality as perceived by Shareholders.**

\(^9\) As perceived by the stakeholders involved in the selection process.
1.4 Relevance of this research

1.4.1 Theoretical relevance

The theoretical relevance of this research is threefold:

Firstly, to date, there has been limited research into the buying of professional services, even though in the majority of organisations professional services is one of the largest indirect spending areas. The services provided by the external financial auditor are part of these professional services and changes in legislation indicate that the services of the external financial auditor are likely to have to be bought more often in the future.

Secondly, this research will investigate the actual process of selection, including the selection criteria used in a situation of mandatory rotation of the external financial auditor.

Thirdly, this research will provide insight into perceived auditor independence and perceived audit quality and question whether the process of selecting the external financial auditor and mandatory rotation of the external financial auditor can affect the perceived independence and perceived audit quality as seen by shareholders.

1.4.2 Practical relevance

The practical relevance of this research is also threefold.

Firstly, it will be of use to the relevant companies (including shareholders, investors and suppliers) which use the services offered by the external financial auditor by providing an insight into the actual selection process initiated by listed OOBs. This will enable these clients to ask the right questions during the annual stakeholders’ meetings to ensure that auditor independence and auditor quality are geared towards their objectives.

Secondly, it will provide the stakeholders involved in the actual process of selecting the external financial auditor (such as the CFO, Audit Committee and Shareholders) with insights into the structure of the selection process in such a way that they are able to setup a selection process that will ensure perceived auditor independence and increase perceived audit quality.

Thirdly, it will provide the developers of the new legislation, Shareholders and other stakeholders with an overview of the impact of the new legislation and help to establish whether this new legislation meets the stated objectives. If not it can help to ensure that legislators develop legislation which meets the objectives of the stakeholders.

1.5 Outline and overview of this research

This research consists of both a theoretical and an empirical part and the content is structured as presented in figure 4.
As presented in figure 4, chapter 1 provides the introduction into the research.

Chapter 2 will provide an overview of the context of the external financial audit with questions such as the following covered: What is an external financial audit? What is the role of the external financial auditor? Who is the principal of the external financial auditor? How can the external financial auditor market be characterised?

Chapter 3 will provide an analysis of the topics that define audit quality and auditor independence. This also serves to ensure that these variables within the research (i.e. audit quality and auditor independence) are defined in the right way.

Chapter 4 will provide an analysis of the Principal Agent Theory and how this relates to the stakeholders involved in the selection of the external financial auditor.

Chapter 5 will provide an analysis of the purchasing theory and how this relates to the services provided by the external financial auditor.

Chapter 6 will present the research aim and research questions. In addition, the conceptual model and the methods used in this research will be introduced.
Chapter 7 will provide the results of the empirical analyses.

Chapter 8 will present next to a summary the conclusions that may be drawn from this research.

Chapter 9 will present practical recommendations as well as limitations of the study and recommendations for further research.
2 External financial audit services

2.1 Introduction
To conduct an analysis on the impact of the selection process on perceived auditor independence and auditor quality, one first needs to understand what an external financial audit is all about. Understanding the role, purpose, principal, market, stakeholders and clients of the external financial auditor will provide an insight into the characteristics that have to be taken into consideration by the stakeholders involved in the selection process.

Therefore, the second section of this chapter explains the purpose of the external financial audit and the requirements that need to be met by the external financial auditor to be able to perform an external financial audit. This basic understanding is needed to obtain an insight into the selection process used by OOBs. At the same time, this section will show that different stakeholders might have different expectations of the services delivered by the external financial auditor. Finally, it will demonstrate that the services provided by the external financial auditor can be split into a formal audit role but also an informal advisory role (in Dutch: natuurlijke adviesfunctie). As a result it can be concluded that the research will have to start with finding out what, according to the stakeholders involved in the selection process, are the clients, services and objectives of the services provided by the external financial auditor.

The third section of this chapter tries to define who the principals of the external financial auditor are according to Dutch law. It will show that the Shareholder is legally the principal of the external financial auditor and that the Audit Committee or Supervisory Board (in Dutch: Raad van Commissarissen) are the delegated principals.

The fourth section will show the stakeholders who are involved in the actual selection processes of listed OOBs listed between January 2008 and December 2012. It will show that in addition to a limited involvement from Shareholders, several internal stakeholders are involved in the process for selecting the external financial auditor.

The fifth section of this chapter provides an overview of the external financial audit market in the context of Dutch listed companies. The purpose of this section is to demonstrate that the number of available suppliers will become smaller due to new legislation.

The final section will provide a summary of the most important findings of this chapter and how they relate to the scope of this research.
2.2 What is an external financial audit?

2.2.1 What is an audit?
The literature on audit research includes various different definitions of auditing. For example, Costello (2003) defines auditing as “a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.”

However, the emphasis of this research is on the most common form of audits: the audit of financial statements. The audit of financial statements (the external financial audit) is mandated by law for supervision of external financial audit firms (in Dutch: *Wet Toezicht Accountantsorganisaties* (Wta)).

The International Standards on Auditing 200.3 (ISA 200 (2009)) describe the objective of an audit of financial statements “The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. In the case of most general purpose frameworks, that opinion is on whether the financial statements are presented fairly, in all material respects, or give a true and fair view in accordance with the framework. An audit conducted in accordance with ISAs and relevant ethical requirements enables the auditor to form that opinion.” According to ISA 200.6 (2009), “The concept of materiality is applied by the auditor both in planning and performing the audit and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the auditor’s perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both. The auditor’s opinion deals with the financial statements as a whole and therefore the auditor is not responsible for the detection of misstatements that are not material to the financial statements as a whole.”

According to Hayes, Dassen, Schilder and Wallage (2005), the goal, or objective, of the external financial audit is communicating the results of the procedures performed to interested users such as stakeholders of the company. Benston (1985) determines that interested parties of an external financial audit can include owners/shareholders, employees, managers, institutional investors, financial analysts, lenders, government agencies, suppliers, company management and customers.
Ashbaugh et al. (2003) state that “the purpose of an external financial audit is to provide assurance on the reliability of its information content. External financial audits serve to reduce asymmetric information risk by attesting to the reliability of a company's published financial information, thereby allowing current and prospective equity stakeholders i.e. investors, to assess a company's profitability, performance and develop expectations for the distribution of its profits”.

Globally, the quality of the services provided by an external financial auditor is managed by different supervising bodies. For the Netherlands the quality of services of the external financial auditor are supervised by the Financial Markets Authority (in Dutch: Autoriteit Financiële Markten). This supervising body “promotes the conscientious provision of financial services to consumers and supervises the honest and efficient operation of the capital markets”. The previous paragraph shows that the services provided by the external financial auditor are standardised by law and regulations and that every external financial auditor has to meet these requirements. In 1993, Porter conducted research among the different stakeholders of the external financial audit in New Zealand. The objective of this research was to identify the audit expectation-performance gap. This gap is defined as “the gap between society’s expectations of the external financial auditor and the external financial auditors’ perceived performance” (Porter (1993)).

The research by Porter (1993) identified that different stakeholder groups such as the companies audited, the financial community and the general public have different expectations of the services provided by the external financial auditor. Therefore, although the services provided by the external financial auditor seem to be set in stone, different stakeholders still seem to have different perspectives on the services delivered.

### 2.2.2 Duties and obligations

According to Porter (1993), several duties fitted within the existing duties and regulations of the external financial auditor. However, Porter (1993) also identified duties that are not required of the external financial auditor but are, however, expected by the stakeholders. According to Porter (1993), this difference in services delivered and expected indicates that the external financial auditor is expected “to act as society’s corporate watchdogs. Society is becoming more aware of the importance of external financial auditors fulfilling this function and further extension of this function is expected in future”.

This audit expectation-performance gap shows that different stakeholders view the services provided by the external financial auditor and the objectives of the external financial audit differently. If this gap also exists between the stakeholders involved in the selection process, it might lead to tensions in the decision-making process and affect the scope of the services that is likely to be selected by these stakeholders. In light of this expectation gap, this research will
commence by finding out what, according to the stakeholders involved in the selection process, are the clients, the services and the objectives of the services provided by the external financial auditor.

2.2.3 Auditors’ “advice” function

ISA 260.16 (ISA 260 (2009)) states that “The auditor shall communicate with those charged with governance:

(a) The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to those charged with governance why the auditor considers a significant accounting practice, that is acceptable under the applicable financial reporting framework, not to be most appropriate to the particular circumstances of the entity;

(b) Significant difficulties, if any, encountered during the audit;

(c) Unless all of those charged with governance are involved in managing the entity:

(i) Significant matters, if any, arising from the audit that were discussed, or subject to correspondence with management; and

(ii) Written representations the auditor is requesting; and

(d) Other matters, if any, arising from the audit that, in the auditor’s professional judgment, are significant to the oversight of the financial reporting process.

In addition ISA 265.5 mentions that the external financial auditor is required “to communicate appropriately to those charged with governance and management deficiencies in internal control that the auditor has identified during the audit and that, in the auditor’s professional judgment, are of sufficient importance to merit their respective attentions.”

However, in addition to these obligations, another role can be identified for the financial auditor as is considered appropriate, according to Frielink and De Heer (1985), by the profession and users of the audit within the Netherlands. According to Frielink et al. (1985), the external financial auditor will encounter during his normal course of work several situations that can be improved to minimise the risks of the company. It is, according to Frielink et al. (1985) expected that the external financial accountant informs the management of these risks and perhaps include advice about how these risks could be mitigated. This is seen as the advice function (in Dutch: natuurlijke adviesfunctie). Frielink et al. (1985) state that this advice function could include advice on “shortages in the internal & external reporting, gaps in the internal controls, inaccuracies in the costing methods, cumbersome or inadequate administrative procedures, financing issues or others”.

In addition, although in the Netherlands it is not required by law, in general the “auditor is expected to present this letter as a component of the audit as a display of the work performed” (Manson, McCartney and Sherer (2001)). According to Manson et al. (2001), a management letter may also include comments on other issues as well as business advice in areas in which the auditor is competent.
The purpose of the comments and advice presented in the Management Letter are:

1) “Improving accounting (policies), financial planning/management, risk management and the systems of internal control”;
2) “Improving efficiency and effectiveness of the business”;
3) “Raising any other matters which have come to the auditor’s attention”.

As such, the auditor has an “advice” role (in Dutch: natuurlijke adviesfunctie) when auditing the financial statements. The direct recipients of this advice are the Management Board, Supervisory Board and/or Audit Committee. Understanding that this service is also delivered by the external financial auditor is crucial because it might be that certain stakeholders involved in the process for selecting the external financial auditor do not take this service into consideration when selecting a new external financial auditor.

2.2.4 Requirements
An external financial audit firm can only perform an external financial audit on a listed company in the Netherlands if granted a licence by the Financial Markets Authority (in Dutch: Autoriteit Financiële Markten (AFM)). The AFM will only grant a licence to “an applicant who has demonstrated that he himself and the external financial auditors employed by him or affiliated with him comply with the standards laid down in the Audit Supervision Act”.

In addition to a licence, the regulator expects the external financial auditor to meet certain audit quality standards. According to DeAngelo (1981), audit quality and auditor independence can be defined “as the probability that a given external financial auditor will discover a breach in the client’s accounting system”.

The regulator expects the external financial auditor to meet certain independence requirements, which are defined by DeAngelo (1981) as “the fact that the external financial auditor will report this breach in the client’s accounting system once discovered”. However in the Netherlands further expectations regarding independence are defined in the Nadere Voorschriften Onafhankelijkheid (NVO (2006))\textsuperscript{10}, which is applicable to individual external financial auditors in the Netherlands (see §3.3.1).

\textsuperscript{10} Since 2014 the VIO (in Dutch: Verordening Inzake de Onafhankelijkheid van accountants bij assurance-opdrachten) is applicable to Dutch external financial auditors. However, the VIO was not in place during the time the interviews with the experts took place and as such cannot be considered as input for this research.
2.3 The principal of the external financial auditor

The law for the supervision of external financial audit firms (article 2:393, Book 2, Dutch Civil Code) states that OOBs should institute an Audit Committee.

“The General Meeting of Members and Shareholders is entitled to the provision of the audit assignment. If the Audit Committee is not qualified, then the Supervisory Board will have the authority. When there is no Supervisory Board or when the Supervisory Board is in default, the Management Board will be responsible for providing the assignment. The assignment can be withdrawn by the General Meeting of Shareholders and by those who provided the assignment. Furthermore, an assignment that is provided by the Management Board can be withdrawn by the Supervisory Board.”

According to the Dutch Corporate Governance Code (2008), “the external financial auditor is appointed by the General Meeting of Shareholders. The Supervisory Board shall nominate a candidate for this appointment, for which both the Audit Committee and the Management Board advise the Supervisory Board. The remuneration of the external financial auditor, and instructions to the external financial auditor to provide non-audit services, shall be approved by the Supervisory Board on the recommendation of the Audit Committee and after consultation with the Management Board”.

According to the Dutch Corporate Governance code (2008) article V2.3 “At least once every four years, the Supervisory Board and the Audit Committee shall conduct a thorough assessment of the functioning of the external financial auditor within the various entities and in the different capacities in which the external financial auditor acts. The main conclusions of this assessment shall be communicated to the General Meeting of Shareholders (In Dutch: Algemene Vergadering van Aandeelhouders (AVA)) for the purposes of assessing the nomination for the appointment of the external financial auditor”.

“The Management Board and the Audit Committee shall report their dealings with the external financial auditor to the Supervisory Board on an annual basis, including its independence in particular (for example, the desirability of rotating the responsible partners of an external financial audit firm that provides audit services, and the desirability of the same external financial audit firm providing non-audit services to the company). The Supervisory Board shall take this into account when deciding its nomination for the appointment of an external financial auditor, which shall be submitted to the General Meeting of Shareholders”.

Finally, the Dutch Corporate Governance code (2008) also explains that, “the external financial auditor may be questioned by the General Meeting of Shareholders in relation to his statement on the fairness of the annual accounts. The external financial auditor shall therefore attend and be entitled to address this meeting”.

29 | P a g e
2.4 Stakeholders involved in the process for selecting the external financial auditor

A desk research was conducted to gain insight into the stakeholders involved in the process for selecting the external financial auditor. To conduct this analysis, a list was compiled of the listed entities (AEX, AMX and AScX) as at 31 December 2012, see Appendix A. The annual reports of these companies were collected from their websites, after which the company annual reports for 2008, 2010 and 2012 were analysed. Based on this list, the companies that changed auditors in the period 1 January 2008 to 31 December 2012 were selected.

This yielded a selection of nine companies that changed their auditor, i.e. out of the 75 listed companies in the Netherlands. The requests for proposal (RFPs) put into the market by these companies were collected from within KPMG where available. Four RFPs were not available and the respective companies were contacted by email, which resulted in two additional RFPs. One other company mentioned that they had not put an official RFP on the market and the other company did not provide any details.

This resulted in seven RFPs of listed OOBs and an analysis of these RFPs showed that the following stakeholders are mentioned within them. As such, it can be assumed that these stakeholders play a role in the process for selecting the external financial auditor (see table 1).

<table>
<thead>
<tr>
<th>Stakeholders mentioned in RFP</th>
<th>Number of times mentioned</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFO</td>
<td>7</td>
</tr>
<tr>
<td>Audit Committee</td>
<td>5</td>
</tr>
<tr>
<td>CEO</td>
<td>5</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td>4</td>
</tr>
<tr>
<td>Finance Department</td>
<td>3</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>3</td>
</tr>
<tr>
<td>Procurement</td>
<td>2</td>
</tr>
<tr>
<td>Controller</td>
<td>1</td>
</tr>
<tr>
<td>Risk</td>
<td>1</td>
</tr>
<tr>
<td>Shareholder Meeting</td>
<td>1</td>
</tr>
<tr>
<td>Reporting &amp; Consolidation</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 1: Overview of the stakeholders mentioned in nine RFPs of listed OOBs.

Table 1 showed that interested users of the services, which according to Benston (1985) include owners/shareholders, employees, institutional investors, financial analysts, lenders, government agencies, suppliers and customers, are almost never mentioned within the RFPs put onto the market by listed OOBs. The analysis also showed that the selection process seems mainly driven by departments within the company that will be audited by the external financial auditor.
2.5 The external financial audit market

A list of Dutch listed companies can be found in Appendix A: List of Dutch listed companies. This list, which is summarised in table 5, clearly shows that the following number of external financial auditors perform the following number of external financial audits with listed Dutch companies.

<table>
<thead>
<tr>
<th>External financial auditor as at December 2012</th>
<th>Number of external financial audits at listed companies</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>BDO</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Deloitte</td>
<td>17</td>
<td>Of which 2 in a Dual Audit¹¹</td>
</tr>
<tr>
<td>EY</td>
<td>14</td>
<td>Of which 1 in a Dual Audit</td>
</tr>
<tr>
<td>KPMG</td>
<td>26</td>
<td>Of which 1 in a Dual Audit</td>
</tr>
<tr>
<td>Mazars</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>PwC</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>77¹²</strong></td>
<td>Of which 2 in a Dual Audit¹³</td>
</tr>
</tbody>
</table>

Table 2: Overview of number of listed OOBs audited by each external financial auditor.

Table 2 shows that most of the listed companies (96%¹⁴) are audited by one of the Big4 firms, namely Deloitte, EY, KPMG or PwC, or by a Dual Audit by two Big4 firms. Medium-sized external financial auditors such as BDO or Mazars only perform an external financial audit on three of the listed companies, which is a market share of 4%¹⁵.

To measure the density of dominant external financial audit firms within a market the Herfindahl-Hirschman Index (referred to as HHI), a common methodology used to determine market concentration, can be used. This index often emerges in theoretical models and has the merit of combining information about the market shares of all the external financial audit firms in the market, instead of just the largest external financial audit firms according to Martin (1994).

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¹¹ Dual Audit means that two external financial auditors are performing the external financial audit of the company.

¹² 77 external financial audits minus 2 dual external financial audits equals 75 companies.

¹³ Dual Audit means that two external financial audit firms are performing the external financial audit of the company.

¹⁴ 72 of the 75 listed companies are audited by Big4 firms, which is equal to 96%.

¹⁵ 3 out of the 75 listed companies are audited by either BDO or Mazars, which is equal to 4%.
When applying this index\textsuperscript{16} to the AEX, AMX and AScX during 2012, an HHI score of 0.253 is determined. The Big4 firms together have an index outcome of 0.252, which implies that the external audit market of Dutch listed companies is a concentrated market, which may also be characterised as an oligopoly\textsuperscript{17}.

As such, it seems that listed companies tend to select one of the Big4 firms as the supplier of the external financial audit. This preference could affect the outcome of the selection process because the new legislation (see §1.2.2) will ensure that the market is limited to three or two of the Big4 firms\textsuperscript{18}.

2.6 The role of the external financial auditor in summary

In summary, this chapter shows that the services provided by the external financial auditor for OOBs are, in contrast to most other services, mandated by law.

It is also clear that the services provided by the external financial auditor provide assurance to stakeholders such as shareholders, investors, lenders, employees, government bodies, suppliers and clients, which can be impacted by the non-performance of a company. This shows that this service, in comparison to other services, is delivered to a wide range of different stakeholders of which the Shareholder is the most important customer as well as the formal principal.

Porter (1993) has already identified that these stakeholders might have different expectations regarding the roles and duties of an external financial auditor. Different expectations might lead to different requirements being set in a selection process and this might lead to different expectations of the services delivered. It is crucial therefore to understand the expectations of the stakeholders in order to understand the impact on the selection process.

At the same time, it is clear that the external financial auditor has to meet certain audit quality and audit independence requirements, because the external financial auditor needs to be able to discover breaches in the accounting system of a company and needs to operate independently from the company to report these breaches. This is also different from any other services delivered and/or bought by a company.

\textsuperscript{16} Applied to the 2012 figures including the dual audits.
\textsuperscript{17} A market which is dominated by a small number of sellers.
\textsuperscript{18} Due to mandatory rotation a company cannot stay with its current Big4 firm and as such it can only select one of the other three Big4 firms. However if another Big4 firm is also their tax supplier, and the company does not want to change tax supplier, the company can only select from the two remaining Big4 firms.
As well as providing assurance, the external financial auditor also performs an “advice” role as stated by Frielink et al. (1985). In this role, the external financial auditor can provide advice on, for instance, improving accounting policies, financial planning/management, risk management and the systems of internal control. However, this “advice” is made available to a subset of stakeholders i.e. the Management Board, Audit Committee and Supervisory Board, which again might lead to different expectations of services to be delivered by the external financial auditor.

This chapter also made clear that the Shareholder according to Dutch legislation is the formal principal of the external financial auditor because the Shareholder approves, during the annual Shareholders’ meeting, the appointment of the external financial auditor. The Shareholder, according to Dutch legislation, has delegated the responsibilities of managing the external financial auditor to the Audit Committee or the Supervisory Board in cases where no Audit Committee is in place. As such, the Audit Committee or Supervisory Board can be seen, according to legislation, as the delegated principal of the external financial auditor who should be responsible for selecting the services of the external financial auditor. However an analysis of the RFPs put on to the market between January 2008 and December 2012 (see §2.4) has shown that internal stakeholders may have a larger say in the selection process.

This chapter also has shown that a limited number of OOBs listed in December 2012 have changed their external financial auditors between 2008 and 2012, which means that it is not common to change external financial auditor. In addition, it has shown that approximately 6119 listed OOBs will have to change external financial auditor before 1 January 2016.

Finally, this chapter has demonstrated that the external financial audit market can be classified as an oligopoly in which the Big4 firms have a dominant position. The new legislation will ensure that the number of suppliers that can be selected by a company is becoming smaller because a company will only be able to choose from either three or two of the remaining Big4 firms20. This limitation of the market could play a part in the outcome of the selection process and the choices a company has to select a supplier.

19 Of the 75 listed companies, 70 are considered OOBs. Of these 70 OOBs, only nine companies have put a RFP on the market and as such 61 companies will have to select a new external financial audit provider before 1 January 2016.

20 Due to mandatory rotation, a company cannot stay with its current Big4 firms and as such it can only select from the other three Big4 firms. However another Big4 firm may already be the company’s tax supplier, and if the company does not want to change tax supplier, it can only select from the two remaining Big4 firms.
3 Audit quality and auditor independence

3.1 Introduction
The previous chapter already explained that audit quality and auditor independence are prerequisites for delivering an external financial audit. The purpose of this chapter is to obtain a clear definition what is meant by audit quality and auditor independence to ensure the construct validity of this research. At the same time, this chapter will identify the measures that determine audit quality and auditor independence so that it can be tested whether these measures play a role in the selection process.

Understanding these measures is of importance for a selection process because selecting an external financial audit provider based on a lower number of hours could, according to Baker (2005) “compromise the quality of the audit, which could lower the standard of the audit performed and therefore mislead shareholders”; while selecting a provider based on the lowest price could, according to Causholli et al. (2012), “lead to a decrease in the quality of the audit and limit the incentives for external financial auditors to improve their technologies”.

Therefore, the second section of this chapter describes the theoretical context related to audit quality. It will explain the methods that are currently used to measure audit quality. The findings of this section will be used to test whether and to what extent these measures are used in the process for selecting the external financial auditor.

The third section of this chapter describes the theoretical context of auditor independence. As such, it will explain the threats to auditor independence and it will explain how legislation threatens independence. The findings of this section will be used to test and/or measure whether the independence of the external financial auditor is influenced during the selection process.

The final section of this chapter will provide a conclusion on both of the topics established and their practical relevance to this research.

3.2 Audit Quality

3.2.1 Audit quality in general
There many definitions of audit quality. ISA 200 (2009) for instance states that the leadership of an external financial audit firm and the engagement partner and other team members involved in the external financial audit are responsible for the overall audit quality in the engagement. According to ISA 200 (2009), audit quality is achieved by:

- Performing work that complies with professional standards and applicable legal and regulatory requirements;
• Complying with the firm’s quality control policies and procedures as applicable;
• Issuing auditor’s reports that are appropriate in the circumstances;
• Raising concerns without fear.

Epstein and Geiger (1994) tested investors’ visions of audit quality. They found that 70% of investors believed that an external financial auditor should provide absolute assurance that there are no material misstatements or fraud in the financial statements.

Wooten (2003) stated that external financial auditors themselves think of audit quality in a different way. According to Wooten (2003), external financial auditors “will in addition to strictly following Generally Accepted Auditing Standards (GAAS), also assess business risk with the intention of avoiding litigation, minimising client dissatisfaction and limiting the damage to a reputation that could follow a ‘bad’ audit”.

DeAngelo (1981), which is according to Breesch, de Muylder, Branson and Hardies (2013) the most commonly used definition of audit quality in academic literature, defines the quality of audit services “as a probability that a given auditor will both discover a breach in the client’s accounting system and report the discovered breach”. Given the fact that this definition is commonly used in academic literature, it will also be the starting point for this research.

Many researchers have tried to develop and identify different ways of measuring audit quality because audit quality is seen as the starting point for the services provided by the external financial auditor. Balsam, Krishnan and Yang (2003) even state that “auditor quality is multidimensional and inherently unobservable; there is no single auditor characteristic that can be used as proxy for it”. As such, both direct and indirect measures have been identified to determine audit quality.

Some examples of direct measures are for instance:
• Sample of bankruptcies; by Geiger and Raghunandan (2002);
• Quality control reviews; by Deis and Giroux (1992),
• Desk reviews; by O’Keefe and Westort (1992), O’Keefe, King and Gaver (1994), Colbert and O’Keefe 1995);
• SEC enforcement actions; by Dechow, Sloan and Sweeney (1996);
• Financial reporting compliance with GAAP in a not-for-profit environment; by Krishnan and Schauer (2000).

Some examples of indirect measures are for instance:
• Size of the external financial audit firm; by DeAngelo (1981);
• Audit fees paid by the company; by Simunic (1980), Breesch et al.(2013);
• Number of hours spent by the external financial auditor; by Deis and Giroux (1996), Meyers, Meyers and Omer (2003);
• Independence and expertise of Audit Committees; by Carcello and Neal (2000, 2003), Cohen, Hoitash, Kirshnamoorthy and Wright (2013);
• Industry expertise; by Francis (2004), Solomon, Shields and Whittington (1999), Francis, Reichelt and Wang (2005);
• Audit tenure i.e. length of the auditor/client relationship; by Mautz and Sharaf (1961); Johnson, Khurana and Reynolds (2002), Junaidi, Miharjo, and Hartadi, B. (2012);
• Professional scepticism; by Nelson (2009), Bamber, Ramsay and Tubbs (1997).

It is practically impossible to directly observe and measure audit quality according to Vanstraelen (2000) and Wooten (2003). Therefore, to directly observe variations in audit quality, different measures have to be taken into account according to Tagesson, Sjödahl, Collin, Olsson and Svensson (2006). As such, one would expect, if a company wants to receive a high quality audit, that a selection process would include selection criteria that relate to the quality measures identified in this chapter.

3.2.2 Commonly used measures to measure audit quality
As explained in §3.2.1 both direct and indirect measures can be used to measure audit quality. “Direct measures have posed empirical challenges due to difficulty generalising results, low occurrence rates, and the proprietary nature of the data,” according to Chadegani (2011). Therefore it is expected that direct measures will not be used as criteria in the process for selecting the external financial auditor, which seems to concur with the initial findings of the analysis of RFPs put into the market by listed OOBs between 1 January 2008 and 31 December 2012 (see §5.3).

In addition it is expected that “audit tenure (length of the audit relationship)” and the “independence and expertise of Audit Committees” will not be used by the stakeholders in the process for selecting the external financial auditor to measure audit quality. This is because the audit tenure (the length of the audit relationship) will be determined by the legislative requirement for mandatory rotation. In addition, the independence and expertise of Audit Committees is a measure that cannot be influenced by the external financial auditor selection process.

Therefore, it could be expected that for the most part the indirect measures outlined below can play a role in the selection of a new external financial auditor, if a company wants a high-quality audit.

3.2.2.1 Size of the external financial audit firm
The study by DeAngelo (1981) demonstrates that there is a direct correlation between the size of an external financial audit firm and the quality of the audit performed. In her study, auditor size is measured by the number of clients and the fraction of the auditor’s income that each client represents. Auditor firm size is, according to DeAngelo (1981), a proxy for quality because
no single client is important to a large auditor and the auditor has a greater reputational risk. This risk is determined by the number of clients the firm stands to lose if it misreports. The studies of Simunic and Stein (1987), and Francis and Wilson (1988) also argue that the large external financial audit firms protect their brand name and reputation by performing high-quality audits.

Becker, DeFond, Jiambalvo and Subramanyam (1998) also find that large external financial audit firms represent high audit quality and small external financial audit firms represent low audit quality. Becker et al. (1998) indicates that higher audit quality is associated with less information asymmetry and higher information quality. In addition, Teoh and Wong (1993) find that the information from Big4 firms is of greater value to the stock market than information audited by non-Big4 firms. This is consistent with the assumption that audits by Big4 firms are of higher quality.

3.2.2.2 Audit fees paid
Several studies have shown that audit fees can be an indicator of audit quality because the more an auditor is paid, the more work and quality the auditor will provide according to Simunic (1980), O’Sullivan (2000) and Francis (2004).

Breesch et al. (2013) even find “extremely low audit fees and extremely high audit fees to be a potential treat to audit quality”. However, at the same time Breesch et al. (2013) find that “the likelihood that the external financial auditor will issue an unqualified opinion regarding a going concern, even though the client goes bankrupt within twelve months of the year-end, is lower when the external financial auditor earns a higher audit fee”.

3.2.2.3 Number of hours spent by the external financial auditor
According to Deis et al. (1992) “the number of audit hours seems to be an acceptable proxy for audit quality differences among audit firms of similar size when a direct measure of audit quality is unavailable”. O’Sullivan (2000) states that the number of hours spent by the external financial auditor is a good proxy for audit quality as it can be assumed that many hours mean a more extensive external financial audit, often with the use of more industry specialists.

3.2.2.4 Industry expertise
Solomon et al. (1999) argue that external audit firms with more clients in an industry have more opportunities for their employees to acquire deep industry knowledge. Auditors with deep industry knowledge will provide a better quality audit than auditors without industry knowledge. Francis et al. (2005) state that “national and city specific industry leadership jointly affect auditor reputation and pricing”. In fact, Francis et al. (2005) did find that clients’ are willing to pay a premium of up to 19% if industry leadership is available. Balsam et al. (2003)
document that abnormal accruals are smaller for companies audited by industry experts, implying a higher audit quality.

3.2.2.5 Professional scepticism

According to the Statements on Auditing Standards, professional scepticism is “an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor uses the knowledge, skill, and ability called for by the profession of public accounting to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence”. Similar wording is used in ISA 200.15. This states that “the auditor shall plan and perform an audit with professional scepticism, recognising that circumstances may exist that cause the financial statements to be materially misstated.” Therefore, an external financial auditor needs to have a questioning mind to assess the evidence critically according to Nelson (2009).

3.3 Auditor independence

3.3.1 Definition of auditor independence

As stated earlier, DeAngelo (1981) argues that an auditor is independent if the auditor reports any breach of accounting regulations he discovers. An early study by Mautz et al. and Sharaf (1961) already stated that the independence of the auditor is crucial for the effectiveness and success of the audit profession. Gill and Cosseral (1996) also emphasise that independence is the cornerstone of the auditing profession.

The definition of independence as stated in the Nadere Voorschriften Onafhankelijkheid (NVO) (2006)\(^\text{21}\), which applies to individual auditors in the Netherlands when performing a financial audit, has two important aspects.

Firstly, an auditor is in fact independent if he or she has the ability to make independent audit decisions even if there is a perception of lack of independence, or if the auditor is placed in a potentially compromising position. In short, the actual auditor independence is a mental state and is in essence engrained in an individual auditor’s mind. However, even if an auditor is in fact independent, one or more factors may lead the public to believe the auditor does not appear to be independent according the NVO (2006).

\(^{21}\) Since 2014, the VIO (in Dutch: Verordening Inzake de Onafhankelijkheid van accountants bij assurance-opdrachten) is applicable for Dutch external financial auditors. However the VIO was not in place during the time the interviews with the experts took place and as such cannot be considered as input for this research.
Secondly, an external financial auditor must be seen to be independent in appearance (in Dutch: *in schijn onafhankelijk zijn*). The auditor is responsible for avoiding all of those facts and situations that would suggest to a knowledgeable, reasonable third party in possession of all the relevant information that the objectivity of the auditor is in doubt. Some threats to the independence of an auditor are self-interest, self-review, advocacy, becoming too familiar with the client and intimidation by the client according to NVO (2006) (see paragraph §2.2.4). Other threats to the independence of the auditor are services and relationships that existed prior to its appointment and services and relationships arising during the appointment according to the NVO (2006).

Given the fact that this research is conducted in the Netherlands, the definitions stated in the NVO (2006) will be used as starting point for this research.

### 3.3.2 What is impacting auditor independence?

Studies performed by DeAngelo (1981) and Beck, Frecka and Solomon (1988), Van Buuren *et al.* (2014) identify that the degree of economic relationships between the auditor and the client can influence auditor independence. Both studies agree the more money an auditor receives from his client, the more incentive the auditor has to give an unqualified audit report.

According to Ashbaugh, Lafond and Mayhew (2003), “the fee ratio, audit fees versus non-audit fees, does not capture the economic importance of the client to the audit firm when the total client fees are immaterial to the audit firm as a whole”. As such, Ashbaugh *et al.* (2003) find no evidence supporting the claim that auditors become less independent as a result of clients purchasing more non-audit services.

Dart (2011) finds that economic dependence and the payment of non-audit fees are perceived as greater threats to auditor independence than long-term relationships between the auditor and the client.

Research by Shockley (1981) finds that auditor’s tenure exceeding five years is not significantly perceived as reducing auditor independence. Dart and Chandler (2013) did research about whether investors perceived the employment of an ex-auditor by a client company as a threat to auditor independence. The outcome of their research showed that investors did not show great concerns about the effect of employment of an ex-auditor by a client company on auditor independence.

On a partner level, Carcello, Hermanson and Huss (2000) suggest that auditors in “small pool” external financial audit firms, where compensation of partners is based on a small pool of clients, may be more concerned than partners in “large pool” external financial audit firms, where compensation of partners is based on a large number of clients, when making certain
going-concern opinion decisions but that further research is needed to conclude whether this really impacts auditor independence.

Lindberg and Beck (2002) investigated Certified Public Accountant (CPA) perceptions of the impact of non-audit services on auditor independence both before and after Enron went bankrupt. Their research concludes that CPAs’ perceptions of the effects of non-audit services on auditor independence were more negative after the bankruptcy than before the bankruptcy. However, the research also concludes that non-audit services negatively affect the public’s perception of independence.

Hollingsworth and Li (2012) investigated whether investors’ perceptions of auditors’ economic dependence on the client changed after the implementation of the Sarbanes Oxley (SOx) law in 2002. Here client importance was measured as the proportion of client non-audit services, audit fees, or total fees to the total audit office revenue. The overall results indicate that the investors’ perception of auditors’ economic dependence has changed in the post-SOx period and that new SOx requirements have mitigated, but not completely eliminated, investors’ concerns over the threat of economic fee dependence. As such, the investors still have the perception that independence is threatened by non-audit fees.

### 3.4 Audit quality and auditor independence in summary

The quality of the services provided by the external financial auditor can be determined by two separate characteristics which, according to DeAngelo (1981), are strongly related.

The first characteristic is the technical ability of the external financial auditor to identify misstatements. The second characteristic is that the external financial auditor is independent of the company that is audited to require the adjustment of any misstatements.

This position is unique in comparison to other services because it shows that the external financial auditor has to be independent while being paid by the company and selected by stakeholders from within the company.

For this research the definition, by DeAngelo (1981), of audit quality “as a probability that a given auditor will both discover a breach in the client’s accounting system and report the discovered breach” will be used.
As stated previously many measures are identified to determine audit quality. However not all of these can be influenced by suppliers and therefore it is expected that the following measures of audit quality might be used in the process for selecting the external financial auditor:

- Size of the external financial audit firm;
- Number of hours spent by the external financial auditor;
- Industry expertise;
- Price of the audit;
- Professional scepticism.

The second characteristic is auditor independence. An external financial auditor is independent if it has the ability to make independent audit decisions, and if the external financial auditor is independent in appearance (or is perceived to be independent). This definition of independence, which is based on the NVO (2006), will be used during this research.

Different researchers such as Hollingsworth et al. (2012) or Lindberg et al. (2002) have found that economic dependence and the payment of non-audit-related fees are perceived as greater threats to auditor independence than long-term relationships between the auditor and the client. However, the new legislation within the Netherlands does not allow external financial auditors to provide non-audit services. As such, the concerns of the economic fee dependence arising from the provision of non-audit services can no longer apply to the Dutch situation. Therefore, this research will analyse if there are other challenges within the selection process (i.e. selection criteria and other) that might impact auditor independence.
4 The external financial auditor and the Principal Agent Theory

4.1 Introduction

It became clear during my analysis of the selection process (see §2.4) that several stakeholders are involved in the process of selecting the external financial auditor. Therefore, it is necessary to analyse how the objectives of these stakeholders can impact that selection process. In addition, an analysis has to be performed as to who the real principal of the external financial auditor is. There are many ways to conduct such analyses but for the purpose of this research, the Principal Agent Theory was used to analyse these objectives and their impact on the services provided by the external financial auditor and the selection process. This methodology has been selected because Tate, Ellram, Bals, Hartmann and van der Valk (2009) and The Audit Quality forum (2005) used the Principal Agent Theory in relation to a purchasing process for the external audit services so the outcomes of this research can be compared.

As a result, this chapter will describe the Principal Agent Theory and the impact of the stakeholders’ objectives on the external financial auditor. Jensen and Meckling (1976) define the Agent relationship as a contract under which one party (the principal) engages another party (the agent) to perform a service on behalf of the principal.

As shown in §2.3, the external financial auditor, in this case the agent, operates within the environment of amongst others the Management Board, Supervisory Board, Audit Committee and Shareholders. However the findings of §2.4 show that more stakeholders other than these four influence the assignment given to the external financial auditor. As such, it seems that the external financial auditor has to deal with several principals and/or other representatives of principals. This chapter will therefore try to gain insight into the principals of the external financial auditor because this could influence the process for selecting the external financial auditor. At the same time, this chapter will try to establish whether goal conflicts arise between the principals and/or other agents of the principals involved in the selection process.

As such, the second section of this chapter will describe the theoretical context of the Principal Agent Theory such as the agent relationship, the agent challenges and assumptions.

The third section of this chapter will describe the research performed around the Principal Agent Theory related to the external financial auditor.

Finally, a conclusion is drawn which combines the learnings of this chapter and how they relate to this research.
4.2 Principal Agent Theory

4.2.1 Agent relationship
The principal Agent problem is a side effect of the benefits of specialisation: management is specialised in managing the company’s daily affairs and shareholders are specialised in risk bearing. It describes the difficulties that arise under conditions of incomplete and asymmetric information when a principal hires an agent to pursue the principal’s interests. It also involves changing the rules of the game so that the self-interested rational choices of the agent coincide with what the principal desires.

According to Fama and Jensen (1983), an organisation is a network of contracts among the owners of production factors and customers. These contracts specify the rights and responsibilities of each agent in the organisation and provide the performance criteria and payoff functions that come with it.

4.2.2 Agent problems
According to Eisenhardt (1989), there are two important problems concerning agent relationships.

The first arises when the desires or goals of the principal and agent conflict. According to Eisenhardt (1989), this might occur when it is difficult or not economically feasible for the principal to monitor the behaviour and performance of the agent. In such a case, the agent might follow his own agenda, instead of acting in support of the goals of the principal. The agent is able to do so because he has a considerable advantage over the principal regarding information on the company. For example, managers have information about the amount and quality of reported earnings, have inside information regarding loan arrangements and know what external factors could endanger the company. If interests are misaligned and there is goal incongruence, then information may be hidden by the agents, thereby creating information asymmetry.

The second problem arises when the principal and agent have a different attitude towards risk. When this happens, the principal and the agent might prefer different actions or decisions to be taken because of different risk preferences. This difference in risk preferences is caused by the fact that agents are more bound to a specific company and, as such, have more firm-specific human and financial capital. For example, agents acquire complex networks of people who are relevant for the specific firm, but far less useful for other firms; and they normally possess relatively more equity of the company for which they work. These factors make agents more risk-averse compared to principals, who can diversify their risk by holding differentiated stock portfolios (Eisenhardt (1989)).
4.2.3 Agent Theory assumptions

According to Eisenhardt (1989), in the Agency Theory, five assumptions related to the behaviour of people and one assumption relating to the organisation can be identified. The assumptions related to the behaviour of people are self-interest, bounded rationality, risk aversion, information and utility of information. The organisational assumption is goal conflict, which is related to goal incongruence for the principal and the agent.

**Self-interest** is best described as a consequence of human nature; different persons will respond differently to particular situations to align their actions with personal goals or the goals of their direct environment.

**Bounded rationality** is a concept proposed by Simon (1957). The concept is based on the fact that decision-making of individuals is limited by the information the individual has. Bounded rationality is not irrationality according to Gigerenzer and Selten (2002). The decision-maker has neither the time nor the ability to make the most correct decision nor does it choose from a simplified array of choices available. In short, bounded rationality decision making is the theory of optimising the decision made in view of the information and resources that are available.

**Risk aversion** relates to the amount of risk the agent and principal are willing to take to achieve certain goals. In the Agency Theory assumption, the difference in the level of risk aversion between the principal and the agent can cause differences in the decision-making process.

In the Agency Theory, **information** is viewed as a commodity according to Eisenhardt (1989). If the interests of the principal and the agent are not aligned, information asymmetry can be a consequence according to Tate, Ellram, Bals, Hartmann and van der Valk (2009). Information can be controlled by the organisation to ensure that the agent acts in their best interest.

The **utility of information** is directly related to the aforementioned information, as the utility strongly depends on the sharing of information between the principal and the agent.

4.3 Agent Theory relating to the external financial audit

Fama et al. (1983) have said that in large organisations decision management and decision control should be separated. In particular, if specific knowledge is required to reach a good decision it is wise to delegate those decisions to the level were the information needed is available because it will reduce agent and information costs.

At the same time Fama et al. (1983) state that, “the contract structure in the definition of an organisation limits the risks faced by most agents by guaranteeing them (partly) fixed payoffs. For shareholders, being involved in decision control is very costly because of their limited influence, lack of relevant knowledge and resources and because they are unqualified for roles in the decision-making process.
This makes it more efficient for them to delegate their decision control rights to specialised agents such as the Management Board”. As a result, almost total separation and specialisation of decision control (Management Board) and residual risk bearing (Shareholders) is common in these corporations according to Fama et al. (1983). As such, Agent Theory can be used to help design the most effective types of contracts and relationships to provide fair outcomes to all parties.

The principal tries to reduce the information asymmetry between him and the company’s management. For a principal to evaluate the performance of the agent (Management Board), he requires information about the company’s results. Therefore, financial reporting should provide timely and credible information to perform the necessary control measures according to Healy and Wahlen (1999). However, this evaluation is only possible when the information provided by the agent is sufficiently reliable. For the principal to trust the information the agent provides, assurance on the reported information is required, by means of a financial audit. In principle, such audits could be conducted by Shareholders, but they may not have the necessary expertise. Therefore, Shareholders seek to hire expert labour in the form of independent external financial auditors, who have an incentive to behave honourably because misbehaviour can erode their reputational capital and capacity to earn economic rents according to Sikka, Filling and Liew (2009). This means there is an incentive for both management and outside investors to engage reputable external financial auditors, who are, due to their independence, able to construct an objective state of corporate affairs according to Hayes et al. (2005).

In the paper “Agency Theory and the Role of Audit”, according to the Audit Quality Forum (2005) the auditor is viewed as an agent of the Shareholder. The Shareholder as such is defined as the principal of the external financial auditor. The Audit Quality Forum (2005) states that due to the principal-agent relationship, a new form of concern about trust arises. External financial auditors “may be risk averse and being conscious of their potential liability, introduce risk management processes that result in limitations in the scope of their work and caveats in their reports which principals may find frustrating”.

The Audit Quality forum (2005) also states that there are further complexities to consider, beyond that of the Shareholder and Supervisory Board relationship. “For example, wherever audited information is in the public domain, it will be seen as a public good and other stakeholders are likely to make use of it. These stakeholders have differing interests and might not fit easily into the principal-agent model depicted in Agency Theory”.

As mentioned earlier, the information that is necessary to perform the audit can be viewed as a commodity by the external financial auditor. The outcome and quality of the audit are dependent on the information supplied by the principal or another agent of the principal, such
as the Management Board, CFO or Internal Audit Director. The goal conflict in the external financial auditor-Shareholder relationship consists of the desire of the Shareholder to have assurance about the accuracy of the financial statements. The external financial auditor, however, has to maintain a good reputation and therefore installs safeguards in his reporting to the Shareholder. This causes the Shareholder to have uncertainties about the financial statements and thus its goal is not completely achieved. In addition, the management of a company might have an incentive to misrepresent financial information if it for instance receives a bonus based on the performance of the company.

4.4 Summary of the Principal Agent Theory
It can be concluded, based on both this chapter as well as the third chapter, that the Shareholder of a company is the legal/formal principal of the external financial auditor who acts as an agent on behalf of the Shareholder. The Shareholder however has delegated its role to the Supervisory Board/Audit Committee. These delegated principals, in addition to the Management Board, receive (see §2.2.3) more information than the Shareholders. As such, the Supervisory Board/Audit Committee could be identified as a kind of functional principal as presented in figure 5.

![Figure 5: Relationship between the Shareholder, Audit Committee and external financial auditor.](image)

According to the Audit Quality Forum (2005) self-interest and/or bounded rationality impacts the relationship between the Shareholder and the external financial auditor. External financial auditors will primarily act in their own best interest, limiting their potential liabilities by using scope exemptions and reservations in their reporting, while the Shareholder wishes to obtain full assurance on the figures presented by the company.

However the Shareholder, as shown in paragraph §2.3, has little involvement in the process for selecting the external financial auditor, while several stakeholders from within the company
such as the CEO, CFO, IAD, Procurement and several representatives of the finance department play a larger role than the Shareholder in the selection process.

This is in line with the statement of the Audit Quality Forum (2005) that the services provided by the external financial auditor do not easily fit with a Principal Agent model.

These stakeholders also might have different objectives regarding the services provided by the external financial auditor and therefore it is necessary to understand if the different objectives of these stakeholders play a role in the selection process. These objectives are currently unclear but the research will show that the objectives of these stakeholders (see §7.4) are not aligned.
5 The Purchasing Theory as it relates to external financial audit services

5.1 Introduction

The second and third chapters of this research explained the role of an external financial audit and the role of the external financial auditor, as well as the principles of audit quality and auditor independence. The information in both these chapters is important to understand the context of this research.

The fourth chapter of this research defined the context of the relationship between the external financial auditor, who acts as an agent on behalf of the principal, the Shareholder. It explains how the Principal Agent assumptions impact this relationship.

However, the objective of this research is to obtain knowledge and insight into the selection process used by listed OOBs for the purchasing of external financial audit services and how this selection process may affect auditor independence and the quality of the financial audit, as perceived by shareholders.

As such, this chapter will provide an overview of the different purchasing models and purchasing theories that could apply to the process for selecting the external financial auditor.

The second section of this chapter will define the steps that need to be taken to conduct a professional selection process. Understanding how a professional selection process is conducted is crucial for this research because the question will be asked, during the interviews with the stakeholders involved in the process for selecting the external financial auditor, whether these steps are taken and which of the stakeholders is responsible for each step of the selection process.

The third section of this chapter will be used to identify the selection criteria that are used to select external financial auditors. These sections shows that limited research has been performed on the topic, indicating that further research is required to clarify this area further.

The fourth section of this chapter will identify the different selection/purchase strategies that are used by companies for buying products/services. It will also identify the different criteria that play a role in determining the selection/purchase strategies. This understanding of the strategies and criteria, which determine the selected purchasing strategy, will be used during the research to determine the different purchasing strategies used by the stakeholders involved in the process for selecting the external financial auditor. This section will also discuss the specific research conducted into the purchasing process of external financial audit services.
The fifth section of this chapter will focus on the theory related to buying professional services. An external financial audit is a professional/business service and as such, the insights related to this topic also apply to this research. This section will provide a classification to determine the buyer-seller interaction best suitable for buying professional/business services. At the same time, this section explains that the services provided by the external financial auditor do not fit the defined classification.

The sixth section of this chapter will focus on the involvement of more than one stakeholder in the selection process. This paragraph shows that the involvement of more stakeholders in the selection process can lead to mixed messages, which could lead to reduced supplier performance.

The final section is a summary of the findings of this chapter.

5.2 Selection Process used by companies

5.2.1 The purchasing/selection process
As stated in §1.2.2, the services provided by the external financial auditor fall into the category of professional business services. Several studies have been conducted on buying professional/business services (e.g. West (1997), Axelsson et al. (2002), Day and Barksdale (2003), van der Valk and Rozemeijer (2009)) and these studies suggest that sequential purchasing processes should be used, similar to those used for the procurement of goods, for buying services.

There are many purchasing processes or purchasing cycles used around the world but there are also some common elements. According to Farrington and Lysons (2012), the process usually starts with a demand or requirements. Monczka, Trent and Handfield (2005) use a purchasing cycle that consists of five major stages which also starts with an identification of the user needs. Van Weele (2005) also designed a purchasing process, consisting of six stages, which starts with a definition of the specification. The purchasing model of Van Weele (2005) is presented in figure 6.

Figure 6: Van Weele purchasing model (2005).

However, some of the steps defined in figure 6 take place pre-acquisition, during the acquisition and/or post-acquisition.
If we superimpose these stages onto the purchasing model of Van Weele (2005) the following model, figure 7, appears.

Figure 7: Van Weele (2005) purchasing model including breakdown into selection phases (pre-acquisition, during acquisition and post-acquisition).

5.2.1.1 Define specification
According to Van Weele (2005), the purpose of this process and the first step in the model created by Van Weele, is to determine the needs to be satisfied by the services or products bought. Generally, functional and technical requirements are distinguished.

Functional requirements describe the desired functionality of the service/product that needs to be delivered. The technical requirements are the technical qualities that the service/product must meet.

When the specification step is completed, the organisation should have a clear idea of what kind of product/service is wanted, which requirements this product or service should satisfy and a list of suppliers which be invited to submit a proposal.

5.2.1.2 Select supplier
According to Van Weele (2005), the purpose of the second step in the process is to make an objective comparison between the different suppliers and eventually select one of these suppliers to enter into business with. The selection process consists of the following steps:

- Determining the method of (sub)contracting;
- Provisional qualifying of suppliers i.e. setting selection criteria;
- Preparing a Request For Proposal (RFP);
- Evaluating proposals received;
- Selecting the supplier.

The suppliers each receive a RFP, in which the requirements are mentioned. These proposals will all be evaluated internally, after which the most suitable supplier is selected.
5.2.1.3 **Contract agreement**
According to Van Weele (2005), the purpose of the third step in the process is to deliver contracting and commercial expertise to ensure that the chosen supplier is contracted under the best legal and commercial terms. The supplier receives a contract, which both the buying organisation and the supplier have to sign. When both have signed, the process can move to the next step.

5.2.1.4 **Ordering**
According to Van Weele (2005), the purpose of the fourth step in the process is to create a purchase order. Often, the contract is equal to the purchase order, but it can also be the case that the purchase order and the contract are separate. In the latter case, the Procurement department has to ensure that the ordering process is as efficient as possible and that the Procurement department will solve any ordering problems effectively. The supplier receives the purchase order, based on which the supplier delivers.

5.2.1.5 **Expediting**
The purpose of the fifth step in the process is to monitor the order. According to Van Weele (2005), there are three main checks to monitor an order:

- Exception expediting: The purchaser has to take action when late delivery is signalled;
- Routine status check: Preventing threatening material and quality issues;
- Advanced status check: Periodic review of the planned and the actual situations.

After the order has been properly monitored, a report of the outcome of the checks has to be made.

5.2.1.6 **Evaluation**
To create a good supplier base, the supplier has to be reviewed after every order. Van Weele (2005) distinguishes three categories of suppliers:

- A-suppliers: No problems at all;
- B-suppliers: Fair, but not without problems;
- C-suppliers: Never place an order here again.

Every supplier is put into one of these categories and the supplier base will improve every time an order is finished. Eventually, the Procurement department can make a list of only A-suppliers, which smoothens the first two steps in the selection process.

5.2.2 **Purchasing process according Reijniers et al. (2009)**
Reijniers et al. (2009) evaluated the model created by Van Weele (2005) and compared it with the model developed by Monczka et al. (2005), better known as the Michigan State University
(MSU) model, which had already been developed by Monczka in 1993. This model represents a step-by-step approach for organisations to improve their purchasing processes.

Based on this analysis, Reijniers et al. (2009) came to the conclusion that the step “developing a strategic purchasing package” from the MSU model was missing from the model created by Van Weele (2005).

As a result, the Reijniers et al. (2009) process is presented in figure 8.

![Figure 8: Van Weele (2005) purchasing model including additional phase identified by Reijniers et al. (2009).](image)

According to Reijniers et al. (2009), a selection process can only be started when an organisation has developed a purchasing strategy. The purpose of this step is to gather enough market information to make a proper decision on the direction in which the organisation wants to go with the products or services they want to buy. Once this is established, the purchasing process can continue with the “define specification” step as defined by Van Weele (2005).

5.2.3 The selection process

Each step in the purchasing processes of Van Weele (2005) and Reijniers et al. (2009) can be split into three specific time periods, namely pre-acquisition, during acquisition and post-acquisition. If one were to split these steps of the purchasing process, the following model shown in figure 9 results.

![Figure 9: Combined Van Weele (2005) and Reijniers et al. (2009) purchasing model and definition of selection process.](image)

Both the pre-acquisition as well as the process steps during the acquisition are often referred to as the supplier selection process.

The setup of the combined purchasing process of Van Weele (2005) and Reijniers et al. (2009) will ensure that the number of suppliers involved in the purchasing process will decrease during the process. For instance, more suppliers will be involved in a selection process yet, in the end,
only the selected suppliers will be involved in the ordering, expediting and evaluation process steps.

The deliverables, identified by Van Weele (2005) and Reijniers et al. (2009), of the selection process are divided as follows. The deliverables of the company during the strategy, specification, selection and contracting process are presented in table 3:

<table>
<thead>
<tr>
<th>Phase of selection process</th>
<th>Step</th>
<th>Document</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy</td>
<td>1</td>
<td>Roles &amp; responsibilities</td>
<td>A document that clearly describes the roles and responsibilities of the stakeholders involved in the selection process</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Market analyses</td>
<td>Analysis of the supply market and a description of services that might be bought</td>
</tr>
<tr>
<td>Specification</td>
<td>3</td>
<td>Functional requirement set</td>
<td>A document that describes clearly the scope of the services that the company wants to buy</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Purchasing strategy</td>
<td>A document that describes, based on the market analyses and functional requirement set, the purchasing strategy &amp; selection process that will be implemented and used to buy the services</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>Selection criteria</td>
<td>A document that describes the selection criteria that will be used in the selection process</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>Long list</td>
<td>A list of potential suppliers, based on the market analysis, that will be invited to participate in the selection process</td>
</tr>
<tr>
<td>Selection</td>
<td>7</td>
<td>Request for information (RFI)</td>
<td>A document used by buyers to obtain more information on the supply market and product/services available and to make a first selection of possible suppliers</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>RFI answer document</td>
<td>A document that contains all questions received by potential suppliers during the RFI and which is shared with all potential suppliers during the selection process</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>RFI evaluation</td>
<td>A document that consists of an analysis of the proposals received by potential suppliers based on the selection criteria defined earlier and that determines which potential suppliers will receive a RFP</td>
</tr>
<tr>
<td></td>
<td>10</td>
<td>Short list</td>
<td>A list of potential suppliers that will be invited to participate in the RFP phase of the selection process</td>
</tr>
<tr>
<td></td>
<td>11</td>
<td>RFP</td>
<td>A document used by buyers to obtain more information on the supply market and to make a first selection of possible suppliers</td>
</tr>
<tr>
<td></td>
<td>12</td>
<td>RFP answer document</td>
<td>A document that contains all questions received by potential suppliers during the RFP and which is shared with all potential suppliers during the selection process</td>
</tr>
<tr>
<td></td>
<td>13</td>
<td>Pre-selection</td>
<td>A document that consists of an analysis of the proposals received by potential suppliers based on the selection criteria defined earlier and that determines which potential suppliers will be invited to participate in a contracting phase</td>
</tr>
<tr>
<td>Contracting</td>
<td>14</td>
<td>Negotiation strategy</td>
<td>A document that describes the approved negotiation strategy</td>
</tr>
<tr>
<td></td>
<td>15</td>
<td>Selection</td>
<td>A document that consists of an analysis of negotiation process and that determines the suppliers to be contracted</td>
</tr>
<tr>
<td></td>
<td>16</td>
<td>Contract</td>
<td>The contract between the supplier and the company that consists of all agreed commercial, functional and legal conditions</td>
</tr>
</tbody>
</table>

Table 3: Overview of the different deliverables during a selection process (source: John Tros).

In cases where there is a limited number of suppliers and a clear knowledge on the services/products available in the market, companies often will not conduct an RFI, in which case steps number 6, 7, 8 and 9 of the selection process do not occur. In case of a clear winner of the pre-selection process, companies tend to enter the contracting phase of the selection process with only one potential supplier.
5.2.4 Performance based procurement processes

In recent times more focus has been put on using performance based procurement processes to select products and services. This although several researchers, see §5.2.1, suggest that sequential purchasing processes should be used, similar to those used for the procurement of goods, in the case of the purchasing of services.

Performance-based procurement, according to Baquero (2005), “is to delegate service delivery to providers under legally binding agreements that tie payments to measurable outputs that meet predefined performance standards, normally expressed in terms of quality, quantity or reliability level”.

The GAO (2002) states that a well-designed performance based procurement process encourages possible suppliers to be innovative and to find cost-effective ways of delivering the services required. This will, according to the GOA, result in a changed focus from meeting the requirements of the selection process to providing the results that are required by the client. Based on this, the GAO (2002) concludes that performance based procurement processes promise better outcomes than traditional procurement processes.

In the Netherlands, Best Value Procurement (BVP)/Performance Information Procurement Systems developed by Dean Kashiwagi of Arizona State University and the Performance Based Studies Research Group (PBSRG) has “in recent years gained popularity in the Netherlands” according to Witteveen and Van de Rijt (2013). Van de Rijt and Santema (2013) state that BVP will follow a process in which suppliers themselves will show who is best given the available budget of the client. Van de Rijt et al. (2013) even state that the use of minimum requirements in a selection process, which is common in traditional selection processes as described in §5.2.1, will cause suppliers to adjust their performance (even lowering their performance) to the level of these requirements. This will, according to Van de Rijt et al. (2013), result in the fact that the minimum requirements set by the client will become the benchmark for the performance of the possible suppliers.

Baquero (2005) states that “important elements of performance based procurement deserving careful attention during the procurement planning phase and its further implementation include the performance based statements of work (including the performance standards and indicators), the quality assurance surveillance plan, the selection procedures, and the contract type”.

According to Van de Rijt et al. (2013), a BVP process can be used to conduct a professional performance based procurement process. During this selection process the future clients, according to Van de Rijt et al. (2013), have to focus on “what” has to be realised by the supplier or which problem has to be solved by the supplier within a given budget, which is a given.
In the same selection process, the supplier has to focus on “how” the project has to be realised or the problem has to be solved within the given budget. In addition, Van Rijt et al. (2013), state that a supplier has to deliver the following three deliverables during the selection process, which are also part of the supplier assessment criteria:

- A document that describes the solution that will be proposed by the supplier;
- A document in which the supplier, on behalf of the client, identifies the risks related to the project and what the supplier will do to mitigate or minimise these risks;
- A document in which the supplier describes the opportunities that the supplier can offer to increase the value of the objectives of the project.

Witteveen et al. (2013) state that BVP has gained popularity in the Netherlands. At the same time, Witteveen et al. (2013) state that:

- “from 2006 to 2013 the Best Value approach has been applied over 200 times, with a budget spend of over EUR 2 billion;
- 26.8% (56 projects) in the private sector and 73.2% in the public sector (153 projects) have used this approach;
- In total an estimated 107 projects in the construction industry, 31 projects in ICT, 5 catering projects, 3 security projects, 16 commodities and 9 in the health sector have been completed using BVP.”

As such, it can be concluded that BVP is not commonly used in the selection of professional services as defined in §1.2.2 or the services provided by the external financial auditor as defined in §2.2. Therefore, this research will test, given the fact that a performance based procurement process seems to increase the quality of the product/services bought, whether the stakeholders in the selection process use a kind of performance based procurement process to select an external financial auditor.

5.3 Selection criteria

5.3.1 Selection criteria in the literature
Selection criteria, as stated in §5.2.1.2, play an important part in the supplier selection process because selection criteria are a translation of the requirements set by the stakeholders in the selection process, which have to be fulfilled by a supplier. However, Pullman (1998) concluded that the selection process was complicated due to conflicts between selection criteria; the number of criteria which are both qualitative and quantitative; involvement of many alternatives; and constraints that influence the buying process. Pullman (1998) also concluded that a selection process is the right partnership between the different functions of a company.
As such, “a supplier selection process including the selection criteria can be identified as a multi-objective problem encompassing many tangible and intangible factors in a hierarchical manner”.

The only research that focused on the selection criteria in the context of external audit services was a study conducted by Deumes et al. (2012). They identified the selection criteria used by more than 100 Audit Committee members and according to their research the skills, experience and expertise of the external financial auditor were selected as one of the top three criteria for selecting an external financial auditor in 73% of the cases. Network and reputation was chosen in the top three in 49% of the cases. Independence and ethics accounted for 31%, while price was included in 19% of the cases.

Boon, McKinnon and Ross (2008) investigated the attributes affecting auditor appointments in compulsory audit tendering in the Australian market. According to Boon et al. (2008), audit quality, specifically technical competence, auditor reputation and relationship with the current auditor, are the main criteria when appointing a new auditor.

Beattie and Fearnley (1995) conducted research in UK listed companies on the reasons why companies considered changing their external financial auditor. The main considerations were the audit fee level, dissatisfaction with the audit quality (i.e. auditor ability to detect problems) and changes in the top management of the company. Beattie et al. (1995) also found that the main reasons for not changing external financial auditor were the current external financial auditor decreased the fees, avoidance of disruption and loss of management time needed to change external financial auditor and the incumbent external financial auditor offered to improve quality.

In addition to this research, the General Accounting Office (GAO, 1987) published technical criteria such as auditor skills, experience of the external financial auditor, commitment and understanding of the audit requirements, which in addition to price, should be taken into consideration when selecting an external financial auditor. These technical criteria for selection, according to the GAO, could depend on the complexity of the audit engagement. According to the GAO, entities also use criteria such as:

- Size and location of the external financial audit firm;
- Range of activities performed by the external financial audit firm;
- Participation of the external financial audit firm in training;
- Description of the quality control procedures of the external financial audit firm;
- Supervisory and review procedures of the external financial audit firm;
- Time frames for the fieldwork to commence and be completed;
- Data processing capabilities of the external financial audit firm;
- Amount of assistance the external financial audit firm expects to receive from the entity.
Whether these criteria play a role in the selection of an external financial auditor is unclear as yet limited research has been performed with regard to the selection criteria used in the process for selecting the external financial auditor, especially in the context of mandatory audit rotation and the fact that several stakeholders are involved in the selection process (see §2.4).

5.3.2 Selection criteria used by listed OOBs
To establish a first view on the selection criteria used in the process for selecting the external financial auditor, a desk research was conducted on the RFPs put into the market by listed OOBs between 1 January 2008 and 31 December 2012 (see §2.4 for more information on the data collection). The outcome of this analysis is presented in table 4.

<table>
<thead>
<tr>
<th>Selection criteria used by Dutch OOBs in RFPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price</td>
</tr>
<tr>
<td>Quality of team</td>
</tr>
<tr>
<td>Audit approach</td>
</tr>
<tr>
<td>Reputation</td>
</tr>
<tr>
<td>Relevant industry experience</td>
</tr>
<tr>
<td>Service level and service possibilities</td>
</tr>
<tr>
<td>Cooperation with IAD</td>
</tr>
<tr>
<td>European/global coverage</td>
</tr>
<tr>
<td>Independence</td>
</tr>
<tr>
<td>Cultural fit</td>
</tr>
<tr>
<td>Chemistry between auditor and client</td>
</tr>
<tr>
<td>Technical consultation</td>
</tr>
<tr>
<td>Approach toward change of auditors/transition plan</td>
</tr>
<tr>
<td>Response times and reporting</td>
</tr>
<tr>
<td>Quality of lead partner</td>
</tr>
<tr>
<td>Experience with regulators</td>
</tr>
</tbody>
</table>

Table 4: Selection criteria used by listed OOBs between 1 January 2008 and 31 December 2012.

This view is based on a limited data set, therefore during the research this list will be compared with supplier selection criteria identified by the different stakeholders in the selection process.
5.4 Purchasing strategies

5.4.1 Purchasing strategies in general
As stated by Reijniers et al. (2009), a selection process can only be started when an organisation has developed a purchasing strategy. In 1983, Kraljic (1983) introduced a purchasing portfolio model that classifies the services and products bought by a company into a matrix.

This matrix consists of four categories based on the supply risk and impact on profit, which can be used as a method to determine a purchasing strategy.

Other authors such as Dubois and Pedersen (2002) and Wynstra and Ten Pierick (2000) have also developed purchasing portfolio models. However according to Gelderman and Van Weele (2005) there are more similarities than differences in comparison to the original Kraljic purchasing portfolio model. Therefore, this research will focus on the model defined by Kraljic in 1983.

Kraljic (1983) recommended a purchasing strategy by category to ensure that both the profit impact and supply risks of the company are optimised. As such, Kraljic (1983) determined the following four main purchasing strategies, see figure 10.

![Figure 10: Strategies identified per quadrant of the Kraljic purchasing portfolio.](image)

Caniëls and Gelderman (2005) identified in 2005 that professional purchasers in the Netherlands make clear distinctions between alternative purchasing strategies per quadrant of the Kraljic Matrix. Gelderman and Van Weele (2003) show that several strategies per quadrant occur in practice but it was unclear what the conditions were determining the choice for a
specific purchasing strategy. Gelderman et al. (2003) state that the literature on buyer-supplier relationships acknowledges that power and interdependence issues are fundamental to the way in which buyers and suppliers interact.

Buchanan (1992) conceptualises power-dependence asymmetries in buyer-supplier relationships as the difference in value that buyers and sellers attach to the relationship. In asymmetric relationships, the most independent partner dominates the exchange.

Anderson and Weitz (1989) determined that buyer-supplier relationships that are characterised by asymmetric interdependence are more dysfunctional because the independent partner experiences high power and will be tempted to exploit it.

The main purchasing strategies identified per quadrant, as identified by Gelderman et al. (2003) are shown in figure 11.

![Figure 11: Main purchasing strategies per quadrant of the Kraljic Matrix (1983) according to Gelderman et al. (2003).](https://example.com/image)

During the research, the persons interviewed will be asked which purchasing strategy they will apply to the services provided by the external financial auditor.
5.4.2 Criteria that determine the right purchasing/selection strategies
In the course of the research, the respondents will be asked which “profit impact” and “supply risk” criteria will apply to the services of the external financial auditor. Understanding this point of view will provide an insight into how the stakeholders involved in the selection process classify the services and if this classification meets the criteria of the selected purchasing strategy.

Kraljic (1983) determined that the “profit impact” of a product/service bought could be based on the following criteria:

- Volume purchased and expected growth in demand;
- Percentage of total cost purchased;
- Impact on product quality;
- Impact on business growth.

Kraljic (1983) determined that the “supply risk” of a product/service bought could be based on the following criteria:

- Market conditions (i.e. scarcity & availability);
- Number of suppliers available;
- Competitive demand;
- Make or buy opportunities (i.e. can the company decide to do it in-house?);
- Storage risks;
- Substitution policies (i.e. can the products/services be substituted by other products/services?).

Over time, various researchers have added specific criteria, especially to “supply risk”, which could also affect the purchasing/selection strategy such as:

- On-time delivery (Das and Handfield (1997));
- Cultural differences (Das et al. (1997));
- Logistic-related facilities (Das et al. (1997));
- Lack of logistical knowledge (Razzaque (1997));
- Supply interruptions (Svensson (2000));
- Payment conditions (Svensson (2000));
- Duty and customs regulations (Anderson and Norman (2002));
- Shortage of qualified personnel (Goonatilake (1990)).

5.4.3 Purchasing of audit services
In addition to the generic purchasing strategies, the General Accounting Office (GAO, 1987) and Causholi et al. (2012) have researched the purchasing process regarding the services delivered by the external financial auditor.
Based on its research, the GAO (1987) made a framework for the purchasing process in respect of external financial audit services. The framework of the GAO (1987) consists of four attributes that have to be considered during the purchasing process in order for a company to obtain audit services at a reasonable cost and ultimately improve the quality of its auditor’s work. The four attributes are competition, solicitation, technical evaluation and written agreement.

According to the GAO (1987), the presence of competition in the purchasing process helps the entity to control the audit expenses by increasing the likelihood that a quality engagement will be performed at a fair price.

The GAO (1987) states that the solicitation process addresses the manner in which the entity communicates its needs and requirements to potential bidders. According to the GAO, an effective solicitation as part of its purchasing process assures the entity that all external financial audit firms clearly understand the requirements of the audit and submit proposals that meet the needs of the entity.

According to the GAO (1987), the technical evaluation process requires an entity to devise a method for evaluating the merits of each external financial audit firm’s technical proposal and for selecting the CPA firm that can provide a quality audit at a fair price. The GAO states that the technical evaluation focuses on the auditors’ skills, experience, commitment and understanding of the audit requirements.

The GAO (1987) states that a written agreement assures the entity that agreements reached with the external financial audit firm adequately represent a mutual understanding as to how the audit will be conducted and specify the accountability of all parties.

According to the GAO (1987), the process of procuring auditing services is an ongoing one. It begins with the entity’s recognition that an audit is required, continues with the entity actually procuring the audit and ends with the final acceptance of the audit report. The GAO states that the responsibility of procuring auditing services is usually assigned to the program manager, other program administrators or to the finance director of an entity.

Furthermore, the GAO (1987) states that traditionally, entities have procured audit services through formal advertising and competitive negotiation. In formal advertising, the entity issues precise, tailored specifications and awards the contract to the bidder with lowest price. This method is only viable when the services are so well defined that it is appropriate to select an external financial audit firm on the basis of price alone. However, the price of an audit should not override the technical qualifications of the external financial audit firm according to the GAO. According to the GAO, competitive negotiations are therefore the preferred method for obtaining audit services, because they are flexible enough to take price into account but permit the entity to make informed choices given the marketplace. Competitive negotiations allow an
entity to trade off features of experience, quality, qualifications and value and to take
advantage of unique talents and proposals that might be offered and tailored precisely to the
entity’s needs.

Causholli et al. (2012) conducted research on the purchasing process in respect of the external
financial auditor. The starting point of this research was based on research by Nelson (1970).
Nelson (1970) distinguished search goods and experience goods where search goods are goods
that can be evaluated on their quality prior to purchase and experience goods are goods that
can only be evaluated on their quality after purchase, but the evaluation is free of charge.
A tool is an example of a search good and a bottle of wine is a typical example of an experience
good. Darby et al. (1973) defined a third type of goods: credence goods. Darby et al. (1973)
defined credence goods as goods which cannot be evaluated on their quality after the purchase
of the goods or if the evaluation of the quality of the bought good is very expensive.

Causholli et al. (2012) published their external financial audit services purchasing process and
considered the fact that the buyer of external financial audit services has limited information on
the service that the buyer will receive. The buyer has limited information due to the fact that
the buyer is uncertain about his/her auditing needs and he/she cannot discern the level of
assurance provided by the auditor according to Causholli et al.

According to Causholli et al. (2012), the external financial audit services can be seen as a
credence good due to the limited information of the buyer. Due to the credence character of
the auditing services, the buyer will tend to choose the external financial auditor with the
lowest audit fee, the reason being that this is the only thing that the buyer has information on
(Causholli et al. (2012)). Causholli et al. state that the buyer’s limited information can lead to
under-auditing, less effort than is appropriate for the client needs, because of the credence
character of external financial audit services. Under-auditing may lead to a decrease in the
audit quality and limit the incentives for auditors to improve their technologies.

5.5 Purchasing of business services

Wynstra et al. (2002) published a research paper about the purchasing process for business
services, of which professional services is a subset. According to Wynstra et al. (2002) and
Fitzsimmons et al. (1998), the purchasing process for services is comparable to the purchase of
complex goods. This is the case because services are intangible, inseparable, perishable and
heterogeneous. These characteristics affect the purchasing process in the sense that some
elements become more important, more difficult or different in comparison to goods (Wynstra
et al. (2002)). For example, “For services, it is often difficult to understand, in advance of the
purchase, precisely the content of the service which will increase the complexity associated
with specification” (see §5.2.1.1).
In research performed by Wynstra, Axelsson and van der Valk (2006) a model was developed which identified four classes of business services. This model is based on how the buying company uses the purchased services with respect to its own offerings. Their rationale for developing this classification is that the required interaction to optimise the use or integration of the purchased service differs based on how the buying company applies the service with respect to its own business processes. Hence, different patterns of interaction are expected to be most effective for different types of services.

In the classification of Wynstra et al. (2006), the following four business services are identified:

- Component services;
- Semi-manufactured services;
- Instrumental services;
- Consumable services.

**Component services:**
Component services are services that are directly delivered to the end customer by the purchasing organisation without any significant transformations. The service is perceived as a complementary service to the existing offerings to the buying company’s customers. By using component services, the customer’s offering can be differentiated and added value may be created. Examples include specialist training programs, baggage handling at an airport and delivery services.

**Semi-manufactured services:**
These services are comparable to component services, with the main difference being that the service is transformed by the buying company before delivery to the customer. Semi-manufactured services are primarily used as an input by the buying organisation for particular offerings for end customers. Examples are data purchased to be used in own delivery and outsourcing of services.

**Instrumental services:**
The most important feature displayed by instrumental services is that they affect the buying company’s operations. They often consist of major investments in intangible assets in order to improve the processes and operations performed by the buying company. As such, they can be perceived as (intangible) capital investments. They are not delivered to the end customer of the company. Another characteristic is that the demand for this service is not related to demand from individual customers of the company buying the service. Examples are consultancy services, advisory services on legal structure and information & communication services.
**Consumable services:**

Finally, this type of service can be recognised because it is consumed by the buying company itself. This kind of service often includes low-cost more routine services such as catering, office cleaning, etc.

It is essential to understand that for all four types of services, buyer-seller interaction has to take place. However, the interaction has to achieve different objectives and consequently they differ with regard to the organisational resources required.

The classification of Wynstra *et al.* (2006), including the decision rules, is presented in figure 12.

![Decision scheme for identifying service type](image)

**Figure 12: Van der Valk (2007) “Decision scheme for identifying service type”**.

It is unclear however, how the services of the external financial auditor fit within this decision scheme. According to the ISA 200 (2009), the objective of an external audit of financial statements is to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. At the same time the external financial auditor also provides (see §2.2.3) an “advice” function. These two different components of the external financial audit mean that the central question for determining the classification according to Wynstra *et al.* (2006) cannot be answered unambiguously. According to the analysis in chapter three, the Shareholder of the external financial audit can be considered, amongst others, as the most important customer of the
opinion of the financial statements. This ‘customer’ does not correspond however to the end customer of the buying company as defined by Wynstra et al. (2006).

In contrast, the “advice” function of the external financial auditor has a smaller subset of clients than the opinion of the financial statements itself. The clients for the “advice” (see §2.2.3) are the Management Board, Supervisory Board and/or Audit Committee. As such, the company itself can also be considered the customer of the advice function. Therefore, a financial audit service should follow an individual approach to the classification criteria presented above for both aspects of the service.

5.6 Triadic relationship in purchasing

Normally commercial business relationships consist of a dyadic relationship between two parties, a buyer and a seller. However many business relationships cannot be analysed in isolation because more parties play a role in the buyer-seller interaction. In a business context, the triad often consists of buyer, seller and intermediary according to Thibaut and Kelley (1959).

Fontaine (2011) states that the external financial auditor operates within a triadic relationship “because of the presence of a third-party user” which can lead, according to Kleinman and Palmon (2000), to potential conflicts between the external financial auditor and the client (the company in this case).

Pemer and Skjølsvik (2012) state that a similar development is taking place within the selection process for management consulting services. Pemer et al. (2012) state that the involvement of Procurement replaces the dyadic relationship between the manager of the company and the representative of the consulting firm representative, by a triadic relationship between the manager of the company, the purchaser of the company and the consulting firm representative. This triadic relationship can according to Pemer et al. (2012) lead to both inter-organisational as well as intra-organisational misalignment.

Tate et al. (2009) analysed the objectives of the stakeholders involved in buying marketing services. Their research showed that the triadic relationship between supplier, marketing manager and buyer can lead to mixed messages. According to Tate et al. (2009), “These mixed messages are likely to hamper supplier performance, and negatively affect efficiency as the supplier tries to interpret conflicting communication”.

Paragraph §2.4 shows that several stakeholders are involved in the process for selecting the external financial auditor. It also shows that the Procurement department has a limited involvement in the selection process. Even the CPOs involved in the research state that the
involvement of Procurement in the process for selecting the external financial auditor is quite recent.

However, in the process of buying the services provided by the external financial auditor, a more complex relationship structure seems to take place. Paragraph §4.4 shows that the external financial auditor, when he/she also has to deal with Procurement, operates in at least a quadratic relationship between the Shareholder, the Supervisory Board/Audit Committee, Procurement and the external financial auditor as presented in figure 13.

This increase in complexity could perhaps negatively influence supplier performance, as already concluded by Tate et al. (2009).

![Diagram](image)

**Figure 13**: External financial auditor in relation to other stakeholders involved in the selection process.

### 5.7 Summary of purchasing strategies

Various researchers (e.g. West (1997), Axelsson et al. (2002), Day et al. and Barksdale (2003)) suggest that the best way to buy professional services and/or business services is to use sequential purchasing processes, similar to the procurement of goods.
The way in which such a selection process can be conducted is answered by Van Weele (2005) and Reijniers et al. (2009). They clearly explain the different steps that should be taken and the documents that need to be delivered during a purchasing process.

Wynstra et al. (2002) determined however that the purchasing process for services is more complex than the purchasing process for goods. Wynstra et al. (2002) stated that business services are intangible, inseparable, perishable and heterogeneous and therefore the process of purchasing business services is quite different from the process of purchasing goods.

The framework of the GAO (1987) for buying the services provided by the external financial auditor clearly states that the competition, solicitation, technical evaluation and written agreement should be included to obtain audit services at a reasonable cost and ultimately improve the quality of the auditor’s work. However, the GAO does not explain which stakeholders should be involved in the selection process and how the selection process should be conducted.

It is clear that the classification of the services provided by the external financial auditor within the Kraljic (1983) model can only be performed if one determines both the “supply risk” and “profit impact” of the services to the company. However, a complete classification cannot be concluded on the basis of the available information and as such §7.5 of this research will identify which “supply risk” and “profit impact” criteria will apply according to the persons interviewed.

However, according to Causholli et al. (2012) the auditing services can be seen as a credence good due to the limited information available to the buyer. As a result, Causholli et al. state that the buyer will probably opt for the most efficient auditor i.e. the lowest price, because this is the only information a buyer has. However, research conducted by Deumes et al. (2012) identified that Audit Committee members selected skills and expertise within their top three criteria for selecting an external financial auditor. Boon et al. (2008) concluded that audit quality, specifically technical competence, auditor reputation and the relationship with the current auditor are the main attributes when appointing an auditor within the context of compulsory audit tendering in Australia. Therefore this research (see §7.6) will identify and prioritise the selection criteria used by the stakeholders in the selection process in a situation where audit rotation is compulsory.

Finally, it became clear that the external financial auditor operates within at least a quadratic relationship when Procurement is involved in the selection process. Such relationships can lead to reduced supplier performance due to mixed messaging according to Tate et al. (2009). This research will start therefore by identifying the objectives of the stakeholders involved in the process for selecting the external financial auditor.
6 Research approach, objective and methodology

6.1 Introduction
This chapter describes the overall research approach, the objectives and aim of this research and the methodologies that have been used to conduct this research.

As such, the second section of this chapter will describe the research approach including the identification of the management challenge. It will also describe and define the research objective as well as the research scope in addition to the way the literature research was conducted. Section two will also describe the research questions and the related conceptual model.

The third section of this chapter will describe the research methodology used in this research. It will explain the method of data collection including the sample design and sample size. This section will conclude with the analysis strategy, which has been used to analyse and present the answers to the research questions.

The final section of this chapter tests if the research approach meets the quality of a research design.

6.2 Research approach

6.2.1 Identification of the challenge
As described in the introduction, participation in the selection process used by a company for the services of the external financial auditor made me wonder if a selection process used by OOBs in which shareholders have invested their money could influence auditor independence or audit quality.

I therefore initiated three interviews with persons who could provide answers to the question I had. The following persons participated in face-to-face interviews:
- Marianne van der Zijde, manager/deputy head supervisor of external financial accounts of the Dutch Authorities of the Financial Markets (AFM);
- Mr. drs. Geert Koster, lawyer at VEB NCVB (Association of holders of securities);
- Prof. Dr. mr. Marcel Pheijffer RA, professor of accountancy at Nyenrode Business University.

I selected these people because it could be expected that a comparison between the information received from a representative of those who supervise the quality systems of the external financial auditor, a representative of the Shareholders and an external financial audit expert could already provide relevant insights into the differences in the selection process.
It became clear for instance that two of the people interviewed expected that the Supervisory Board (in Dutch: RVC) or Audit Committee of a company would take the lead in the selection process while another expert mentioned that the CFO and CEO would take the lead. The comparison also showed that one of the representatives mentioned that the Supervisory Board or Audit Committee would determine which external financial audit firm would be invited to participate in the tender while the two other persons identified the CFO and CEO as the persons who would determine the external financial audit firm that would participate.

These interviews already identified differences between the views of the representatives of a controlling body of the external financial audit firms, the representatives of the shareholders and the external financial audit expert.

At the same time, the persons interviewed said that the selection process of companies regarding the services of the external financial auditor was never analysed in their opinion and it was never considered that a selection process could impose a risk to audit quality and auditor independence. As such, it could be concluded that it was worthwhile to conduct a study, especially in light of the fact that all three representatives expected that new legislation would be introduced that would result in the use of more selection processes by OOBs for the services of the external financial auditor.

As such, the management challenge of this research is to understand the impact of the selection process on the services performed by the external financial auditor.

### 6.2.2 Research objective, scope, research questions and conceptual model

#### 6.2.2.1 Research objective & scoping

The justification for this research translated into the following research objective:

The overall objective of this research is to obtain knowledge and insight into how the services of external financial auditors are selected by listed OOBs in the Netherlands and how this selection process affects, according to the stakeholders\(^{22}\), the auditor independence and audit quality as perceived by Shareholders.

This means that the main focus of this research is on the selection process used by the OOBs in the Netherlands to select the services of the external financial auditor.

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\(^{22}\) As perceived by the stakeholders involved in the selection process.
This research will not measure actual audit quality or actual auditor independence because direct measures to measure Audit Quality (see 3.2.1) are practically impossible to observe and measure according Vanstraelen (2000) and Wooten (2003). In addition, different researchers (see §3.2.2) have contradicting findings on the impact of indirect measures on audit quality. Therefore, this research will only focus on the effects of the selection process on perceived, as perceived by the stakeholders in the selection process, audit quality and perceived, as perceived by the stakeholders in the selection process, auditor independence.

In addition, a decision was made to limit the scope of the research to listed OOBs only. This is because listed OOBs all have to meet the same legal and corporate governance requirements and are managed by the same supervisory and controlling bodies, such as the AFM and the Dutch Central Bank. At the same time, these listed OOBs all operate within a similar stakeholder environment with the chief amongst them being the Shareholders. Therefore, this group of companies (although they operate in different industries, have different management organisations and are of different sizes) can be identified as a comparable group of companies for a study related to the selection process of the external financial auditor.

6.2.2.2 Research questions & conceptual model

This research aims to link the selection process used by Dutch OOBs to an impact on perceived auditor independence and perceived audit quality as perceived by Shareholders. A selection process in this research is defined as the process of Van Weele (2005) and Reijniers et al. (2009) is presented in figure 14.

![Figure 14: Van Weele (2005) and Reijniers et al. (2009) purchasing model and definition of the selection process.](image)

All the steps in the selection process as shown in figure 14 have their own pre-defined purposes (see §5.2.1) and deliverables (see §5.2.3).

Figure 14 shows that the purpose of the first step of the selection process (Strategy Development) is to establish a common understanding of what a company wants to achieve with the products and/or services they want to buy. The company in a selection process is represented by stakeholders who conduct the selection process and, as stated by Jones, Felps and Bigley (2007), different objectives of the stakeholders will influence the decision-making process. The literature analysis, see §2.4, shows that several stakeholders are involved in the
selection of the external financial auditor and that the objectives of stakeholders, see §4.2, can be linked to different assumptions. At the same time, the literature shows that different clients of the services of the external financial auditor, see §2.2, might have different expectations of the services delivered by the external financial auditor.

So to understand the “Strategy Development” step of a purchasing process a clear understanding has to be created about:

- The services that are provided by the external financial auditor;
- The clients of the services of the external financial auditor;
- The stakeholders involved in the selection process;
- The objectives of stakeholders involved in the selection process.

The second step of the selection process (Define Specification) is to establish a common understanding of the requirements which have to be met by the services of the external financial auditor and the purchasing strategy that has to be developed. The literature analysis has shown, see §2.5, that the supply market of the external financial audit can be qualified as an oligopoly. However §5.3 shows that it is unclear which selection criteria will be used during the selection of an external financial auditor in the situation of a mandatory rotation while one would expect that certain audit quality criteria, see §3.2.2, would play a role in this selection process. §5.4 shows that it is unclear how the services of the external financial auditor could be classified according to the purchasing strategies. At the same time §5.5 shows that the services of the external financial auditor do not fit the models which were created especially for business services while §5.6, shows that the external financial auditor seems to operate in a complex relationship which could influence supplier performance.

So to understand the “Define Specification” step of a purchasing process a clear understanding has to be created about:

- The selection criteria used to select the external financial auditor and how do these selection criteria relate to the audit quality criteria commonly used;
- How the market of the external financial auditor is classified in relation to the relevant procurement theories.

The purpose of the third step of the selection process (Select Supplier) is to establish a common understanding on the steps taken during the selection of the supplier. However, limited literature is available about the selection process of the external financial auditor. However, §2.4, shows that several stakeholders are involved in the selection of the external financial auditor and that the objectives of these stakeholders can differ.
As such, to understand the “Select Supplier” steps of a selection process, a clear understanding has to be created about:

- The way the selection process is conducted;
- The role of the stakeholders in the selection process.

The final step of the selection process (Contract Agreement) is to establish a contract with the selected supplier with the most favourable commercial and legal terms. This contract is the starting point for the delivery of the services. Therefore after the “Contract Agreement” step of a selection process, a clear understanding has to be created about:

- The impact of the new legislation on the perceived audit quality;
- The impact of the new legislation on perceived auditor independence.

Based on the items above the following research questions were identified as part of answering the overall research objective:

1) What types of services are, according to the stakeholders involved in the selection process, provided by the external financial auditor?
2) Who are, according to the stakeholders involved in the selection process, the clients of the services delivered by the external financial auditor?
3) Which stakeholders are involved in the selection process and what will be their objectives in the selection process?
4) How do the stakeholders involved in the selection process classify the services provided by the external financial auditor?
5) What kind of selection process do the stakeholders involved in the selection process use for selecting an external financial auditor?
6) What are, according to the stakeholders in the selection process, the roles of the stakeholders in the selection process?
7) Which selection criteria will be used by the stakeholders of the selection process and how do these compare to the audit quality criteria?
8) How does the selection process impact the perceived quality of the external financial audit and what is the impact of the new Dutch legislation (see §1.1)?
9) How does the selection process impact the perceived independence of the external financial auditor and what is the impact of the new Dutch legislation (see §1.1)?
These research questions, and the interrelationships, were translated into the following conceptual model as shown in figure 15.

As shown in figure 15, there are several concepts influencing the selection of an external financial auditor.

The research starts by obtaining clarification on the perception of the services provided by the external financial auditor as defined by the stakeholders involved in the selection process of the external financial auditor. The theoretical research has shown (see §2.2.2) that an external financial auditor has to provide assurance services to a set of stakeholders based on requirements set in law. However, at the same time, paragraph §2.2.2 shows that different stakeholders can have different expectations of the services provided by the external financial auditor. These different expectations could influence the objectives set by the stakeholders involved in the selection process as well as the perception of the clients of the services of the external financial auditor, which explains why obtaining clarification on the perception of the services delivered is the first step in the research.

These services are delivered to a group of interested parties/clients (see §2.2) but the stakeholders involved in the selection process (see §2.4) might have a similar or different view on who the interested parties/clients are and which of them is the principal, the actual client, for the services of the external financial auditor.
Differences in who the stakeholders involved in the selection process understand to be the clients of the services could have an impact on the objectives set in the selection process by the stakeholders involved in the selection process as well the perception of the services delivered by the external financial auditor which is why this is the second step in the research.

The objectives of the stakeholder in the selection process are influenced by a perception of the services, a perception of the clients as well as the perception of the classification of the external financial audit market. In addition, the objective of the different stakeholders impacts their perception of the clients, their perception of the classification of the external financial audit market, their perception of the services as well as the selection criteria used during the selection process and the roles the different stakeholders take in the selection process.

The stakeholders’ perception of the external financial audit market impacts both the selection criteria used, the objectives of the stakeholders involved and the selection process used to select the external financial auditor. At the same time, the role of the stakeholders in the selection process will impact the selection process used to select the external financial auditor.

Finally, the selection process will lead to a contract with the new external financial auditor selected. Under this contract, the external financial auditor will provide the external financial audit and this service delivery could affect the perceived, as perceived by the stakeholders in the selection process, quality of the financial audit and the perceived, as perceived by the stakeholders in the selection process, independence of the external financial auditor. Finally, and additionally, the results of this research could be translated into the established purchasing theory.

6.3 Research methodology

6.3.1 Qualitative versus quantitative approach
Myers (1997) states that quantitative research methods were originally developed “in natural sciences to study natural phenomena” and examples include survey methods, laboratory experiments, formal methods and numerical methods such as mathematical modelling.

Qualitative research methods were developed, according to Myers (1997), in social sciences to enable researchers to study social and cultural phenomena and examples include action research, case study research and ethnography with data resources such as observations, interviews, questionnaires, documents, texts and researcher’s impressions and reactions. At the same time Myers (1997) states that qualitative research is not a synonym for interpretive research because, according to Myers (1997), “qualitative research can be positivist, interpretive or critical based on the underlying philosophical assumptions of the researchers”.

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The research presented in this thesis attempts to gather an in-depth understanding of the “why” and “how” of the selection processes, which are decision-making processes, used by listed OOBs related to the services of external financial auditors and how this selection impacts perceived auditor independence and the perceived quality of the audit as perceived by the Shareholders. Several stakeholders (see §2.4) are involved in the selection process. Jones, Felps and Bigley (2007) state that the different objectives of the stakeholders will influence the decision-making process. As such, this research has to identify the objectives of the different stakeholders. Obtaining an in-depth understanding of the “why” and “how” can best be obtained, according to Denzin and Lincoln (2005), by using a qualitative research method.

The theoretical part of this research was conducted prior to the design of the research method and to develop the checklist used for the interviews. This is in line with Yin (2012), who states that theoretical propositions should be in place prior to data collection and analysis, when the outcomes of this research and the context are not yet clearly evident. That is why this research can be defined as exploratory research and theory-testing.

6.3.2 Method of data collection
Qualitative data, according to Patton (2002) can be collected in three different ways, namely interviews, observations and documents. These, according to Patton (2003), can be defined as follows:

- “Interviews: Open-ended questions and probes yield in-depth responses about people’s experiences, perceptions, opinions, feelings, and knowledge. Data consist of verbatim quotations with sufficient context to be interpretable”.
- “Observations: Fieldwork descriptions of activities, behaviours, actions, conversations, interpersonal, interactions, organisational or community processes, or any other aspect of observable human experience. Data consist of field notes: rich, detailed descriptions, including the context within which the observations were made”.
- “Documents: Written materials and other documents from organisational, clinical, or programme records; memoranda and correspondence; official publications and reports; personal diaries, letters, artistic works, photographs, and memorabilia; and written responses to open-ended surveys. Data consist of excerpts from documents captured in a way that records and preserves context”.

The data needed to answer the research questions can only be provided by experts, who in this case are individuals who because of their functions or roles can provide insights into the selection processes used by OOBs for selecting the services of the external financial auditor.
This data is available to a limited extent in documents\textsuperscript{23} and cannot be collected through observations and as such, conducting expert interviews is a logical step to collect the data required for answering the research questions.

All the experts were interviewed for 1 to 1.5 hours during the period June 2013 to October 2013. Almost all the interviews were conducted at the experts’ offices. The interviews were taped and minutes were recorded after the interviews. The minutes were sent for approval to the experts and the data processed once the approval was received. When additional clarification was needed, contact was sought with the experts via email. A copy of their answers was also stored.

The interviews were partially structured. According to Reulink and Lindeman (2005), partially structured interviews consist of closed and open-ended questions. The closed questions, with a fixed formulation, are asked in fixed sequence to collect the data in a similar way. The open-ended questions are asked to obtain more in-depth knowledge by asking additional questions and to obtain further understanding.

A checklist (see Appendix C: Checklist for the qualitative interviews) was used to conduct these interviews. At the same time, the checklist leaves space for unforeseen answers and for probing. This checklist was based, as stated by Groenland and Janssen (2010) and Groenland (2014), on the conceptual model as defined in §6.2.2.2.

All of the concepts of the conceptual model are represented in the checklist. The checklist was tested by conducting three interviews with three colleagues\textsuperscript{24}. During the interviews the questions, the order of questions, the timing and the words used were tested. At the same time it was ensured that the answers to the questions could be linked to the conceptual model as defined in §6.2.2.2.

6.3.3 Sample design
A selection was made of listed OOBs of which financial information, such as annual reports, is publicly available and all of which have to operate under similar corporate governance rules due to their listing. At the start of the research, a total of 75 PIEs (70 OOBs + 5 other PIEs) are

\textsuperscript{23} The RFPs collected from OOBs only give the information sent to the market and this does not include the activities which gave rise to the RFPs.
\textsuperscript{24} KPMG Advisory colleagues with limited experience regarding the topic of external financial audit.
listed on the AEX, AMX or AScX (see Appendix A: List of Dutch listed companies for more
details).

To establish an overview of the stakeholders that could play a part in the process of selecting
the external financial auditor, desk research was conducted (see §2.4) on the RFPs put on the
market by listed OOBs between 1 January 2008 and 31 December 2012. This analysis revealed
that the following stakeholders played a role in the selection process for the external financial
auditor:

<table>
<thead>
<tr>
<th>Stakeholders mentioned in RFP</th>
<th>Number of times mentioned</th>
</tr>
</thead>
<tbody>
<tr>
<td>CFO</td>
<td>7</td>
</tr>
<tr>
<td>Audit Committee</td>
<td>5</td>
</tr>
<tr>
<td>CEO</td>
<td>5</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td>4</td>
</tr>
<tr>
<td>Finance Department</td>
<td>3</td>
</tr>
<tr>
<td>Internal Audit</td>
<td>3</td>
</tr>
<tr>
<td>Procurement</td>
<td>2</td>
</tr>
<tr>
<td>Controller</td>
<td>1</td>
</tr>
<tr>
<td>Risk</td>
<td>1</td>
</tr>
<tr>
<td>Shareholder Meeting</td>
<td>1</td>
</tr>
<tr>
<td>Reporting &amp; Consolidation</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 5: Table with stakeholders mentioned in the selection process of listed OOBs between 1 January 2008 and 31
December 2012.

Table 5 shows that the CFO, Audit Committee, CEO, Supervisory Board and the Finance
Department are mentioned most within the RFPs. However, the Audit Committee is a part of
the Supervisory Board, while the Finance Department, Controller and Risk fall under the control
of the CFO. As such, the top six stakeholders identified in the selection process are:

- CFO/Finance Department;
- Audit Committee/Supervisory Board;
- CEO;
- Internal Audit Department;
- Procurement;
- Shareholders.

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25 Only the stakeholders involved in the buying side of the selection process are in the scope of
this research. Parties involved in the sales of the external financial audit services, such as the
external financial audit firms or external financial auditors, are not included.
It is obvious that the external financial audit firms and/or external financial auditors are not considered as one of the stakeholders. This is because they represent the sales process and not the purchasing process, which is the scope of this research\textsuperscript{26}.

The data could be selected either by interviewing the stakeholders as outlined above from a few OOBs (i.e. to discuss the topic with all the representatives involved within an OOB), which is similar to a case study methodology, or by selecting stakeholders from a broad range of OOBs.

A case study approach (i.e. interviewing all the representatives of one company) would provide a more in-depth understanding of the selection process and the interrelationship between the stakeholders involved in the selection process within an OOB. This could either be done by interviewing companies who already conducted a selection process (see §2.4) or by selecting companies who would be going to change external financial auditor. During the research (see §1.1) the legislation changed which meant that an analysis of previous selection processes could not be related to the current situation of mandatory rotation in the Netherlands. At the same time, a case study of companies that were going to select a new external financial auditor might mean that the data only could be related to the situation of a specific OOB. The outcome of such analysis could not be translated to all listed OOBs in the Netherlands. In contrast, an interview approach with a broader stakeholder group from a range of OOBs would provide a view of the selection process used by all these OOBs but could lead to a less complete view of the interrelationship between the stakeholders involved in the selection process.

The main purpose of this research is to gain a view of the selection process used by listed OOBs for the services of the external financial auditor and therefore the broader interview approach was used to collect data. This meant that five respondents/experts were contacted per sub-population, which is in line with Groenland \textit{et al.} (2010), to create a total sample size of 30 respondents. This is in line with Charmaz (2006), who suggests that 25 respondents are adequate for smaller projects. Green and Thorogood (2009, 2004) state that the experience of most qualitative research is that in interview studies little that is “new” comes out of transcripts once 20 or so people have been interviewed. Finally, this is also suggested by Creswell (1998) who suggests a range of between 20 and 30.

\textsuperscript{26} I have been in contact with the board of another external financial audit firm and this company did not want to participate in the research.
For the Shareholders, five representatives were selected, to include the Association of Shareholders (in Dutch: *Vereniging van Effecten Bezitters* (VEB)), the Association of Institutional Investors (in Dutch: *Eumedion*) and three large Shareholders.

According to Groenland *et al.* (2010), a theoretical sample on behaviour may consist of a diversity of sub-populations. It is expected that each sub-population will provide different answers to the relevant questions and that a sample of the sub-population needs to consist of at least four to five respondents to allow comparison with the answers from the different stakeholder groups.

Table 6 provides an overview of the different subgroups of representatives of listed OOBs that were invited to participate in structured interviews:

<table>
<thead>
<tr>
<th>Stakeholder groups</th>
<th>Number of participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief Executive Officers</td>
<td>5</td>
</tr>
<tr>
<td>Chief Financial Officers</td>
<td>5</td>
</tr>
<tr>
<td>Internal Audit Directors</td>
<td>5</td>
</tr>
<tr>
<td>Chief Purchasing Officers</td>
<td>5</td>
</tr>
<tr>
<td>Audit Committee/Supervisory Board members</td>
<td>5</td>
</tr>
<tr>
<td>Shareholders/representatives of Shareholders</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total number of interviews needed</strong></td>
<td><strong>30</strong></td>
</tr>
</tbody>
</table>

Table 6: Stakeholder groups invited to participate in research.

A selection based on convenience was made to decide participation in this research. This selection could be made based on the character of the sample group of companies. However, given the character of the external financial audit market (see §2.5), and the limited number of suppliers, a decision was made to ensure that the participating persons would cover the range of different suppliers of external financial audit services\(^\text{27}\). A list of the persons interviewed can be found in Appendix B: List of persons interviewed.

36 representatives were contacted via email and asked if they wanted to participate in qualitative research related to the topic of buying the services of external financial auditors. Three of the representatives did not react to the invitation and one representative did not want to participate in the research because the company for which the expert worked was

\(^\text{27}\) The persons interviewed covered the range of external financial auditors i.e. who performed the external financial audit of the company for which the person interviewed works.
conducting a selection process at the time of the interviews. 32 of the respondents that participated were very open and willing to discuss the topics and wanted to participate in the research under the condition that no individual citations were made available. In addition, one interview was excluded from the research because it took place with both a CFO and an Internal Audit Director at the same time. Therefore, the result was not comparable to interviews with one expert alone and could as such not be used for the study.

This approach is in line with the principles of data collection defined by Yin (2012). According to Yin (2012), the following principles need to be taken into account:

- Multiple sources of evidence;
- Creating a case study database;
- Maintaining a chain of evidence.

I used triangulation to ensure the principle of multiple sources of evidence was met. Triangulation is discussed by many researchers such as Creswell and Miller (2000) who defined triangulation as “a validity procedure where researchers look for convergence among multiple and different sources of information to form themes or categories in a study”. O’Donoghue and Punch (2003) defined triangulation as a “method of cross-checking data from multiple sources to search for regularities in the research data”. In fact, the purpose of the triangulation is to ensure weaknesses of one data collection method are balanced by strengths of another method.

Denzin (1978) identified four basic types of triangulation such as:

1) Data triangulation: More than one data source;
2) Investigator triangulation: More than one researcher to gather and interpret data;
3) Theoretical triangulation: More than one theoretical position in interpreting data;
4) Methodological triangulation: More than one method for gathering data.

Data triangulation has been secured because at least five different representatives per subgroup of experts were interviewed. Investigator triangulation was difficult to secure but the approved minutes of the interviews were also given to two KPMG Accounting trainees. These trainees were asked, after the methodology was explained, to interpret the interviews and categorise the answers given according to the data model as explained in §6.3.4. The data model created by the trainees was compared, question for question, with my own data model and the few differences were discussed.

Theory triangulation has been provided by making use of several theories as described in chapters 3, 4, 5 and 6. Methodological triangulation has been achieved by not only using
interviews but also by data collection via archives or through contacting the OOBs to obtain the RFPs they put on the market between 2008 and 2012 (see §2.4).

I used an Excel Database to collect all the data and to create the data matrix. This Excel Database is stored on my secured and encrypted computer. Once the encryption is complete, the data is easy accessible and enables researchers to counter-check data. Two backups are created, of which one can be found on my personal external hard drive and another one is in the cloud.

The chain of evidence is followed to increase reliability and to ensure that readers can follow the trajectory of any evidence, from the initial research questions to the ultimate conclusion of this research.

Much information was gathered in the course of the research. This included, amongst others, articles on; what is an audit, audit quality, auditor independence, codes of conducts, corporate governance, buying business services, buying professional services, legislation, benchmark data, RFPs of listed and non-listed OOBs, RFPs of companies of which the stakeholders participated in the tender, annual reports and articles in newspapers. All these archive materials were analysed to triangulate and support and check the findings from the interviews and other sources.

6.3.4 Analysis strategy
The matrix methodology was originally designed to obtain a better understanding of the decision-making process and the diversity of the market for the services according to Groenland et al. (2010) and Groenland (2014). The matrix analysis methodology, according to Groenland et al. (2010), combines the topics of the checklist and the answers of the different sub-populations into a qualitative data matrix. Groenland (2014) states that “the basis of the matrix methodology is rooted by Gordon and Langmaid (1988)”, is process-structured research which is based on semi-structured interviews. The various different steps in the decision-making process are defined in the conceptual model and explored through interview questions. These questions partly focus on the experiences of the respondents and partially focus on their future expected behaviour. The data output from the interviews is then ordered (cells of the matrix) according to the conceptual model, in search of meaningful patterns. In this case, a meaningful pattern means that it is interpretable for the issues identified in the conceptual model.

Within the matrix methodology, a data matrix is created which consists of two entrance points namely “Checklist issues” and responses from “Stakeholder groups”.

An example of such a data matrix can be found in figure 16.
Figure 16: Example of a data matrix.

The cells of the raw data matrix are filled with “words” and/or “short sentences” which are taken out of the minutes of the respondents.

An example of the raw data which is processed can be found in figure 17.

![Data Matrix](image)

Figure 17: Example of a data matrix with raw data.

The answers of the respondents are categorised according to the topics of the conceptual model. In a second phase, the individual cells of the stakeholder groups are combined in relation to topics of the conceptual model. This means that the individual answers of the respondents in each stakeholder group are combined in one overview per stakeholder group.

An example of the combined data model can be found in figure 18.
The categorised data is used to analyse meaningful patterns that can be linked to the issues of the conceptual model. According to Groenland et al. (2010), this analysis can be obtained by tallying the data that is a variant of the Property Space analysis of Becker (1998). As such figure 18 is translated into table 9, see §7.2.

The data matrix data, which is qualitative data, should preferably be presented in such a way that it cannot be used in a numerical or mathematical way. This can for instance be achieved by using tally tables, heat maps or Harvey balls. The challenge with tally tables is that the data can still be interpreted in a numerical way whereas a heat map or Harvey balls makes this harder. Heat maps use a lot of color, which can be challenging for people who are color-blind, therefore for the purposes of this research Harvey balls as shown in figure 19 will be used.

6.4 Quality of research design
There are four tests to establish the quality of a research design according to Kidder, Judd and Smith (1986). These tests are:

- **Construct validity**: Identifying correct operational measures for the concepts being studied;
- **Internal validity**: Seeking to establish causal relationships, whereby certain conditions are believed to lead to other conditions, as distinct from spurious relationships;
- **External validity**: Defining the domain to which a study’s findings can be generalised with confidence;
- **Reliability**: Demonstrating that the stages of a study, such as the data collection procedures, can be repeated with the same, basic results.
If these tests are applied to this research, table 7 can be created:

<table>
<thead>
<tr>
<th>Test</th>
<th>Research tactic</th>
<th>Phase in research in which the tactic occurs</th>
</tr>
</thead>
</table>
| Construct validity    | • Multiple sources of evidence  
• Establishing a chain of evidence  
• Key informants reviewed the draft report  
• Clear definition of the research variables during the research | • Data collection  
• Data collection  
• During the process the draft report was reviewed several times by supporting promoters  
• Research design and setup |
| Internal validity      | • Do pattern matching  
• Do explanation building  
• Address rival explanations  
• Use logical models  
• Setup of checklist | • Data analysis  
• Data analysis  
• Data analysis  
• Data analysis  
• Research design and data collection |
| External validity      | • Use replication logic  
• Use protocol  
• Develop database | • Research design  
• Data collection  
• Data collection |
| Reliability            |                                                                                 |                                                                                                               |

Table 7: Criteria for assessing quality for research design according to Kidder and Judd (1986).

Construct validity is assured because I first defined the variables that were part of this research. In addition, I used multiple sources of evidence during the data collection. At the same time, I established a chain of evidence throughout the research and key informants and experts in the areas of external financial auditing and procurement have reviewed my draft reports during the process.

Internal validity is not applicable as this research is exploratory research and not an explanatory or causal study. This is exploratory research because the conceptual model is developed from theory and the outcomes of the research are being empirically tested for the first time. Nevertheless, the checklist used for the data collection was set up in such a way to exclude influences from outside the research area.

External validity ensures the domain to which outcomes of studies can be generalised with some degree of certainty. Generalisation is not a given and therefore findings should be tested several times before they can be replicated. I used multiple sources during the research to test the findings. At the same time, I have tested the outcomes of the findings against other studies e.g. by Deumes, Schelleman, Vander Bauwhede and Vanstraelen (2012). As such, the findings of this research are replicable to other listed OOBs and/or OOBs which operate within an
environment with multiple external Shareholders. This study can serve as a starting point for research with other companies in scope.

Reliability is ensured because the data collection procedures can be repeated and the analysis can be reproduced based on the approved minutes, tapes of the interviews and the ways the interviews were conducted. The tapes show that interviewees were not steered into providing answers and that probing was performed in a standardised way. At the same time, the tapes show that interviewees were realistic about their role in the selection process and sometimes even stated that they should have, as explained by an Audit Committee member, taken a larger role. Of course in any matrix model, data from the interviews is categorised and this action leaves room for interpretation. Therefore, this interpretation was reviewed by several trainees to minimise errors or biases in the study, as explained in §6.3.3. As a result, the proposed research design is of sufficient quality, which means that the same results will be achieved if someone else conducts the same research within the same stakeholder group.
7 Results of the empirical analysis

7.1 Introduction

This chapter will provide an overview of the answers given by the experts/interviewees on the research questions described in §6.2.2.2, therefore this chapter will follow the structure of the conceptual model as shown in figure 19.

As show in figure 20, section two of this chapter will focus on the “Stakeholder’s perception of the services provided by the external financial auditor”. These answers are presented in a table using Harvey balls. After each table it is discussed how the table could be interpreted, what patterns are identified during the research and possible causes for these patterns.

Section three of this chapter will focus on the “Stakeholder’s perception of the clients of the external financial auditor”. The answers of the experts/interviewees are presented in a table using Harvey balls. Below the table is a discussion of how the table could be interpreted, any patterns identified during the research and possible causes of these patterns.

Section four of this chapter will focus on “Stakeholder’s objectives related to the selection process”. These answers are presented in a table using Harvey balls. Below the table is a discussion of how the table could be interpreted, any patterns identified during the research and possible causes of these patterns.
Section five of this chapter will focus on “Stakeholder’s perception of the classification of the services of the external financial auditor”. This section will describe how experts/interviewees classify the services and the external financial auditor market according to the criteria as set in §5.4.2. As such, this section may provide an overview of the possible selection strategies used by the experts/interviewees.

Section six of this chapter will focus on “The selection criteria that are being used by the stakeholders of the selection process”. Obtaining insights into the selection criteria may provide an insight into which criteria are most important according to the experts/interviewees and how they relate to the audit quality criteria as stated §3.2.2.

Section seven of this chapter will focus on “The role of the stakeholders in the selection process”. Obtaining insights into the roles of the stakeholders during the different steps of the selection process may provide an understanding of who makes the decisions during the different steps of the selection process.

Section eight of this chapter will focus on “The selection process used by the stakeholders when selecting an external financial auditor”. Understanding which selection method is used (e.g. traditional or performance based, §5.2) and how the selection process will be conducted may provide an insight into whether the experts/interviewees use a professional selection process and which steps of the process are followed.

Section nine of this chapter will focus on “The impact of the selection process, as perceived by the stakeholders involved in the selection process, on the perceived quality of the external financial audit”. In addition, this section will provide an insight into the way the stakeholders measure perceived audit quality and the way new legislation will impact the perceived audit quality of the external financial auditor. Stakeholders are also asked if perceived audit quality is impacted by a low price for the external financial audit.

Section ten of this chapter will focus on “The impact of the selection process, as perceived by the stakeholders involved in the selection process, on perceived independence of the external financial auditor”. In addition, this section will provide an insight into the way stakeholders measure perceived auditor independence and the way the new legislation will impact the perceived independence of the external financial auditor.

### 7.2 Types of services provided by the external financial auditor

In line with the conceptual model, the interviewees were asked what types of services are provided by the external financial auditor. No guidance was given during the interviews so it was expected that the interviewees would give different answers for the same kind of services,
therefore they were also asked what was meant by these services so that the services could be clustered accordingly. Table 8 provides an overview of the answers given.

<table>
<thead>
<tr>
<th>What types of services are provided by the external financial auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit of annual report (check if the reported figures are the right figures)</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Tax related services</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Support on SOX reporting</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>ERP audit, testing electronic data processing</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Sustainability statement, stating if company meets sustainability requirements set</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Support of AC/Supervisory Board</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Management letter or in control statement</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Sparring partner</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Non-audit-related services such as advisory services</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Audit-related services such as due diligence services, special statements for grants, regulatory statements</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely green, which means that all the interviewees mentioned that this service was delivered by the external financial auditor, to no fill, which means that none of the interviewees mentioned the particular service.

Table 8: Type of services delivered by the external financial auditor.

Table 8 shows that almost all the interviewees state that the external financial auditor reviews the company’s annual figures to ensure the figures presented by company management are correct, which is in line with the role of the external financial auditor as stated in the ISA 200 (2009).

The table also shows that the persons interviewed, who often work closely with the external financial auditor, such as the CFO, Audit Committee members and Internal Audit Directors (IAD), mentioned more services that are delivered by the external financial auditor compared to the interviewees who work less closely with the external financial auditor, such as the CEO, CPO or Shareholders, who often only receive the output of the services provided by the external financial auditor.

The interviewees were also asked what the objectives of the services delivered by the external financial auditor were. This question was posed to understand whether the interviewees had the same expectations of the services delivered by the external financial auditor. This could influence the criteria used in the process for selecting the external financial auditor.
Table 9 shows the answers given by the interviewees.

<table>
<thead>
<tr>
<th>What are the objectives of the services provided by the External Financial Auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meet the legal requirements (e.g. tick in the box)</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Get an unqualified opinion / independent auditor's opinion on annual report</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Check on the annual figures and the risk processes of the company</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Providing assurance to external stakeholders including shareholders</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mentioned that this was the objective of the services delivered by the external financial auditor, to no fill, which means that none of the interviewees mentioned the objective in question.

**Table 9: Objectives of the services delivered by the external financial auditor.**

It was expected that the answer given about the role of the external financial auditor would be as stated in §2.2 i.e. that the services provided by the external financial auditor would be used to provide assurance to the external stakeholders including the Shareholders. However during the interviews it became clear that some interviewees had a slightly different vision of the objectives of the services provided by the external financial auditor, which is aligned with the findings of Porter (1993) (see §2.2.2).

Some of the interviewees mentioned that the external financial audit is a service that they wouldn’t normally buy. According to the interviewees, the company has invested in tools, systems and resources to ensure they are in control and they do not need an external party to check the figures. However, it is required by law and therefore these stakeholders want to meet the legal requirements. It appears that this objective is strongly linked to the Agent assumption of “self-interest” and “bounded rationality”. The bounded rationality seems to play a role because the interviewees already feel that they have all the information at hand to make decisions. Self-interest seems to play a role because stakeholders sometimes see limited reasons to share this with the external environment. During the interviews, one CFO said for instance that, “he is only conducting an external financial audit because it is required by law”.

Receiving an unqualified opinion is seen as receiving a stamp of approval. It relates to “meeting legal requirements” however, a greater emphasis is put by the interviewees on receiving an unqualified opinion in the most effective way so that the company can continue its work. It feels that this objective is strongly related to “self-interest”. The interviewees need to receive the stamp of approval and sign-off so they can continue with their own objectives. One CFO for instance mentioned during an interview that “the outcome of the external financial audit is a sign that I have done my work properly”.

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A check on the annual figures and risk processes means that the services are really seen as an independent check. However, the focus of the check is to show that the interviewees themselves can feel/show that they have performed their work appropriately. This objective is strongly related to “self-interest”, “utility of information” and “risk aversion”. The interviewees want to protect their own position because the services of the agent are used to evaluate the performance of the expert. An Audit Committee member for instance said, “The external financial auditor is one of the important information channels to get an insight into the actual performance of the company and the management of the company”.

Finally, interviewees mentioned that the objective of the services provided by the external financial auditor is to provide assurance, in some cases the word trust was even used, to the external environment rather than to themselves. It appears that this is strongly related to the assumption of “utility of information”. The interviewees do not have the information to hand but use the agent, the external financial auditor, to get the information needed. One Shareholder for instance said, “The external financial auditor is the provider of trust and in some cases a kind of insurance”.

According to answers given by the interviewees, the CFOs, CEOs, IADs and CPOs are mainly focused on meeting legal requirements and/or receiving an unqualified opinion. Audit Committee members and Shareholders have a greater focus on having an independent risk assessment of the annual figures and risk processes of the company. In addition, the Audit Committee members and Shareholders state that the objectives of the services provided by the external financial auditor are to provide assurance to external stakeholders. Some Shareholders even stated that the services provided by the external financial auditor can offer trust to the public i.e. the external environment.

The differences between the answers of the interviewees can probably best be explained by the differences between the Agent assumptions as described in §4.2.3. All interviewees are driven by “self-interest” but interviewees such as CFOs, CEOs, IADs and CPOs have, according to themselves, most of the information that is gathered by the external financial auditor at hand to make decisions. As such, it seems that the function of the external financial auditor is not to provide additional information for improved decision-making to the stakeholders involved in the selection process. Interviewed persons such as Audit Committee members and Shareholders use the external financial auditor to provide them with the additional information for decision-making such as delivering assurance on the figures, information on performance management, company, risk processes and so on.

7.3 The clients of the services of the external financial auditor
In line with the conceptual model, the interviewees were asked who the clients for the services provided by the external financial auditor were. Again, no guidance was given by the
interviewer during the interview and as such, it was to be expected that the interviewees gave different names for the clients. The interviewees were therefore asked to give somewhat more details as to what was meant by these clients. They were also asked why these were the clients for the external financial auditor’s services. Table 10 provides an overview of all the answers given.

Table 10: The clients of the services delivered by the external financial auditor.

Table 10 shows for instance that all CFOs mentioned the Audit Committee as one of the clients for the services provided by the external financial auditor. All CPOs for instance mentioned the CFO as one of the clients of the external financial auditor. The CFOs and the Audit Committee were seen as clients because they had to co-operate with the external financial auditor and they were both seen as principals of the external financial auditor.

Table 10 shows that most of the interviewees recognise that the external financial auditor has many different clients from within and outside the company.

When the answers of the interviewees are compared, it seems that the Shareholders, or representatives of the Shareholders, recognise more external clients and fewer internal clients than the other interviewees. An exception was for instance an Internal Audit Director who
mentioned that, “The public is the only client” which he explained as everyone outside the company with an interest in the company.

This difference between the Shareholders and CFOs, CEOs, IADs and CPOs can probably be best explained by the outcome as defined in §7.2 where it seems that CFOs, CEOs, IADs and CPOs have a narrower vision of the objectives of the services delivered by external financial auditor than the Shareholders.

The interviewees were also asked to put these clients in order of importance. This was done by writing the names of the clients they had identified in the previous question on small cards. Then the interviewees were asked to select the top five and rank the cards physically in order of importance while answering why this client was placed at this position in comparison to other places. Table 11 provides an overview of the answers given.

<table>
<thead>
<tr>
<th>Who are the most important clients of the services of the external financial auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Supervisory board</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>CFO</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>CEO</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Internal Audit Department</td>
<td>☽</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Corporate Control</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Corporate Reporting/Finance</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Tax Department</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Shareholders</td>
<td>☽</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Risk Management</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Credit suppliers</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>Employees</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
<tr>
<td>The public</td>
<td>☽</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
<td>☾</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are in order from completely filled, which means that almost all the interviewees mention this as a very important client of the services delivered by the external financial auditor, to no fill, which means that none of the interviewees did so. If a Harvey ball is filled in green, it means that this is the most important client according to the specific expert group.

Table 11: The most important clients of the services delivered by the external financial auditor.

Table 11 above shows that the Audit Committee, CFOs and CEOs are mentioned most by the different expert groups as being an important client for the services provided by the external financial auditor. Table 11 also shows that the CFO, CEO, IAD and CPO identify the CFO as the most important client of the services provided by the external financial auditor, while both the Audit Committee and Shareholders consider themselves the most important clients.

28 Group of similar experts/interviewees.
It was expected that the Shareholders or the delegated principal of the Shareholders, namely the Supervisory Board or Audit Committee, would be seen as the most important client of the external financial auditor. This would be in line with the Dutch Corporate Governance Code (2008) (see §2.3). However, the outcome of the expert interviews shows that this is rarely the case. All internal stakeholders such as CFOs, CEOs, IADs and CPOs put the CFO, and even in some cases the CEO, higher than or equal to the Audit Committee and/or the Supervisory Board in terms of importance. The main reason according to the interviewees for this ranking was that the CFO is, according to them, the most important client because the CFO is the person who has to work frequently with the external financial auditor. In addition, it was mentioned that the outcome of the work of the external financial auditor will influence the performance and the perception of the performance of the CFO. One Audit Committee member for instance said, “If the CFO doesn’t like the external financial auditor, limited information will be shared between the company and the external financial auditor, which will affect the external financial audit”.

7.4 Objectives of the stakeholders involved in selection process

The interviewees, in line with the conceptual model, were asked which stakeholders were involved in the process for selecting the external financial auditor. It was expected that the experts/interviewees would give different names to the different stakeholders and therefore they were asked to give more details about what was meant by these stakeholders and also why these stakeholders were involved. Table 12 provides an overview of the answers given.

<table>
<thead>
<tr>
<th>Which stakeholders are involved in the selection process of the External Financial Auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee (includes head of Committee)</td>
<td>●</td>
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<tr>
<td>Supervisory board</td>
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<tr>
<td>CFO</td>
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<td>CEO</td>
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<td>Management Board</td>
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<td>Internal Audit Director</td>
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<tr>
<td>Chief Procurement Officer</td>
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<tr>
<td>Corporate controller</td>
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<tr>
<td>Corporate Accounting &amp; Reporting</td>
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<tr>
<td>Local CFO</td>
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<tr>
<td>Actuarial Department</td>
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<tr>
<td>Tax Department Manager</td>
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<td>IT Director</td>
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<tr>
<td>Regulatory &amp; Compliance</td>
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<tr>
<td>Deputy Secretary</td>
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<td></td>
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<tr>
<td>(Major) Shareholder</td>
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</tbody>
</table>

The Harvey balls in this table are in order from completely filled, which means that almost all the interviewees mentioned that this stakeholder is involved in the selection process, to no fill, which means that none of the interviewees mention this as a stakeholder involved in the selection process. If a Harvey ball is filled in green, it means that all the interviewees have mentioned that this stakeholder is involved in the selection process.

Table 12: Stakeholders involved in the process for selecting the external financial auditor.
Table 12 shows that all the interviewees mention that the CFO is involved as a stakeholder in the process for selecting the external financial auditor. At the same time, the table clearly shows that the Audit Committee is also often mentioned by the interviewees as a stakeholder involved in the process for selecting the external financial auditor. This is because the CFO is seen by most of the interviewees as the principal of the external financial auditor. The IAD, Corporate Controller and the Accounting & Reporting Department are seen as the stakeholders that have to co-operate with the external financial auditor to deliver the services. Sometimes, in case of the IAD, the cooperation is so close that the external financial auditor has to base his opinion on the annual figures of the company on work already provided by the IAD.

It was initially expected that the Audit Committee and/or Supervisory Board members, in addition to the Management Board of the company, would be involved in the selection process. However the analysis of the RFPs put onto the market by listed OOBs between 1 January 2008 and 31 December 2012 (see §2.4) already showed that the list of stakeholders involved in the selection process is more extensive. This finding is confirmed by the answers given by the persons interviewed, because it seems that the company that will be audited includes the roles/departments that will have to co-operate with the external financial auditor in the selection process. From outside the company it is hard to recognise who those stakeholders are because little information is shared publicly regarding the process of selecting the external financial auditor.

Table 12 clearly shows that internal stakeholders (CFOs, CEOs, IADs, CPOs) and Audit Committee members acknowledge more stakeholders than the Shareholders. This difference can be explained by the fact that the Shareholders, as explained by the interviewees during the interviews, have a limited view of the process for selecting the external financial auditor. The Shareholders are only informed of the selection of a new external financial auditor during the Annual Shareholders’ Meeting, during which they receive limited insight into how the selection process was conducted and who was involved in it.

Another difference which can be seen in the table is that only a limited number of the interviewees acknowledge the role of the Shareholders in the selection process even though, according to the Dutch Corporate Governance Code (2008), they have to approve the appointment of the external financial auditor during the General Shareholders’ Meeting (in Dutch: Algemene Vergadering van Aandeelhouders (AVA)). Two CFOs and one Audit Committee member even mentioned that, “The Shareholder is not seen as a contributor to the selection process because they lack the knowledge, and the approval of the Shareholders is seen as a formality (een hamerstuk)”. It also clear that the Corporate Controller, or a representative from the Control & Risk departments, plays a larger role in the selection process than anticipated at the start of this
research. According to the interviewees, the Corporate Controller owns the risk framework and as such is involved in selecting the external financial auditor.

Based on this outcome, the interviewees were asked what the objectives of the mentioned stakeholders could be during the process for selecting the external financial auditor. The answers of the different interviewees were combined with the perspectives of the Agent Theory (see Chapter 4). This is similar to the way in which Tate et al. (2009) analysed the objectives of the stakeholders involved in buying marketing services.

Table 13 shows, based on the answers given during the interviews, that the stakeholders involved in the selection process have mixed objectives, which could lead to mixed messages in the selection process. This could, as stated by Tate et al. (2009) lead to a “reduced supplier performance as the supplier tries to interpret conflicting information”.
<table>
<thead>
<tr>
<th>Agency Theory</th>
<th>Objectives of the CFO</th>
<th>Objectives of the CEO</th>
<th>Objectives of the IAD</th>
<th>Objectives of the CFO Controller</th>
<th>Objectives of the Corporate Committee</th>
<th>Objectives of the Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Self-interest</strong></td>
<td>Focus on getting an independent and unqualified opinion that ensures that the figures give a true and fair view to ensure reliability.</td>
<td>Focus on getting an independent and unqualified opinion in order to assure that the company is in control.</td>
<td>Focus on delivering an annual report that meets the legal requirements to ensure reliability.</td>
<td>The CFO wants to make use of the advice function of an auditor.</td>
<td>Finding the best auditor i.e. who suits the company best and delivers the highest quality at a fair price.</td>
<td>Focus on assurance about the figures and insights into business risks.</td>
</tr>
<tr>
<td><strong>Bounded rationality</strong></td>
<td>The CFO has all the required information and is more concerned about improving the quality of the business by sparring with the external auditors.</td>
<td>The CEO does not have all the required information but uses the CFO to get insight into financials. However, the CEO is more concerned with the performance of the finance function and uses the external financial auditor to test this.</td>
<td>The IAD has all the required information and is therefore more focused on getting information to improve reliability.</td>
<td>The Corporate Controller has all the required information and is therefore more focused on getting information to improve quality and cooperation.</td>
<td>Limitations come from limited access to information, therefore the Audit Committee benefits from an independent auditor which provides the required information.</td>
<td>Limitations come from limited access to information, therefore the Shareholders benefit from an independent auditor which provides the required assurance.</td>
</tr>
<tr>
<td><strong>Risk aversion</strong></td>
<td>Controls the financial information of a company.</td>
<td>Relies partly on the relationship with the CFO and AID to obtain financial information of the company.</td>
<td>Performs risk controls within a company.</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Utility of information</strong></td>
<td>Uses information from the auditor to improve the quality of the business.</td>
<td>Uses information from the auditor to improve the quality of the finance function.</td>
<td>Uses information from the auditor to obtain additional technical information to improve the quality of the internal audit department.</td>
<td>-</td>
<td>Uses information from the auditor to get insights into business risks and performance of the company's management.</td>
<td>-</td>
</tr>
<tr>
<td><strong>Goal conflicts</strong></td>
<td>Goal is to create a reliable image by focusing on the assurance that the figures give a true and fair view.</td>
<td>Goal is to get an independent unqualified opinion from an external financial auditor in order to assure the external stakeholders that the company is in control.</td>
<td>Goal is to create a professional internal audit department that leads the audit activities within the company and takes over the activities of the external financial auditor.</td>
<td>Goal is to achieve savings (i.e. lower external financial auditor costs) and/or meet commercial conditions &amp; low costs.</td>
<td>Goal is to control management of the company and minimise company risks to show AC is in control.</td>
<td>Goal is to maximise dividend payments and/or maximise share value.</td>
</tr>
</tbody>
</table>

Table 13: Objectives of stakeholders involved in the process for selecting the external financial auditor expressed through to Agent Theory perspectives.
Table 13 suggests that the CFO focuses on receiving an unqualified opinion. In addition, the CFO is focused on showing that the risk framework is operating professionally and is meeting the required standards. The CFO also focuses on confirming the “in control” and using the external financial auditor as a sparring partner. The objectives of the CEO are, according to the persons interviewed, aligned with the objectives of the CFO for the most part. However, the CEO can also use the external financial auditor to obtain a view of the performance of the Finance Department and the CFO.

The Audit Committee members are more focused on testing the risk framework of the company followed by receiving an unqualified opinion on the figures. The Audit Committee also focuses on obtaining a complete view of the company’s risks and an insight into the quality of the finance organisation and the performance of the management of the company. They do this using the services of the external financial auditor because they have limited access and/or time to gather information within the company.

In the selection of the external financial auditor, the Internal Audit Director (IAD) focuses on cooperation, because the IAD wants to use the knowledge of the external financial auditor to improve the department’s own service delivery and its position within the company. In addition, the IAD will focus on establishing clear agreements on the scope of work to ensure the position of the IAD within the company is secure. In the end, the IAD wants to ensure that the company is in control of its risks and is appropriately managing legal requirements.

The Corporate Controller is searching for an external financial auditor that delivers the services at a fair price. The Corporate Controller will focus on relationships and cooperation in the selection process to ensure that the Corporate Controller can make use of the knowledge of the external financial auditor to improve its own services and position within the company. In the end, the Corporate Controller wants to improve the control processes within the business to minimise risk to the company.

The CPO is not really identified as a customer of the external financial auditor. However, the CPO will formally focus on running a professional selection process so that the company can find an external financial auditor that meets the requirements set by the stakeholders involved in the selection process. The CPO will also focus on achieving group purchasing objectives such as realising cost savings. Several interviewees, including several CFOs, mentioned that, “Procurement added no value to the selection process other than facilitating it”. Most of the CPOs mentioned that Procurement only recently became involved in the process of selecting the external financial auditor. One CPO mentioned that, “The buying process of selecting the external financial auditor used to be organised by the finance team”.

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The Shareholder would like to receive information about the company’s actual performance and business risks. However, the information the Shareholder actually receives is limited. As such, the services provided by the external financial auditor are used to build trust in the company and the management of the company.

7.5 Classification of the services provided by the external financial auditor

To obtain a better understanding of the external financial auditor market, the interviewees were asked, in line with the conceptual model, to provide their view on the services and the external financial auditor market according to the theories used by procurement professionals.

7.5.1 Different risk classifications

To obtain a better understanding of the perception of the external financial auditor market, the interviewees were asked to classify the market of the external financial audit service providers according to the “supply risk” and “profit impact” criteria (as defined by various studies, see §5.4.2). Understanding how the interviewees classify the services provided by the external financial auditor according to the supply risk and profit impact areas can be used as input for analysing the selection strategies used by the interviewees.

Table 14 below provides an overview of the answers given:

![Table 14: Supply risks and profit impact.](image-url)
The answers of the interviewees, as shown in table 14, will be presented by risk criteria.

7.5.1.1 Shortage of qualified personnel

Table 14 shows that a limited number of interviewees mention that the risk of “shortage of qualified personnel” affects the external financial auditor market.

Where interviewees indicated that a “shortage of qualified personnel” is affecting the external financial auditor market, this relates mostly to the availability of qualified lead partners with specific industry knowledge or seniority. This is especially mentioned by Audit Committee members and CPOs.

Interviewed persons who mention that there is no “shortage of qualified personnel” within the market mainly state this because they believe that their company is large enough to be so attractive to external audit firms that they free up the resources needed, even if they have to come from abroad. One CFO for instance mentioned that, “If I put an RFP in the market, all the external financial auditors will put their best employees forward because we are a must-have company”.

Based on the answers from the interviewees it can be assumed that the size of the company can play a role in the perception of the risk of “shortage of qualified personnel” applying to the external financial auditor market and possibly impacting the selection process.

7.5.1.2 Tax or export duty regulations (“duty regulations”)

Table 14 shows that a limited number of interviewees mention that the risk of “duty regulations” affects the external financial auditor market.

The interviewees who mention that the risk of “duty regulations” impacts the external financial auditor market relate this to knowledge of tax legislation, which is needed to perform the external financial auditor function. One IAD mentioned that, “It would be preferable to have an external financial auditor that has knowledge of tax legislation to make the external financial audit more efficient”.

The interviewees who mention that the risk of “duty regulations” do not impact the external financial auditor market mention that no duty regulations apply to the market of the external financial audit.

It can be assumed, based on the answers of the interviewees that “duty regulations” do not apply to the external financial auditor market and as such will probably will not impact the selection process.
7.5.1.3 Substitution policies
Table 14 shows that a limited number of interviewees mention that the “substitution policies” risk applies to the external financial auditor market.

The interviewees who mention that the risk of “substitution policies” impacts the external financial auditor market mention this because the services provided by the external financial auditor can be performed in part by the Internal Audit Department. One CFO mentioned that, “The total cost of an audit can be calculated by adding the costs of the internal audit department and the external financial audit, and the costs of the internal and external audits are strongly linked (i.e. high internal audit costs will lead to lower external financial audit costs)”.

The interviewees who mention that the risk of “substitution policies” does not affect the external financial auditor market mention this because the services provided by the external financial auditor cannot be replaced. Companies by law have to provide an Audit Report, which has to be issued by an external financial auditor.

It can be assumed, based on the answers from the interviewees, that “substitution policies”, with the exception of sharing activities with the IAD, apply to the market in cases where the IAD also performs financial audit services. In the end, the external financial auditor has to sign off on the audit, but some of the activities can be substituted by the services of the IAD and this can play a role within the process of selecting the external financial auditor.

7.5.1.4 Storage risks
Table 14 shows that a limited number of interviewees mention that “storage risks” will influence the external financial auditor market.

The interviewees who mention that “storage risks” will influence the external financial auditor market mention this because the external financial auditor has to store the company’s confidential information and the risk exists that this might not always be done securely. In addition, the information is stored within the minds of the people involved and that is why, according to one CFO, “you must ensure that the external financial auditor provides a strong team that shares information”.

Most of the interviewees mention however, that “storage risks” will not influence the external financial auditor market because the service provided is not a product which can be stored. One Audit Committee member for instance mentioned that, “Storage risks are only applicable to products”.

It can be assumed, based on the answers from the interviewees that “storage risks” will not apply to the external financial auditor market or services because most of the stakeholders do
not consider this relevant. This criterion is therefore not expected to influence the selection process.

7.5.1.5 On time delivery
Table 14 shows that most of the interviewees mention that the risk of “on time delivery” is applicable to the services provided by the external financial auditor.

Interviewed persons who indicated that “on time delivery” affects the services provided by the external financial auditor stated that a delayed delivery can impact the market position of the audited company. The interviewees also mention that on time delivery is dictated by law since every listed company is required to present its annual figures within four months of the end of the fiscal year.

Interviewed persons who mention that no “on time delivery” risk affects the services provided by the external financial auditor mention this because they assume that the external financial auditor will always have the resources to make sure timelines are met.

Based on the answers of the interviewees it can be assumed that “on time delivery” applies to the external financial auditor market and as such might impact the selection process.

7.5.1.6 Lack of logistical knowledge
Table 14 shows that a limited number of interviewees mention that the risk of “lack of logistical knowledge” applies to the services provided by the external financial auditor.

The interviewees who mention that the risk of “lack of logistical knowledge” impacts the services provided by the external financial auditor work for a company that has a lot of logistical processes.

The interviewees who mention that the risk of “lack of logistical knowledge” does not apply to the services provided by the external financial auditor mention that no logistical processes are included in the services provided by the external financial auditor. One CPO mentioned that, “This is not product and therefore logistical supply chain characteristics do not apply”.

It can be assumed, based on the answers from the interviewees that “lack of logistical knowledge” does not apply to the process for selecting the external financial auditor. Only in cases where the company audited depends on logistical processes is knowledge of logistical processes required in the selection process.

7.5.1.7 Cultural differences
Table 14 shows that most interviewees mention that the risk of “cultural differences” is applicable to the external financial auditor market.
Most of the interviewees indicated that a “cultural differences” risk does apply to the external financial auditor market because the external financial auditor has to fit in with the culture of the company and/or has to understand the cultures of the different countries in which the company operates. One CFO for instance mentioned that, “An external financial auditor has to understand the company’s internal ways of working to ensure a successful audit”.

Some interviewees mention that there is no “cultural differences” risk within the market and believe that this does not play a role in the selection process because of the nature of the services provided. One Shareholder for instance mentioned that, “An external financial auditor has to conduct specific checks and therefore the auditor does not have to understand the culture of a company”.

Based on the number of interviewees that state that this criterion applies, it can be assumed that “cultural differences” applies to the external financial auditor market and selection process.

### 7.5.1.8 Competitive demand

Table 14 shows that opinions of the interviewees are mixed about the impact of the risk of “competitive demand” on the external financial auditor market.

Interviewed persons who indicated that a risk of “competitive demand” is impacting the external financial auditor market say that, due to the mandatory rotation, a competitive environment exists for companies who want the right audit lead partner and audit team. One CEO for instance mentioned that, “His company operates in a specific market and there are only two external financial audit partners available in the Dutch market that have knowledge of this market”.

Interviewed persons who mention that there is no “competitive demand” risk within the market mention that the external audit firms have the resources available to support the market because their company does not need specific knowledge and/or the company is a must-have company in the market. One Audit Committee member explained that, “We will always get the right team due to the size of our company”.

Based on the answers from the interviewees it can be assumed that “competitive demand” can affect the market and the selection process especially in cases were specialised industry knowledge is needed.
7.5.1.9 Make or buy opportunities

Table 14 shows that the opinions of interviewees are mixed about whether the risk of “make or buy opportunities” applies to the external financial auditor market.

Interviewed persons who indicated that “make or buy opportunities” apply to the external financial auditor market say that the services provided by the external financial auditor can largely be replaced by an Internal Audit Department.

Interviewed persons who mention that “make or buy opportunities” do not influence the external financial auditor market say that an Internal Audit Department should focus on operational and not financial audits.

Based on the answers from the interviewees it can be assumed that “make or buy opportunities” could impact the market and also the selection process for the external financial auditor. This is especially dependent on whether a company uses an Internal Audit Department to perform financial audits.

7.5.1.10 Logistics-related facilities

Table 14 shows that none of the interviewees think that the risk of “logistics-related facilities” applies to the external financial auditor market. The interviewees mention that no products are transported and as such no logistics-related facilities are needed to perform the services.

Based on the answers of the interviewees it can be assumed that “logistics-related facilities” will not impact the external financial auditor market and the selection process.

7.5.1.11 Payment conditions

Table 14 shows that a limited number of the interviewees think that the risk of “payment conditions” is applicable to the external financial auditor market.

Interviewed persons who indicated that “payment conditions” apply to the external financial auditor market say that the impact is limited and can be resolved during the final negotiations with the external financial audit firm. One CPO mentioned that, “He will negotiate these terms during the contract negotiations”.

Interviewed persons who mention that “payment conditions” do not influence the market state that the financial positions of the external financial audit firms are too good to impact the market. One Audit Committee member mentioned that, “External financial auditors earn enough to bear an increase in payment conditions”.

Based on the answers of the interviewees it can be assumed that “payment conditions” do not influence the selection process. This because of the financial positions of the external financial
audit firms and/or it is expected that payment conditions will be resolved during the negotiation process.

7.5.1.12 Supply interruptions

Table 14 shows that a limited number of interviewees think that the risks of “supply interruptions” are applicable to the external financial auditor market.

Interviewed persons who indicated that “supply interruptions” are impacting the services provided by the external financial auditor say that these services are delivered by a number of individuals, and the quality of the services could be impacted if something were to happen to some of these individuals. One of the CFOs for instance mentioned that, “I always look at the composition of a team to ensure team members can duplicate roles”.

Interviewed persons who mention that there are no “supply interruption” risks influencing the external financial auditor market note that these are services which by their nature do not have a supply risk. It was also mentioned that that crucial people performing the external financial audit can always be replaced.

Based on the answers of the interviewees it can be assumed that “supply interruptions” do not influence the external financial auditor market and services due to the size of an external financial audit firm and the ability to replace team members so that the services can be delivered.

7.5.1.13 Low number of suppliers

Table 14 shows that most of interviewees think that the risk of “low number of suppliers” is applicable to the external financial auditor market.

Interviewed persons who indicated that “low number of suppliers” is impacting the external financial auditor market state that the mandatory auditor rotation impacts the market. If you want or have to work with one of the Big4 firms, and one of the Big4 firms is already your tax advisor (which you want to keep), you only have a choice of two possible providers. This raises the question whether or not companies have enough choice to guarantee auditor quality and auditor independence. One CFO mentioned that, “The market, due to mandatory rotation, is getting too small, especially when you operate in a market which requires specific knowledge which is not available in every external financial audit firm”.

The respondents that say that the low number of suppliers does not influence the external financial auditor market or services say that a selection of two or three suppliers is enough. One Audit Committee member mentioned that, “They will always force an external financial auditor to participate in the pitch, even if the external financial auditor does not want to due to non-audit services or tax services”.

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Based on the answers from the interviewees it can be assumed that the “low number of suppliers” does influence the external financial audit market and the process for selecting the external financial auditor.

### 7.5.1.14 Impact on business growth

Table 14 shows that a limited number of interviewees think that the risk of “impact on business growth” is applicable to the external financial auditor market.

Interviewed persons who indicated that there is an “impact on business growth” state that business growth is related to operations and that business strategies and financial performance, which the external financial auditor reviews, is an outcome of these strategies. One Audit Committee member mentioned that, “The audit report of the external financial auditor will impact the finance capabilities of the company”.

Interviewed persons who mention that there is no “impact on business growth” influencing the market state that an external financial auditor only reviews the financial performance of a company and as such does not influence the business growth of the company.

Based on the answers from the interviewees it can be assumed that “impact on business growth” does not influence the external financial audit market because the services provided by the external financial auditor are too geared towards the financial processes rather than the company’s business process.

### 7.5.1.15 Market conditions

Table 14 shows that most interviewees think that the “market conditions” (scarcity & availability) risk applies to the external financial auditor market.

Interviewed persons who indicated that “market conditions” affect the external financial auditor market combine both the challenges mentioned under shortage of qualified personnel, competitive demand and number of suppliers.

Interviewed persons who mention that there are no “market conditions” risks influencing the market state this because they see the external financial auditor as a commodity which is available on demand.

Based on the answers of the interviewees it can be assumed that “market conditions” do influence the external financial audit market, especially in cases were specialised industry knowledge is needed.

### 7.5.1.16 Impact on product quality

Table 14 shows that a limited number of interviewees think that the risk of “impact on product quality” is applicable to the services provided by the external financial auditor.
Interviewed persons who indicated that there is no “impact on product quality” state this because the services provided by the external financial auditor are not seen as part of a company’s operational processes, and/or as related to the services or products that a company delivers. In addition, they state that the external financial auditor does not review the operational processes of a company.

Interviewed persons who mention that there is an “impact on product quality” mention that this is influenced by the in control statements and the “advice” role (in Dutch: natuurlijke adviesfunctie) (see §2.2.3).

Based on the answers of the interviewees it can be assumed that “impact on product quality” does not influence the external financial audit market because external financial auditors are not involved in the production process of a company.

7.5.1.17 Percentage of total costs purchased is low

Table 14 shows that almost all interviewees mention that the risk “percentage of total costs purchased” applies to the external financial audit market.

Interviewed persons who indicated that the “percentage of total costs purchased is low” also state that the total amount charged by an external financial auditor is still high and that the management of the company will try to reduce this overall amount by both reducing the scope of activities of the external financial auditor and negotiating on price. One Audit Committee member and one CEO for instance mentioned that, “It is seen as a victory by management to achieve an extra cost reduction on the external financial auditor’s fee”.

Some of the interviewees, especially interviewees from Audit Committees, mentioned that the overall amount may be large, but still it is limited if you compare it to the risks involved and the position the services occupy in the public domain. One Audit Committee member for instance mentioned that, “He, especially in light of the assurance given, found the overall price of the external financial audit low in comparison to the risks borne by the external financial auditor. However, external financial auditors are fighting for market share and that is something you must use in negotiations”.

Interviewed persons who mentioned that the “percentage of total costs purchased” was not low did not know what the company paid for the services provided by the external financial auditor in relation to the total expenditure of the company.

Based on the answers from the interviewees it can be assumed that “percentage of total costs purchased” is low. However, the overall price paid to the external financial auditor will play a large role in the selection process.
7.5.1.18 Expected growth in demand

Table 14 shows mixed opinions among the interviewees about whether the risk of “expected growth in demand” applies to the external financial auditor market.

Interviewed persons who indicate that “expected growth in demand” applies to the external financial auditor market expect that new legislation, additional products such as Corporate Social Responsibility Reports or increased supervision by controlling bodies will ensure growth in demand.

Based on the answers from the interviewees it can be assumed that “expected growth in demand” does not influence the external financial audit market because they expect that mandatory rotation will mean that external financial auditors will be asked to perform only the necessary checks on a limited scope of companies to reduce costs and/or meet legal requirements.

Based on the answers of the interviewees it can be assumed that “growth in demand” is only foreseen if controlling bodies demand more services.

7.5.2 Which “supply risk” and “profit impact” criteria are relevant?

To obtain a better understanding of the procurement strategy used during the selection process by the interviewees, the interviewees were also asked, based on the previous questions, to classify the services provided by the external financial auditor in the Kraljic (1983) purchasing portfolio (see §5.4).

Table 15 provides an overview of the answers given:

<table>
<thead>
<tr>
<th>Commodity (low supply risk, high profit impact)</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottleneck (high supply risk, low profit impact)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Strategic (high supply risk, high profit impact)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Nuisance (low supply risk, low profit impact)</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees agree that they would classify the services provided by the external financial auditor accordingly, to no fill, which means that none of the interviewees agree. If a Harvey ball is filled in green, it means that all the interviewees mentioned that they would classify the services provided by the external financial auditor accordingly.

Table 15: Positioning of the services provided by the external financial auditor in the Kraljic (1983) purchasing portfolio.

When the answers presented in table 16 are transposed into the Kraljic Matrix, figure 20 is the result.
The larger and darker the filling the more respondents agreed with the positioning.

Figure 20: The positioning of the services provided by the external financial auditor according to the respondents into the Kraljic Matrix (1983).

The interviewees who position the services provided by the external financial auditor in the nuisance quadrant state that they do so because they believe that the services provided by the external financial auditor introduce a low supply risk and low profit impact given the previous answers.

The interviewees who position the services provided by the external financial auditor as a bottleneck and/or strategic quadrant are of the impression that the services provided by the external financial auditor can have a large impact on the value of the company. If an external financial auditor is not willing to provide an unqualified opinion due to the fact that misstatements are identified, it is most likely that the company’s share price will fall, impacting the company’s financing and funding capabilities. According to these interviewees this will indirectly affect business growth, profit and even going-concern status. One Audit Committee member for instance mentioned that, “You cannot put the services provided by the external financial auditor into this matrix because the impact on costs might be low but the impact on the value of the company could be extremely high”.

Based on the answers from the interviewees it can be assumed that most of the interviewees who are involved in buying the services provided by the external financial auditor will identify these services as a “Nuisance” product. This position means, according to Gelderman and van Weele (2003), that a company could use a purchasing strategy which would either “pool requirements” or “order individually with a focus on optimising processing costs”. Pooling
requirements, given the uniqueness of the external financial audit services, is not to be expected and as such companies who buy these services can be expected to focus on obtaining the services for a low price and ensuring that the transition costs are minimised.

7.5.3 Is the reputation of the supplier also a supply risk?
The analysis of the selection criteria previously used by listed OOBs (see §5.3) showed that the “supplier reputation” is a selection criterion. However, in theory no evidence can be found for the statement that “supplier reputation” is perceived as a supply risk and therefore the interviewees were asked whether the reputation of the external financial auditor is important for a company to select an external financial auditor. If yes, the interviewees were asked whether the reputation of the external financial auditor could impact the reputation of the buying company. Table 16 provides an overview of the answers provided by the interviewees.

<table>
<thead>
<tr>
<th>Is the reputation of the external financial auditor important for a company for selecting an external financial auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>No</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Could the services provided by the external financial auditor impact the reputation of the company?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>●</td>
<td></td>
<td></td>
<td>●</td>
<td>●</td>
<td>●</td>
</tr>
<tr>
<td>No</td>
<td></td>
<td>●</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees agree with the statement, to no fill, which means that none of the interviewees agree with the statement. If a Harvey ball is filled in green, it means that all the interviewees agreed with the statement.

Table 16: Reputation and the impact on the company’s reputation.

Table 16 shows that all interviewees believe that reputation of the supplier is important for selecting an external financial auditor. At the same time, most of the interviewees feel that the reputation of the external financial auditor could damage the reputation of the company. According to the interviewees, this is caused by the fact that an external financial auditor has a role in earning the trust of the external environment on behalf of the company. One Audit Committee member for instance said, “You do not want to do business with an external financial auditor that has a bad reputation and a lot of claims. This will result in questions during the annual Shareholders’ meeting and you do not want to have that”.

The interviewees also state that the damage would be at its worst if an external financial auditor were to provide an unjustified unqualified opinion. This, according to the interviewees, would affect the share price and financing capabilities of a company.

The interviewees who state that the services provided by the external financial auditor could not damage the reputation of the company state that the reputation of a company is mostly influenced by the Board of Directors and the culture in the company and not the external
One IAD for instance mentioned that, “It is the other way around, the reputation of the company will impact the reputation of the auditor, because any undetected fraudulent actions of a company can impact the reputation of the external financial auditor”.

It is interesting to see that the CPOs, Audit Committee and Shareholders have a strong tendency to agree with the fact that the reputation of the external financial auditor may affect the reputation of the company, while CFOs, CEOs and IADs have a mixed view. This difference might be caused by the fact that Audit Committee members and Shareholders see the external financial auditor as a party which has to provide trust and that CFOs, CEOs and IADs believe that this trust is created more by management and the auditor is seen only as a legal requirement as explained in §7.2.

### 7.6 Selection criteria that are being used by the stakeholders of the selection process

#### 7.6.1 The selection criteria used during the selection process

The interviewees, in line with the conceptual model, were asked which selection criteria they would use during the process for selecting the external financial auditor. The interviewees were not guided and therefore it was expected that the interviewees would give different meanings to the selection criteria used. Therefore the interviewees were also asked to give more details about what was meant by the respective selection criteria and why they would use these criteria.

The answers of the interviewees were also compared with the selection criteria that were identified during the analysis of the RFPs put onto the market by listed OOBs (see §5.3.2). Therefore, a column was added to the table clarifying whether the respective selection criterion is mentioned in the RFPs.

At the same time each criterion will be tested against the measurements identified to measure audit quality as defined in §3.2.2.

Table 17 provides an overview of the answers given by the interviewees.
The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mentioned that they use this criterion in the selection process, to no fill, which means that none of the interviewees use this criterion in the selection process. If a Harvey ball is filled in green, it means that all the interviewees mentioned that they use this criterion in the selection process. An X means that the respective criterion has not been used in the RFPs put into the market by listed OOBs while a V means that the respective criterion is used by the listed OOBs (see §5.3.2).

Table 17: Criteria used in the selection process.

The outcome of table 17 will be presented by criterion. Only the criteria that are mentioned by more than three expert groups and/or that are not mentioned in the RFPs and are mentioned by more than two expert groups will be presented.

### 7.6.1.1 Quality of lead partner

According to the interviewees, the “quality of the lead partner” relates to whether or not the lead partner understands the challenges of the industry in which the company operates. Does this lead partner have the accounting knowledge and fit the culture of the organisation? At the same time, the interviewees expect that the partner is willing to co-operate and is able to have a good relationship with the organisation. Finally it is expected that the partner is critical enough, showing professional scepticism, to challenge (i.e. stand up to) the company’s management and/or other stakeholders.

Table 17 shows that there is almost no difference of opinion among the interviewees about this criterion. The Audit Committee mentions this criterion more often than the other interviewees because this is the only person from the external financial audit company with whom the Audit Committee has dealings during the external financial audit engagement. One Audit Committee

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29 RFPs put into the market by listed OOBs (see §5.3.2)
member mentioned that, “The lead partner is the only link with the Audit Committee and the person with whom we speak regularly”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). This criterion can also be linked to the measures used to measure audit quality (see §3.2.2.5) because professional scepticism is one of the criteria mentioned.

7.6.1.2 Audit approach
According to the respondents, the “audit approach” refers to the way the external financial auditor audits the company and how this approach explores the risks of the company. This is the product you actually receive from the external financial auditor. At the same time the interviewees expect the approach to show how effectively the audit is conducted e.g. with IT systems.

The CPOs are very interested in this criterion because it tells them how many hours are used by the external financial auditor. This enables them to compare the external audit firms’ hours during the negotiation process. CEOs and Audit Committee members are less focused on the audit approach because they expect the external financial auditor to follow guidelines. One CPO mentioned that, “The approach used determines the number of hours used by the external financial auditor, which are the main cost driver in the end”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). As stated, the “audit approach” can be directly linked to the number of hours spent which is identified as a way to measure audit quality (see §3.2.2). However, the persons interviewed seem to use the insight into hours not to increase audit quality but to decrease the costs of the external financial auditor during negotiations.

7.6.1.3 Reputation of supplier
According to the respondents, the “reputation of supplier”, i.e. negative performance by an external financial auditor at a company, can impact the reputation of that external financial auditor and indirectly affect the reputation of the company to which it is providing the external financial audit services.

It seems that the Audit Committee, in comparison to the other interviewees, finds the selection criterion “reputation of supplier” less important, however, this is not because the Audit Committee sees the “reputation of supplier” as a knockout criterion. This means rather that a supplier with a lesser reputation would, according to the interviewees, not be asked to participate in the selection process because of the reasons explained in §7.5.3.
It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). This criterion cannot be related to one of the measures of audit quality (see §3.2.2) so one would expect this criterion to not be included in the selection process but more as a hurdle (i.e. a dissatisfier) to being invited to participate in the selection process.

### 7.6.1.4 Relevant industry expertise

According to the interviewees “relevant industry expertise” refers to how the external financial auditor understands the challenges and risks within the industry in which the company to be audited operates. By understanding the industry, the interviewees expect that the external financial auditor will be able to provide a higher quality audit.

The IADs are very interested in the relevant industry expertise because they believe that this will improve the quality of the audit. One IAD explained that “having relevant industry expertise should be a given”. CFOs and Audit Committee members, according to the interviewees, find this less important because any good partner of an external financial audit firm will identify the company’s risks. One Audit Committee member explained that “he recently switched external financial auditor and the new external financial auditor did not have the deep industry expertise, but is nonetheless really doing a good job”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). At the same time industry expertise is one of the items used to measure audit quality (see §3.2.2) so one would expect this criterion to be included in the selection process.

### 7.6.1.5 Audit fee

According to the interviewees, the “audit fee” is the fee paid by the company for the external financial audit. According to the respondents, the fee should be competitive and in line with the fee paid by similar companies within the industry.

Almost all the interviewees mention that the stakeholders use this selection criterion during the selection process. One CPO mentioned that, “The audit fee as a percentage of turnover in comparison to our competitors is very transparent. This will ensure that the fee paid will always be within a certain bandwidth”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). This criterion can be related to one of the measures of audit quality (see §3.2.2), however an “audit fee” as selection criteria is focused solely on achieving a low audit fee. In case of audit quality, Breesch et al. (2013) state that a low audit fee or extremely
high audit fee can be a threat to potential audit quality. One would expect therefore that this criterion would be used during the selection process but that the criterion would be more focused on ensuring the external financial auditor is not under- or over-paid.

**7.6.1.6 Cooperation with the Internal Audit Department**

According to the interviewees, “cooperation with the Internal Audit Department” refers to the way the external financial auditor co-operates with the Internal Audit Department. It also refers to the way in which the external financial auditor shares information & knowledge with the Internal Audit Department, and the way in which the external financial auditor is willing to build on the work performed by the Internal Audit Department and share dossiers.

According to the interviewees, some Internal Audit Departments focus on the operational risks while the external financial auditor will focus on the financial risks. One IAD mentioned that, “I want to make sure that activities are shared evenly and that the external auditor is willing to share knowledge and discuss findings with us before the external financial auditor presents the outcome to the Board Members and the Audit Committee”. However, neither the Audit Committee members nor the Shareholders mention this selection criterion at all because they do not see cooperation with the IAD as a key selection criterion. One Shareholder explained that, “An external financial auditor should be in the lead and the Internal Audit Department should follow”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). However this criterion cannot be linked to the measures of audit quality (see §3.2.2) as such one would not expect this selection criterion to influence the selection process.

**7.6.1.7 Global reach & coverage**

According to the interviewees, “global reach & coverage” means that the external financial auditor can act as one company globally. This also means that the external financial auditor can provide an adequate quality of services within each country in which the company operates.

Within the financial services industry it is necessary to have one external financial auditor globally according to several respondents. This is therefore seen as a must-have for participating in a selection process within this industry.

Both the IAD and the Audit Committee members mention this selection criterion most because they believe that “one” external financial auditor will help them to perform their role in a more effective way. One Audit Committee member mentioned that, “Having one external financial auditor globally helps to monitor quality in a consistent manner”. One IAD explained however: “We have split the audit between one smaller external financial audit firm with a global reach
which will focus on the smaller countries and one Big4 firm which will focus on the larger countries. This is done to ensure that each country receives the same level of focus because a small country disappears in the overall external financial audit”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). This criterion can be linked directly to the size of the external financial audit firm, which is one of the measures of audit quality (see §3.2.2). As such, one can expect this criterion to play a role in the selection process.

### 7.6.1.8 Transition plan

According to the interviewees, “transition plan” refers to the plan presented by the external financial auditor to transition from the current external financial auditor to the new one. The interviewees expect a transition plan to provide an insight into the way the risks of transitioning are mitigated, the way each country is transitioned and how the communication will run between the company and the external financial auditor.

The transition plan is only mentioned by interviewees from within the company such as CFOs, IADs, CPOs and CEOs. It was explained by these interviewees that they use this selection criterion to ensure that a smooth transition of external financial auditors takes place and that business as usual is not interrupted. One IAD explains that “a transition plan is needed to transfer activities from the current auditor to the new auditor and my team”.

It was clear at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). This criterion cannot be linked to the measures of audit quality (see §3.2.2), however it can be linked to the procurement strategy (see §3.2.2) followed by the companies. The services provided by the external financial auditor are considered a nuisance product so minimising transition costs and the price of the service bought is a key driver for selection once a product/service is classified as nuisance.

### 7.6.1.9 Continuity of the team

According to the interviewees, “continuity of the team” is a selection criterion for managing the risk of team members leaving and/or not being committed to the company. Companies fear that team members could be transferred by the external financial auditor team to another team once the external financial audit firm is awarded the specific audit.

This selection criterion was mentioned by the CFOs and IADs, but not by the other interviewees. The CFOs and IADs mentioned that they expected that the mandatory rotation would result in demand for the best resources of the external financial auditor and that an external financial audit firm might try to sell the best resources twice to win a contract with a
company. A CFO explains: “I expect that the team selected will perform the audit. I do not want them to go to another company, and that is why I demand assurance about continuity of the team during the selection process”.

It was not expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders. However, the answers from the interviewees show that this selection criterion might be used to minimise supply risks in cases where several mandatory rotations take place at the same time.

### 7.6.1.10 Independence

According to the respondents, the “independence of the external financial auditor” is a selection criterion used to ensure that an external financial auditor will behave independently and will inform the relevant stakeholders if a misstatement is identified. This reflects the findings in chapter 3.

Independence as a selection criterion is just mentioned by several interviewees. However, others see it as a knockout criterion for participating in the selection process. One IAD mentioned that, “An external financial auditor that is not independent will not be allowed to participate. As such, one external financial auditor was not allowed to participate in a tender we ran earlier because an Audit Committee member was a strategic consultant for that external financial audit firm”.

It was clearly expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by listed OOBs (see §5.3.2). However, one would expect that “independence of the external financial auditor” would be a knockout criterion given the importance of this criterion to overall audit quality.

### 7.6.1.11 Quality of the team

According to the interviewees, the “quality of the team” is a selection criterion that is aligned with the selection criterion “quality of the lead partner”. The interviewees want to know that the team has enough industry knowledge, and that the team members will co-operate with the different departments within the company.

Most interviewees mention this selection criterion because according to them the “quality of the team” plays an important role in receiving a high quality audit from an external financial auditor. An Audit Committee member mentioned that, “The people on the external financial audit team will decide the quality of the external financial audit”.

It was expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders because it was already identified in the RFPs put onto the market by
listed OOBs (see §5.3.2). This criterion can also be linked to the measures used to measure audit quality (see §3.2.2.5) because professional scepticism is one of the criteria mentioned.

### 7.6.1.12 One of the Big4 firms

According to the interviewees being “one of the Big4 firms” is a selection criteria because they expect that Big4 firms, namely Deloitte, EY, KPMG and PwC, have better quality systems, can provide continuity, have knowledge systems and industry knowledge and have a global reach. At the same time, the interviewees mention that they expect Shareholders would not agree to the appointment of an external financial auditor that is not a Big4 firm because of the reputation difference.

Not all interviewees mention this selection criterion. However the ones who did mention it also mention that not being “one of the Big4 firms” is a dissatisfier (in Dutch: hygiënefactor) and that non-Big4 firms are asked to participate, but will not be selected in the end because of Shareholders lack of acceptance. One CEO mentioned that, “A non-Big4 firm will not be accepted by the Shareholders” and a Shareholder mentioned that, “A listed company would have to explain why they would select a non-Big4 firm”. “The stamp of a Big4 firm is seen as better than a stamp of a non-Big4 firm”.

It was not expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders. However, it became clear that this criterion is more of a dissatisfier than a pure selection criterion and by making this choice; the stakeholders involved in the selection process are reducing the number of suppliers they can use as external financial auditor.

### 7.6.1.13 Acceptance of accounting policies

According to the interviewees “acceptance of accounting policies” is a selection criterion that is used to make the transition from an existing external financial auditor to a new one more effective. The future external financial auditor is asked to adhere to the accounting policies used by the company and the former external financial auditor so that companies do not have to restate their annual reports and/or make adjustments in their annual report if the new external financial auditor does not accept these policies. According to the respondents, this criterion will ensure the consistency of financial statements, which will build trust with Shareholders.

Only a few interviewees mentioned this selection criterion, however those who did had selected a new external financial auditor recently.

These interviewees mentioned they had used this selection criterion to minimise the risks caused by appointing a new external financial auditor. One IAD stated that “using this criterion will ensure that we will not have to make restatements in our next annual report”.

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It was not expected at the beginning of the empirical analysis that this selection criterion would be used by the stakeholders, however it became clear that this criterion has become important because companies have to change external financial auditors and this selection criterion is used to minimise transitioning risks.

7.6.2 Order of importance of the selection criteria used

In addition, the interviewees were asked which selection criteria were most important and why. This was done by writing the selection criteria on individual cards and asking the interviewees to put them in order of importance. The results from the interviews related to this question in the checklist are presented in table 18.

<table>
<thead>
<tr>
<th>Which selection criteria used by the stakeholders for selecting the external financial auditor are the most important?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CFO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of lead partner</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Audit approach</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Reputation of supplier</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Relevant industry expertise</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Audit fee</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Quality of team</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Global reach &amp; coverage</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Continuity of the team</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>Independence</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
<td>☐</td>
</tr>
<tr>
<td>One of the Big 4</td>
<td>☐</td>
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<td>☐</td>
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<td>☐</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mention this as a very important selection criterion, to no fill, which means that none of the interviewees mention this as an important selection criterion. The Harvey balls which are completely green correspond to the most important selection criteria per expert group.

Table 18: Importance of selection criteria.

Table 18 shows that when all the interviewees’ answers are combined, the following order of importance of the selection criteria becomes apparent:

1) Quality of lead partner;
2) Relevant industry expertise;
3) Quality of the team;
4) Reputation of supplier;
5) Audit fee;
6) Audit approach;
7) Global reach & coverage.

The quality of the lead partner is especially important to CFOs, Audit Committee members and the Shareholders. An external financial audit is, according to these interviewees, a people business and the lead partner is the manager of the relationship with management and the Audit Committee.
At the same time, the Lead Partner is the communication channel within and outside the company and if something were to go wrong the respondents would expect the lead partner to stand tall and protect the position of the company.

The relevant industry expertise is seen as the second most important selection criterion by most respondents. This is due to the fact that they expect that the external financial auditor can bring them best practices and/or learnings from within the industry to their specific work environment. The CEOs, however, do not value this selection criterion as highly because they have other channels through which they obtain industry knowledge. One CEO mentioned: “I have my trusted advisors who bring me the latest developments within the industry”.

With a ranking almost equal to that of industry expertise, the quality of the team is the third most important selection criterion. Respondents find this criterion important because the team will actually do all the work and the lead partner is managing this team.

The fourth most important selection criterion is the reputation of supplier (i.e. external financial auditor). Both the CPOs and IADs see reputation not as a key selection criterion, but more as a “sine qua non” condition. A supplier with a bad reputation will not be invited to participate in the selection process.

The fifth most important selection criterion is the audit fee, which is especially valued by the CEO and the IAD. The fee is expected to be competitive and in line with the peers.

The sixth and seventh most important selection criteria are audit approach, followed by global coverage. It is interesting to see that the audit approach is especially valued by the CPO but the CFO and CEO rank this criterion very low because they see almost no differences between the approaches of the different external financial auditors.

In terms of the answers given by the Audit Committee, the outcome of this research seems to be aligned with the research by Deumes et al. (2012) as the main selection criteria of the Audit Committee are related to skills, experience and expertise. However the research by Deumes et al. (2012) did not consider the influence of other stakeholders involved in the selection process while the present research shows (see §7.4 and §7.7.3) that Audit Committee members are not the only participants involved in setting the selection criteria. As such, it is expected that the overall combined order of selection criteria presented in this research is likely to reflect more closely the actual selection criteria used by companies.

At the same time the outcome shows that the selection criteria are linked to the indirect audit quality measurements as defined in §3.2.2 and only the “number of hours spent” seems to be a criterion which is not seen as important. At the same time, “size of the audit firm” is not mentioned as a criterion but being “one of the Big4 firms” is mentioned as a dissatisfier.
7.7 Roles of the stakeholders in the selection process

The interviewees, in line with the conceptual model, were asked to provide an insight into the roles of the different interviewees during the different steps of the selection process, as defined by Reijniers et al. (2009), to obtain an insight into the roles of the different decision makers during the selection process.

7.7.1 Who decides how the external financial auditor will be selected?

All the interviewees were asked which of the stakeholders involved in the selection process will decide how the external financial auditor will be selected and why this stakeholder decides. The significance of this question is to obtain an overview of the importance of the stakeholders in the selection process. The results of the answers can be found in table 19.

<table>
<thead>
<tr>
<th>Which of the stakeholders decides how the external financial auditor will be selected?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supervisory Board</td>
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<tr>
<td>Management Board</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Audit Department</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procurement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cross-functional team</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mention that this stakeholder in the selection process decides how the external auditor will be selected, to no fill, which means that none of the interviewees mention that this stakeholder will do so. The Harvey balls which are completely green mean that all the interviewees in that category mention this as the stakeholder who decides how the external financial auditor will be selected.

Table 19: Decision-makers of the selection process.

Table 19 shows that the interviewees have a mixed view on who will decide how the external financial auditor will be selected. The Shareholder for instance expects that the Audit Committee decides how the external financial auditor is selected while the CEO states that either the Management Board or the CFO decides how the external financial auditor will be selected.

Most of the internal stakeholders such as the CFOs, CEOs, IADs and CPOs think that the CFO is the one who decides how the external financial auditor will be selected. This because the CFO is the person responsible within the company for the financial processes and the person who has to co-operate with the external financial auditor most frequently. One CFO mentioned that, “I will be responsible for the process because I will work most closely with the external auditor over the duration of the assignment”.

In some cases interviewees could not appoint a single person and mentioned that a cross-functional team or selection committee decides how the external financial auditor will be selected.
selected. Members of this cross functional team or selection committee consist for instance of the Audit Committee, CFO, Internal Audit and Control.

It was not expected at the beginning of the empirical analysis that the CFO, given the legislation and the roles of the Audit Committee and Supervisory Board, would play such a large role in the process for selecting the external financial auditor.

### 7.7.2 Who decides the specification (the scope) of the external financial audit?

All interviewees were asked which stakeholder will decide the specification (the scope) of the external financial audit that will have to be delivered by the external financial auditor. The importance of this question is to understand who will determine the scope of the external financial audit. The results of the answers can be found in table 20.

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee</td>
<td>⬤</td>
<td></td>
<td></td>
<td>⬤</td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>Management Board</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>CFO</td>
<td></td>
<td>⬤</td>
<td></td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>Internal Audit Department</td>
<td></td>
<td></td>
<td>⬤</td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>Cross-functional team</td>
<td>⬤</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>The external financial auditor</td>
<td>⬤</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
<tr>
<td>No answer</td>
<td></td>
<td>⬤</td>
<td>⬤</td>
<td></td>
<td></td>
<td>⬤</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mention that this stakeholder in the selection process decides the specification of the external financial audit, to no fill, which means that none of the interviewees mention that this stakeholder will do so.

**Table 20: Decision-makers on the specifications (the scope) of the external financial audit.**

Table 20 shows that most of the internal stakeholders such as the CFOs, CEOs, IADs and CPOs think that the CFO sets the specification of the external financial audit because the CFO understands the financial processes of the company best. A CEO mentioned that, “The Audit Committee will give the final go-ahead, only after consultation with the CFO and myself”.

Stakeholders such as the Audit Committee or Shareholders say that the Audit Committee decides on the specification of the external financial audit. This because the Audit Committee, in cases were an Audit Committee is present, is responsible for the assignment of the external financial auditor.

It was not expected at the beginning of the empirical analysis that the CFO, given the legislation and the roles of the Audit Committee and Supervisory Board, would play such a large role in setting the scope of the external financial audit.
7.7.3 Who decides which selection criteria will be used?

All the interviewees were asked which stakeholder involved in the selection process will decide which selection criteria will be used and why this stakeholder decides. The results of the answers can be found in table 21.

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee</td>
<td>🌿</td>
<td></td>
<td></td>
<td>🌿</td>
<td></td>
<td>🌿</td>
</tr>
<tr>
<td>Supervisory Board</td>
<td></td>
<td>🌿</td>
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<td>🌿</td>
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<tr>
<td>Management Board</td>
<td></td>
<td></td>
<td>🌿</td>
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<tr>
<td>CFO</td>
<td>🌿</td>
<td>🌿</td>
<td>🌿</td>
<td>🌿</td>
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<tr>
<td>Internal Audit Department</td>
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<td>🌿</td>
<td>🌿</td>
<td></td>
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<tr>
<td>Procurement</td>
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<td>🌿</td>
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<tr>
<td>Cross-functional team</td>
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</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mention that this stakeholder decides the selection criteria to be used during the selection of the external financial auditor, to no fill, which means that none of the interviewees mention this stakeholder. If a Harvey ball is completely green it means that all interviewees agree that this stakeholder decides which selection criteria will be used.

Table 21: Decision-makers that determine the selection criteria.

Table 21 shows that the interviewees have mixed views on who decides which selection criteria will be used in the selection process. The Shareholders for instance expect the Audit Committee to decide the selection criteria that will be used during the selection of the external financial auditor.

Several of the interviewees, including in the CFO, CEO, IAD, CPO and IAD categories, state that the CFO sets the selection criteria. According to the interviewees the CFO is responsible for the day-to-day business relationship with the external financial auditor and as such sets the criteria for the selection process.

The interviewees who mention that the Audit Committee decides on the selection criteria used do so because the Audit Committee is seen as the principal of the external financial auditor.

It was not expected at the beginning of the empirical analysis that the CFO or the Management Board, given the legislation and the roles of the Audit Committee and Supervisory Board, would play such a large role in setting the selection criteria.

7.7.4 Who will prepare the documents used during the selection process?

All the interviewees were asked which stakeholder involved in the selection process will prepare the documents that will be used during the selection process. This question was asked because the stakeholder that prepares the documents can influence the information received by the potential external financial auditors. The results of the answers can be found in table 22.
Table 22: Overview of persons/roles that prepare the documents used in the selection process.

Table 22 shows that the Shareholders for instance expect that the Audit Committee plays a large role in the preparation of the documents because they expect that the Audit Committee runs the process.

Other interviewees expect that the CFO will prepare the documents, because the CFO understands what will have to be delivered by the company so that an external financial auditor can prepare a proposal. The interviewees who mention that the Internal Audit Department (IAD) will prepare the documents do so because the IAD has to co-operate with the external financial auditor and therefore knows how to scope the request. One IAD mentioned that, “I have developed the documents to ensure activities are shared in the right way between my department and the external financial auditor”.

In some cases, interviewees mention that more than one person or departments are responsible for preparing the documents. This is because the preparation of the documents is split between for instance the Internal Audit Department or Corporate Reporting, who prepares the scopes of services and the tender document that is provided by for instance Procurement.

Table 22 also shows a difference between Shareholders and other expert groups. It shows that the Shareholders expect that Audit Committee members have a large involvement in the creation of the documents used for selecting the external financial auditor. A Shareholder mentioned that, “I would expect the Audit Committee or Supervisory Board to do this, but it is probably delegated to representatives of the company”.

It was not expected at the beginning of the empirical analysis that so many internal departments would play a role in the preparation of the documents that will be used during the selection of the external financial auditor.
### 7.7.5 Who will facilitate the selection process?

All the interviewees were asked which stakeholder involved in the selection process will facilitate the selection process. This question was asked because the facilitator of the selection process can influence the selection process. The results of the answers can be found in table 23.

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee</td>
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<tr>
<td>Supervisory Board</td>
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<tr>
<td>Management Board</td>
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<tr>
<td>Internal Audit Department</td>
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<tr>
<td>Procurement</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Corporate Controller</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Corporate Reporting/Finance</td>
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<tr>
<td>Cross-functional team</td>
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<tr>
<td>Secretary of the company</td>
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</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mentioned that this stakeholder will facilitate the selection process, to no fill, which means that none of the interviewees mentioned that this stakeholder will do so.

Table 23: Stakeholders that will facilitate the selection process.

Table 23 shows that departments such as Procurement, Corporate Control and Corporate Reporting play a role in the facilitation process. Procurement in particular is seen by many stakeholders as a department which facilitates the selection process.

Table 23 also shows a difference between the expert group of Shareholders and other expert groups. It shows that the Shareholders have different expectations of the stakeholders that facilitate the selection process in comparison to the other groups. A Shareholder mentioned that, “The process would have to be facilitated by the Audit Committee and any information required should be delivered by management of the company”.

It was not expected at the beginning of the empirical analysis that so many internal departments, which all have different objectives, would play a role in the preparation of the documents that will be used during the selection of the external financial auditor. As such, the selection documents could include conflicting information which could in turn lead, as stated by Tate et al. (2009) to decreased supplier performance.

### 7.7.6 Who will determine the long list?

All the interviewees were asked which stakeholder involved in the selection process would decide which external financial auditor will be invited to participate in the selection process. This question was asked because the one who decides the long list also is already excluding potential external financial auditors. The results of the answers can be found in table 24.
The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mention that this stakeholder will determine the long list, to no fill, which means that none of the interviewees mention that this stakeholder will do so.

Table 24: Stakeholders that determine the long list.

Table 24 shows that some interviewees mention that no long list is made, because the long list is the same as the shortlist, the other three of the Big4 firms. Table 24 also shows that the Shareholders and the Audit Committee members mostly think that the Audit Committee or the Supervisory Board decide the long list because the Audit Committee or Supervisory Board are seen as the functional principal.

The internal stakeholders such as the CFOs, CEOs, IADs or CPOs identify more internal stakeholders than the Shareholders that would determine the long list. This because these stakeholders, according to the interviewees, only want to work with an external financial auditor they like to work with.

It was not expected at the beginning of the empirical analysis that so many internal departments would play a role in determining the long list of external financial auditors. However, the analysis shows that in the end the Audit Committee, Supervisory Board and the Management Board will decide which external financial auditor is allowed to participate in the selection process.

7.7.7 Who will determine the short list?

All the interviewees were asked which stakeholder involved in the selection process would decide which external financial auditor will be invited for the shortlist. This question was asked because the one who decides the shortlist will by doing so exclude possible external financial audit suppliers. The results of the answers can be found in table 25.
The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mentioned that this stakeholder will determine the shortlist, to no fill, which means that none of the interviewees mention that this stakeholder will do so.

Table 25: Stakeholders that determine the shortlist.

Table 25 shows that the interviewees are mainly divided between those who state that the CFO will decide the external financial auditors that are put on the shortlist and those who opt for the Audit Committee.

The interviewees who mention that the CFO will determine which external financial auditor is put on the shortlist do so because they believe that the CFO is the most important person that has to co-operate with the external financial auditor. Both a CFO and Audit Committee members mentioned that, “An Audit Committee will never select an external financial auditor that is not approved by the CFO”.

The interviewees who mention that the Audit Committee will decide which external financial auditor is put on the shortlist do so because they believe that the Audit Committee members are the decision-makers during the selection process.

The internal stakeholders such as the CFOs, CEOs, IADs or CPOs identify more internal stakeholders that determine the shortlist. This because these stakeholders, according to the interviewees, do not want to work with an external financial auditor they do not like.

It was not expected at the beginning of the empirical analysis that the CFO would play such a large role in the selection of the external financial auditors to be put on the shortlist.

7.7.8 Who will lead the financial negotiations?
All the interviewees were asked which stakeholder will lead the financial negotiations with the selected financial auditor. This question was asked to understand who finalises the negotiations. The results of the answers can be found in table 26.
The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mention that this stakeholder will lead the financial negotiations, to no fill, which means that none of the interviewees mention that this stakeholder will do so. When a Harvey ball is filled in green it means that all the interviewees within the group agree that this expert is leading the financial negotiations.

Table 26: Stakeholders that will lead the financial negotiations.

Table 26 shows that most of the interviewees mention that the CFO is leading the financial negotiations. This is because the CFO is responsible, according to the interviewees, for the financial relationship with the external financial auditor. One Audit Committee member stated that, “A CFO will manage the costs of the external financial auditor”.

The Shareholders have a different perspective and feel that either the Audit Committee and/or the Supervisory Board should run the negotiations. This difference is probably caused by the fact that the Shareholder has a limited view of the actual selection process and would expect that a representative of the Shareholders would run these negotiations.

It was not expected at the beginning of the empirical analysis that the CFO would play this role in the financial negotiations with the external financial auditor, because the CFO is often also focused on reducing the costs of the company. This objective could lead to the negotiation of low audit fees, which according to Breesch et al. (2013) which could be a “threat to audit quality”.

7.7.9 Who will decide which external financial auditor will be selected?

All the interviewees were asked which stakeholder will decide which external financial auditor will be selected. This question was asked to obtain a view of the final selection. The answers can be found in table 27.

Table 27: Stakeholders that decide the final selection.
The answers from the interviewees show that the Audit Committee will be the entity that will decide which external financial auditor will be selected. According to the interviewees, this is their role and responsibility. One Audit Committee member for instance said, “The CFO will introduce one or two candidates and we will decide which one to select. Of course if the CFO has a preference we will select that preferred external financial auditor because the CFO will have to work most with this external financial auditor”.

The interviewees who say that it is primarily the CFO who decides do so because the CFO is responsible for the departments that manage the financial process of a company and, as such, the external financial auditor also. One CFO mentioned that, “I will decide and the Audit Committee will ratify”.

The interviewees that said that the Shareholder will decide stated that the Shareholder has to give final approval after the decision is made by the company and the Audit Committee. However, several interviewees mentioned that, “The Shareholders do not understand the services provided by the external financial auditor and as such their approval is seen as a formality (in Dutch: *het is een hamerstuk*).

It was expected at the beginning of the empirical analysis (see §2.3) that the stakeholders in the selection process would state that the Shareholder would select the external auditor after the nomination of the Supervisory Board. However, the research shows that the Audit Committee decides who the external financial auditor will be.

### 7.8 Selection process used by the stakeholders

#### 7.8.1 Selection process used to select the external financial auditor

The interviewees, in line with the conceptual model, were asked to describe the selection process they use to select a financial external auditor. The interviewees were also asked why they use this selection process.

After their description, which was used to identify if the stakeholders would use a sequential (see §5.2.1) selection process or a more performance-based selection process (see §5.2.4), the interviewees were given an image of the Reijniers *et al.* (2009) model selection process (see §5.2.2) to gain an understanding of whether they would define their selection process as a formal one; a process that would use most of the steps defined by Reijniers *et al.*; or an informal selection process with a more free format. The answers can be found in table 28.
The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees mentioned that they use the specific selection process, to no fill, which means that this selection process is not used. If a Harvey ball is filled in green, it means that all the interviewees mentioned that this selection process applies to the selection of the external financial auditor.

Table 28: Selection process used to select the external financial auditor.

Table 28 shows that the interviewees, with a few exceptions, all mention that they will use or have used some kind of formal selection process to select the external financial auditor. In comparison to the Reijniers et al. (2009) model, the interviewees start off immediately with the development of a Request For Proposal (RFP), the definition of the selection criteria and a definition of the scope of the services required from the external financial auditor. Little time is spent on the strategy development because the market i.e. the potential suppliers, is already identified and consists of the Big4 firms and perhaps a smaller external financial audit firm. One Audit Committee member for instance said that “the market is clear and is limited to one of the Big4 firms because the shareholders will not accept a non-Big4 firm”. This also means that no Request for Information is put into the market (§5.2.3) and an RFP is put straight on the market for proposals from the suppliers on the long list.

The Audit Committee members explained that they delegate the selection process to the CFO or the Internal Audit Director who run the selection process on their behalf. Only after a pre-selection is made and one or two external financial audit firms are left on the shortlist is the Audit Committee or Chairman of the Audit Committee present at the final presentations by the external financial auditors. All the intervening steps of the selection process are run by either the CFO or IAD of the company. One Audit Committee member said, “It would take too much time to get involved in the whole process”. Another Audit Committee member said, “The Chairman of the Audit Committee only wanted to be involved at the end of the process. However I thought it was important to be involved from the start and therefore I was”.

The interviewees who according to the table above initiated a more informal selection process mentioned that they would initiate a kind of “beauty contest” but not along the lines of the process defined by Reijniers et al. (2009). In this beauty contest, three suppliers would be asked to provide a proposal and to provide a presentation to a selection of stakeholders such as the CEO, CFO, IAD and Audit Committee. After the presentation, negotiations would take place and the supplier who would become the external financial auditor would be selected. One CEO for instance mentioned that, “I know the players already so why would I want to put much time into this process”.

<table>
<thead>
<tr>
<th>Describe the selection process which is used for selecting the External Financial Auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CFO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal selection process</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
</tr>
<tr>
<td>Informal selection process</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
</tr>
<tr>
<td>Do not know how the selection process would be initiated</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
<td>🌟</td>
</tr>
</tbody>
</table>
The interviewees who claimed that they did not know how the selection process was organised mentioned that they had either delegated it to the CFO and/or really did not know how to select an external financial auditor.

Based on the description of the process given by the interviewees, two clear approaches could be identified. One approach was the more open approach in which the interviewees invited the external financial audit firms to have several interviews and presentations during the selection processes. The objective of this approach was, according to the interviewees, to give the external financial auditor a better understanding of the company so that the external financial auditor could create a fit for purpose proposal. At the same time, the increased number of interviews would give the interviewees from the company an improved view of the capabilities of the external financial audit firm, the audit team and the audit partner that would be servicing them. This process does not seem to be aligned with the outcome of paragraph §7.5 which identified the services provided by the external financial auditor as a non-critical product on which limited time is normally spent by the company.

The other approach was a very clinical approach in which external financial auditors only had to provide a proposal based on the information provided by the company. Only the best or the best two external financial audit firms, according to the interviewees, were invited to give a final presentation that was used for the selection. The objective of this approach is to run an effective and efficient selection process because the differences between the external financial audit firms are too small to really make a difference according to the interviewees. This clinical approach is in line with the outcome of §7.5. One IAD mentioned that, “We set the scope of the audit so it is easy to compare the proposals of the external financial auditors”.

At the same time, it became clear that the stakeholders involved in the selection process tend to use a traditional selection process to select an external financial auditor. The use of a performance-based procurement process or methodology as described in §5.2.4 was not identified as being used by any of the stakeholders involved in the selection process.

### 7.8.2 Impact of new legislation on procurement process used

During the period that this research was being carried out, new legislation was introduced (see §1.1). Some of the interviewees involved in the research had already entered into a process of selecting a new external financial auditor and other were still preparing for it. Therefore, the interviewees were asked if this new legislation would change the selection process they had described, to ensure that the answers of all interviewees could be used for the empirical research. The answers can be found in table 29.
In which way will the new legislation change the selection process?

<table>
<thead>
<tr>
<th>In which way will the new legislation change the selection process?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Limits the choice of the auditor because you cannot continue with your current external financial auditor.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>Will not change the process itself, only frequency because of the mandatory change.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>It increases the importance of the procurement process. More attention will be paid and best practice applied.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>Risk of mismatch between audit firm and company due to forced rotation. Company might not get the right auditor that fits best with the firm.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>Will lead to a carousel. Partners and teams will switch to other firms because of shortage of qualified personnel.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>Forced rotation will help to select an even better auditor because the external financial auditor constantly has to put forward his best team to win the tender.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>It will decrease your negotiation power.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>Audit firms will focus more on lowering audit fees which could harm the quality of the audit.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
<tr>
<td>Don’t know the impact.</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
<td>🌅</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that almost all the interviewees agree on what will happen with the selection process due to the new legislation, to no fill, which means that none of the interviewees agree. If a Harvey ball is filled in green, it means that all the interviewees have mentioned that this will apply.

Table 29: Impact of the new legislation on the process for selecting the external financial auditor.

Table 29 shows that, according to the interviewees, the new legislation will not change the selection process other than that the selection process will have to be initiated more frequently.

In addition several interviewees explain that the mandatory rotation will limit the choice in the market which is further explained in paragraph §7.5.1.13.

7.9 Impact on perceived audit quality

The interviewees, in line with the conceptual model, were asked to provide an insight into the impact of the selection process on auditor quality as defined in §3.2.

7.9.1 How do you measure audit quality?

As stated in §3.2.2, several criteria are identified by different researchers to define audit quality. One of the objectives of this research is to test the impact of the selection process on perceived audit quality as perceived by Shareholders. Therefore, it is important to first establish how audit quality is measured by the interviewees that participated in the selection process. As such, the interviewees were asked, after it had been explained what was meant by the term
audit quality in this research (see §3.2.1), how they measured audit quality. The answers from the interviewees are shown in table 30.

<table>
<thead>
<tr>
<th>How do you measure quality of the external financial audit?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevance and quality of Management Letter</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>On time delivery</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>LOW COST</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Sufficient and qualitative discussion and challenge with auditor regarding judgemental and complex issues</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Does the auditor see the same points of attention and risks as the firm</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Other clients’ feedback</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Quality of the recommendations from the audit firm</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Involvement and quality of the audit team</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Reputation/evaluations from (AFM and press)</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>When the auditor can find a good balance between obtaining sufficient audit evidence and limit the burden for the company</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Communication with Supervisory Board/Executive Board/Audit Committee</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Audit approach/trail that meets professional requirements and standards</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Sufficient industry knowledge</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Quality of the annual report</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Quality of the lead partner</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
<tr>
<td>Not measurable / do not know</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
<td>🌊</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees agree with the statement, to no fill, which means that none of them agree with the statement.

Table 30: Measures to determine audit quality.

The table above shows that the interviewees have a very mixed view on how audit quality is measured. It seems that both CFOs and Audit Committee members mostly measure the audit quality on the relevance of the Management Letter and challenge on complex issues while the CEOs use the quality of team as a measure, while the IADs focus on the burden of the company. Shareholders mostly state that they do not know how to measure audit quality. One CEO next to several Shareholders for instance said, “I do not know how to measure audit quality”.

It is interesting to see that the indirect measures identified by different researchers (see §3.2.2), such as the size of the external financial audit firm; audit fees paid by the company; number of hours spent by the external financial auditor; or longevity of the auditor/client relationship, are hardly mentioned as a way of evaluating audit quality by the stakeholders involved in the selection process.

It was expected at the beginning of the research that the interviewees involved in the selection process would use methods similar to those of the researchers to measure audit quality and that these measures would be included in the selection process.
As such, the outcome of this analysis shows that stakeholders involved in the process for selecting the external financial auditor do not have a common view of how to measure audit quality. As such, the outcome of this research is aligned with Darby et al. (1973) who defined goods that cannot be evaluated on their quality after the purchase as credence goods. At the same time, it shows that the stakeholders involved in the selection process measure audit quality in a different way, which could lead to increased transparency in the selection process due to different measuring methods used.

7.9.2 Impact on the perceived audit quality

The interviewees were also asked, based on the feedback on how they measure audit quality, what the impact of the selection process is on the perceived audit quality as perceived by the Shareholders. This question was posed to all interviewees to build a picture from different perspectives. The answers from the interviewees are included in Table 3.

<table>
<thead>
<tr>
<th>How does the selection process contribute to the perceived audit quality?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scoping &amp; determining priorities including the selection criteria used</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Involvement of Audit Committee</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Selection of the right lead partner with the right industry knowledge</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Transparency of the procurement process to shareholders</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Considerations in procurement process negotiations, finding balance between audit price and quality</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Trust in quality of stakeholders involved in the procurement process</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>By selecting an independent and objective auditor</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Good balance of involvement of shareholders in process / minimising conflict of interests</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>Good collaboration and sparring partner with auditor</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
<tr>
<td>No contribution</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
<td>〇</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees agree with the statement, to no fill, which means that none of them do.

Table 3: Impact of selection process on perceived audit quality.

The answers of the interviewees provide a mixed view of the impact of the selection process on the perceived audit quality. The CPOs for instance state that audit quality will be improved by selecting an independent and objective external financial auditor.

Other interviewees also do not seem to have a common view on how the selection process can impact perceived audit quality.

Shareholders state that involvement of the Shareholders and minimising conflicts of interest between stakeholder groups can ensure that the selection process will impact positively on perceived auditor quality. However outcomes of earlier questions during the research show (see for instance §7.2, §7.3 and §7.4), that the stakeholders involved in the selection process seem to have different objectives and that Shareholders have limited involvement in the
selection process. As it seems that the perceived audit quality as perceived by Shareholders will be influenced negatively because the objectives of the stakeholders involved in the selection process are not aligned with the objectives of the Shareholders.

### 7.9.3 Change in the selection process to increase perceived audit quality

The interviewees were also asked this question to obtain an understanding of what they would like to change in the selection process to improve perceived audit quality. The main reason for this question was to test whether the audit quality could be improved if the selection process were to be changed. The answers from the interviewees are presented in table 32.

<table>
<thead>
<tr>
<th>What would you like to change in the selection process to improve the perceived audit quality</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPD</th>
<th>IAC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gaining feedback about lead partner from other clients</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>To control the balance between audit quality and fee</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Give the Shareholders more insights into whether the company is in control/more transparent</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>More checks and balances for role of CFO in process</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Involvement of the current auditor in the selection process of new auditor</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>To reduce the throughput of process</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Increase independence and standardise selection criteria for quality</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Increase the involvement of the major Shareholders</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
<tr>
<td>Nothing</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
<td>⬜️</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees agree with the statement, to no fill, which means that none of them do.

**Table 32: Changes in the selection process to improve perceived audit quality.**

Table 32 shows that most of the interviewees state that nothing has to change regarding the selection process to increase the perceived audit quality.

However, table 32 also shows that the Shareholder has a different vision and that the Shareholder would like to be more involved in the process for selecting the external financial auditor to influence the quality of the services bought. One Shareholder for instance mentioned that, “I would, as large Shareholder, like to be consulted in the selection process”.

As such, it seems that the perceived audit quality may be improved by a stronger involvement of the Shareholders in the process for selecting the external financial auditor.

### 7.9.4 Impact on perceived audit quality when price is low

Based on the fact that the audit fees of listed OOBs as a percentage of revenues are decreasing (see §1.2) and the conclusion of Breesch *et al.* (2013) that extremely low audit fees could be a potential threat to the audit quality, the interviewees were asked to give an insight into whether commercial negotiations would impact the perceived audit quality. The answers from the interviewees are presented in table 33.
Table 33 shows that the different interviewees have different views on the impact of a low price on the perceived audit quality. However, the table also shows that interviewees think that audit quality cannot be ensured because too many factors play a role in the service delivery. One Audit Committee member for instance stated, “I think too much emphasis is put on price by the company”. A CFO stated, “Shareholders can of course always conduct a benchmark but that doesn’t say anything about the audit quality delivered”. Another CEO stated, “An external financial auditor is willing to absorb a loss because the eradication of a listed company will make up for it”.

Other interviewees, especially interviewees from within the company, such as CFOs and CPOs state that the external stakeholders have to trust that the management of the company will make the right decision. A CPO mentioned that, “There is no correlation between price and quality. An external financial audit firm will decide to do it or not do it because their reputation depends on it”, and an IAD mentioned that, “You first have to focus on quality and setting the right scope before you focus on price”.

The interviewees also state that the responsibility for the audit quality is in the hands of the external financial audit firms because they will draw the line when the quality is too low.
Based on the answers provided it can be concluded that the audit quality cannot be secured when the price is low and that it is expected that the external financial audit firm will uphold the audit quality even if it means they make a loss on the account.

### 7.9.5 Impact of new legislation on perceived audit quality

The interviewees were also asked if the new legislation had an impact on perceived audit quality. The answers of the interviewees are presented in table 34.

<table>
<thead>
<tr>
<th>What is the impact of new regulations on perceived audit quality</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease</td>
<td>●</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>●</td>
</tr>
<tr>
<td>Increase</td>
<td></td>
<td>●</td>
<td></td>
<td>●</td>
<td></td>
<td>●</td>
</tr>
<tr>
<td>No impact</td>
<td></td>
<td></td>
<td>●</td>
<td></td>
<td>●</td>
<td>●</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees agree with the statement, to no fill, which means that none of them do.

**Table 34: Impact of new regulation on perceived audit quality.**

The table above shows that most of the interviewees believe that the new regulations will cause a decrease in perceived audit quality.

The interviewees who stated that the perceived audit quality will cause a decrease say that the focus of the external financial audit will shift from a complete external financial audit including the “advice” function to a process which is focused on providing an unqualified opinion. In addition, interviewees state that the perceived audit quality will decrease due to the fact that an auditor will have limited insights into the company because the scope of the external financial audit will decrease. One IAD mentioned that, “A new external financial auditor will not have all the insights which the old auditor had and as such the quality of audit may decline”. An Audit Committee member mentioned that, “The scope of the audit will probable change to a smaller scope and as such the mandatory rotation will provide false security (In Dutch: *schijnzekerheid*)”, and a Shareholder mentioned that, “In theory the quality will increase, but in practice it will surely decrease due to scope changes”.

Respondents who share the opinion that the quality of professional services will increase argue that the rotation of auditors refreshes the view of a company. A CFO mentioned that, “The quality will increase because new eyes will provide fresh views”.

As such, the outcome of this analysis shows that most interviewees believe that the mandatory rotation will cause a reduction in perceived audit quality. This will be caused in particular, according to the interviewees, by decreases in audit scope and the fact that the new external financial auditor will have to build knowledge of the company. This is in line with findings of Paape et al. (2012) and Arrunada and Paz-Ares (1997).
7.10 Impact of the selection process on perceived auditor independence

The interviewees, in line with the conceptual model, were asked to provide an insight into the impact of the selection process on perceived auditor independence as defined in §3.3.

7.10.1 How does this selection process impact perceived auditor independence?

The interviewees were asked, after it was explained what was meant by auditor independence, how the selection process defined by them would impact perceived auditor independence. This question was asked because DeAngelo (1981) and Beck et al. (1988) identified that the degree of economic relationships between the auditor and the client can influence auditor independence and, as such, a selection process, which is the starting point of an economic relationship, could influence the auditor’s independence. The answers of the interviewees are provided in table 35.

<table>
<thead>
<tr>
<th>How does the selection process impact auditor independence?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CFO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not, it is the responsibility of the external financial auditor</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>It is avoided by segregating duties between stakeholder involved in the selection process</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Not, when the company uses a professional procurement process</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>By judging the integrity/soft skills of the external financial auditor</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>By involving Shareholders</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>This is guaranteed by law</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>No opinion/impartial</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees mention that this impacts auditor independence, to no fill, which means that none of them do so.

Table 35: Impact of the selection process on auditor independence.

Table 35 shows that a lot of the interviewees have no opinion or are impartial on the question of whether the selection process affects auditor independence.

However, the table also shows that several interviewees, such as the CFO, IAD and Audit Committee, state that independence is not the responsibility of the company but that the external financial auditor itself should secure its independence. One CFO for instance stated, “Auditor independence is the responsibility of the external financial auditor”. This is in line with the NVO (2006) conclusions.

At the same time, table 35 shows that according to other interviewees, a segregation of duties between the stakeholders involved in the selection process ensures auditor independence. An
IAD for instance mentioned that, “By involving more parties in the selection process independence will be secured”.

Table 35 also shows that, according to other interviewees such as the CEO and CPO, a professional procurement process ensures independence.

However, table 35 also shows a difference between Shareholders and the other expert groups. Shareholders state that auditor independence is secured by involving the Shareholder in the selection process. This is currently, according to the interviewees, not the situation because the Shareholder only approves the decision taken by the Audit Committee or Supervisory Board at the annual Shareholders’ meeting.

It can be assumed, based on the initial answers given by the interviewees, that the selection process will not impact perceived auditor independence.

### 7.10.2 Changes in the selection process to increase perceived auditor independence

The interviewees were also asked what they would like to change about the selection process to cause an increase in auditor independence. The main reason for this question was to test whether the auditor independence could be improved if the selection process were to be changed. The answers from the interviewees are presented in table 36.

<table>
<thead>
<tr>
<th>What would you like to change in the selection process to increase the independence of the external financial auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Is guaranteed, not necessary</td>
<td>🎓</td>
<td>🎓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Not applicable, auditor's responsibility</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Nothing has to be changed</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>More transparency in selection process</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>❌</td>
</tr>
<tr>
<td>Setting a pre-fixed audit fee</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Invitation of a non-Big4 audit firm</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Evaluation after audit with AC and auditor</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Determine the objectives and decision matrix early in the process, minimisation of preferences</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Involve an compliance officer/external party during the procurement process</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Make Audit Committee more responsible and involve the (Major) Shareholders</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>Minimise the influence of the CFO and top management in the procurement process</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
<tr>
<td>I do not know</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
<td>☓</td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees mention that this can be changed to increase auditor independence, to no fill, which means that none of them do so.

Table 36: Which changes would result in higher perceived auditor independence?

Table 36 shows that a lot of the interviewees think that nothing needs to be changed regarding the selection process to increase the auditor independence.
Table 36 however also shows that there is a difference between Shareholders and the other interviewees. The Shareholders currently perceive that they are not involved and/or have a limited involvement in the selection process, which is why these interviewees perceive that they should have a larger involvement.

It can be assumed, based on the initial answers given by the interviewees, that the selection process will not impact auditor independence. However, this is not perceived to be the case by the Shareholders and it seems that they expect a larger involvement in the selection process.

### 7.10.3 Impact of the new legislation on perceived auditor independence

The interviewees were also asked what the impact of the new legislation on the perceived auditor independence will be. The answers from the interviewees are presented in table 37.

<table>
<thead>
<tr>
<th>What is the impact of the new legislation on the independence of the external financial auditor?</th>
<th>CFO</th>
<th>CEO</th>
<th>IAD</th>
<th>CPO</th>
<th>AC</th>
<th>Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase</td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
</tr>
<tr>
<td>No impact</td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
</tr>
<tr>
<td>Decreases</td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
</tr>
<tr>
<td>No opinion</td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
<td><img src="image" alt="Harvey ball" /></td>
</tr>
</tbody>
</table>

The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees agree with the statement, to no fill, which means that none of them do so.

**Table 37: Impact of new legislation on perceived auditor independence.**

Table 37 shows that the interviewees have mixed views on whether or not the new legislation will impact perceived auditor independence. The interviewees who answered that the new legislation will cause a decrease in the perceived independence of the external financial auditor stated that this was caused by the fact that the number of available suppliers that can be selected will be reduced. For instance, of the Big4 firm only three will remain available for selection and in some cases the number of suppliers is reduced even further to two or one. This can happen in cases where one of the suppliers is the current tax provider and the other supplier recently helped in a due diligence for an acquisition and/or does not have the required knowledge. One Audit Committee member stated, “It seems at first glance that independence increases but in the end it will decrease due to the number of available parties”.

The interviewees who claimed that the perceived independence would increase mainly stated that this was caused by the mandatory split, i.e. an external financial auditor is no longer allowed to provide non-external financial audit services. The interviewees also stated that the legislation could be clearer regarding the scope of services that could be performed by the external financial auditor such as services outside the Netherlands, due diligence services, fairness opinions, etc. in order to really form a conclusion about the impact of the new legislation. A Shareholder stated that, “The independence increases because the external financial auditor is not allowed to provide non-audit services anymore”.

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An interesting difference within the table is the difference between the AC and the Shareholders. Most of the Audit Committee members mention a decrease in perceived independence while the Shareholders mention an increase. The Audit Committee members especially focus on the reduction in available suppliers while the Shareholders, who seem to have a more distanced view, see the split between non-external financial audit services and external auditor services as resulting in a major improvement in perceived independence. This is in line with the outcome of Lindberg et al. (2002) and Hollingsworth et al. (2012), who concluded that non-external financial audit services influence the public’s perception of independence. However, one Audit Committee member stated that, “The split between the external financial audit and the non-external financial audit services was already covered by an internal approval process which secured the split”.

As such, the outcome of this analysis is not conclusive about whether the mandatory rotation will increase perceived auditor independence.
8 Summary & conclusions

8.1 Introduction
The overall objective of this research is to obtain knowledge and insight into how the services of external financial auditors are selected by OOBs in the Netherlands and how this selection process affects, according to the stakeholders, the auditor independence and audit quality as perceived by Shareholders.

As such, the research questions that needed to be answered focused particularly on all the information needed to conduct a professional selection process for the services of an external financial auditor, resulting in the following research questions:

1) What types of services are, according to the stakeholders involved in the selection process, provided by the external financial auditor?
2) Who are, according to the stakeholders involved in the selection process, the clients of the services delivered by the external financial auditor?
3) Which stakeholders are involved in the selection process and what will be their objectives in the selection process?
4) How do the stakeholders involved in the selection process classify the services provided by the external financial auditor?
5) What kind of selection process do the stakeholders involved in the selection process use for selecting an external financial auditor?
6) What are, according to the stakeholders in the selection process, the roles of the stakeholders in the selection process?
7) Which selection criteria will be used by the stakeholders of the selection process and how do these compare to the audit quality criteria?
8) How does the selection process impact the perceived quality of the external financial audit and what is the impact of the new Dutch legislation (see §1.1)?
9) How does the selection process impact the perceived independence of the external financial auditor and what is the impact of the new Dutch legislation (see §1.1)?

Section two of this chapter will give a brief summary of the findings of the theoretical research.

Section three will answer the different research questions and section four will provide the final conclusion of this research.

8.2 A brief summary of the findings of the theoretical research
In chapter 2, we learned that the external financial auditor provides a service that is mandated by law and around which international and national standards exist, such as the International

30 As perceived by the stakeholders involved in the selection process.
Standards on Auditing (ISA). The purpose of the external financial audit, according to Ashbaugh et al. (2003), is “to provide assurance on the reliability of its information content. External financial audits serve to reduce asymmetric information risks by attesting to the reliability of a company’s published financial information, thereby allowing current and prospective equity stakeholders i.e. investors, to assess a company’s profitability, performance and develop expectations for the distribution of its profits”.

It also became clear that services provided by the external financial auditor, according to Benston (1985), are of interest to many parties which include both stakeholders from within the company (e.g. employees, managers) as well as stakeholders from outside the company (e.g. institutional investors, financial analysts, lenders, government agencies, suppliers and customers) as well as the Shareholders.

According to the law of supervision, the Shareholders are entitled with the provision of the external financial audit. As such, the Shareholder is seen as the formal principal of the external financial auditor. However according to corporate governance guidelines, the Supervisory Board (in Dutch: Raad van Commissarissen) or Audit Committee is seen as the delegated principal which acts as a functional principal on behalf of the Shareholder/Owner.

Although the services provided by the external financial auditor are mandated and described by law, research by Porter (1993) showed that different stakeholders, which use the services provided by the external financial auditor, could have a different view of the services that they expect to receive from the external financial auditor. This perceived difference in expectations of services delivered could have an impact on the selection process because chapter 3 also shows that several of these stakeholders take part in the process for selecting the external financial auditor and this could lead, according to Jones et al. (2007) to a “tension in decision-making”.

In addition to the services as defined under ISA 200 (2009), the external financial auditor also provides an “advice” service. These services, which are not required by law, relate to the provision of advice including on how to improve accounting and risk policies, increase efficiencies in the business and raise other matters that have come to the attention of the external financial auditor. The recipients of this “advice” include the Management Board, Supervisory Board and Audit Committee.

Finally, chapter 2 demonstrated that the external financial audit market can be characterised as an oligopoly with four external financial audit companies dominating the market.

New legislation introduced by the Dutch government means that out of the 75 listed companies, 61 will have to select a new external financial audit before 1 January 2016. Given the new mandatory rotation legislation, a company cannot stay with its current supplier and as
such it can only select one of the other three suppliers. However if another of these suppliers is already the company’s tax services supplier, and the company does not want to change tax supplier, it can only select from the two remaining Big4 firms.

In chapter 3, a more detailed analysis was conducted on the characteristics of audit quality and auditor independence. According to DeAngelo (1981) audit quality and auditor independence are two separate characteristics that are strongly related. We learned that both direct and indirect measures are used to measure audit quality but that direct measures, according to Arezoo et al. (2011), are hard to use because of low incidence rates and the proprietary nature of the data.

The most frequently used indirect standards to measure “audit quality” which might be used in the selection process are the size of the external financial audit firm, audit fees paid (i.e. the price of the audit), number of hours spent by the external financial auditor, industry expertise and professional scepticism. It could be expected that these criteria will play a role within the selection process.

The second characteristic is “auditor independence”. An external financial auditor is independent, according to NVO (2006), when he or she has the ability to make independent audit decisions and when the external financial auditor is independent in appearance (or perceived independence).

Different researchers (see §3.3.2) found that economic dependence and the provision of non-audit fees are perceived as greater threats to auditor independence than long-term relationships between the auditor and the client. However, the new legislation within the Netherlands does not allow external financial auditors to provide non-audit services and as such the concerns of the economic fee dependence will no longer apply to the Dutch situation. Therefore, this research will try to analyse if there are other challenges within the selection process (i.e. selection criteria and other) which might impact auditor independence.

Chapter 4 confirmed the finding that the shareholder of a company is the principle of the external financial auditor and, as such, the external financial auditor acts as an agent on behalf of the shareholder. However, according to the Audit Quality Forum (2005), self-interest and/or bounded rationality impacts the relationship between the shareholder and the external financial auditor. External financial auditors may be risk averse and may introduce risk management processes resulting in scope limitations and/or caveats in their reports, whereas the Shareholder requires full assurance about the figures presented by the company.

At the same time the Shareholder, the principal of the external financial auditor as explained in §2.3, seems to have a limited involvement in the process for selecting the external financial auditor while stakeholders from within the company, such as the CEO, CFO, Internal Audit
Director and Procurement Director seem to have a larger influence in the selection process. Given the fact that these stakeholders take a role in the selection process it is necessary to understand if the different objectives of these stakeholders play a role in the selection process.

Chapter 5 showed that different researchers suggest that the best way to buy professional services is to use sequential purchasing processes, similar to those used in the procurement of goods, for buying services. At the same time, this chapter showed that performance-based procurement processes are gaining popularity in the Netherlands but that it seems that external financial audit services have never been selected by using a performance-based procurement method.

However Wynstra et al. (2002) determined that the purchasing process for business services is more complex in comparison to the purchase process for goods. This because business services are intangible, inseparable, perishable and heterogeneous and therefore the process of purchasing business services is quite different from the process of purchasing goods.

The framework of the GAO (1987) for buying the services provided by the external financial auditor clearly states that the competition, solicitation, technical evaluation and written agreement should be included to obtain audit services at a reasonable cost and ultimately improve the quality of the auditor’s work. However, the GAO does not explain which stakeholders should be involved in the selection process, how the selection process should be conducted and how competition could increase quality of the work.

It is clear that the classification of the services provided by the external financial auditor within the matrix designed by Kraljic (1983) can only be performed if one determines both the “supply risk” and “profit impact” of the services to the company. As such, the right sourcing strategy could not be concluded from existing theories and therefore it needs to be identified as part of the research.

In addition, audit services, according to Causholli et al. (2012), can be seen as a credence good due to the buyer’s limited information. As a result, Causholli et al. (2012) state that the buyer will probably choose the most efficient auditor i.e. the lowest price, because this is the only information a buyer has. However, research conducted by Deumes et al. (2012) identified that among Audit Committee members, skills and expertise were selected in 76% of cases as top three criteria for selecting an external financial auditor. Beattie et al. (1995) conducted research on the selection criteria used by companies for selecting the services of an external financial auditor.

They concluded that integrity of the external financial audit firm, technical competence of the external financial audit firm and the quality of the working relationship with the audit partners were the three most important characteristics. Boon et al. (2008) concluded that audit quality,
specifically technical competence, auditor reputation and the relationship with the current auditor are the main attributes when appointing an auditor within the context of compulsory audit tendering in Australia. However, none of these studies focused on the context of mandatory rotation and/or the impact of having more stakeholders in the selection process. Therefore, this research will identify and prioritise the selection criteria used by the stakeholders in the selection process in a situation with compulsory audit rotation.

Chapter 5 also made clear that the external financial auditor operates within at least a triadic relationship. Such relationships can lead to reduced supplier performance due to mixed messaging according to Tate et al. (2009).

Finally, chapter 5 showed that the services provided by the external financial auditor do not fit the buyer-seller interaction model created by Wynstra et al. (2006). As a result, another buyer-seller interaction for buying the services of the external financial auditor, with the Shareholder as real principal, has to be developed.

### 8.3 Answers to research questions
The following paragraphs will summarise the answers given to the different research questions.

#### 8.3.1 What types of services are, according to the stakeholders involved in the selection process, provided by the external financial auditor?
This research shows (see §7.2) that all the interviewees expect the external financial auditor to provide the services which are described in Dutch law article 392 sections 1a to 1f.

However, the research also shows that the objectives of the CFO, CEO, and IAD seem to be focused on receiving an “unqualified opinion on the financial statements of the company audited” and or “meeting legal requirements”, i.e. the services provided by the external financial auditor are seen as a “tick in the box”.

The objectives of the Shareholders and the Audit Committee are focused on “a check of the risk processes” and/or “receiving assurance from the external financial auditor”. This is because the Audit Committee uses the services provided by the external financial auditor to obtain an insight into the risks, especially related to the financial processes, and the performance of the management of the company. The Shareholders use the services provided by the external financial auditor to build trust in the company.

The differences in objectives indicate that an audit performance gap also exists (see §2.2.2) within the Netherlands. As such, it is expected that this audit performance gap will be translated by the stakeholders involved in the selection process into different scopes for the services required of the external financial auditor.
8.3.2 Who are, according to the stakeholders involved in the selection process, the clients of the services delivered by the external financial auditor?

The outcome of the research shows (see §7.3) that the interviewees identify many clients from within and outside the company that have to be serviced by the external financial auditor. At the same time, the research shows that more clients from within the company than outside the company are mentioned as clients for the external financial auditor’s services.

A further analysis (see §7.3) shows that the stakeholders involved in the selection process identify the Audit Committee, Supervisory Board, CFO and CEO as the most important clients for the external financial auditor’s services. Shareholders, which are the legal principal of the external financial auditor, are almost not mentioned and are seen as a less important client while the CFO is indicated as the most important client.

This could indicate that when the interviewees are involved in the process for selecting the external financial auditor, the services selected through the process will be geared towards the objectives of the most important clients.

8.3.3 Which stakeholders are involved in the selection process and what will be their objectives in the selection process?

The research shows (see §7.4) that the following stakeholders will be involved in the process for selecting the external financial auditor:

1) CFO;
2) Audit Committee;
3) Internal Audit Department;
4) Corporate Controller;
5) Procurement;
6) CEO;
7) Corporate Accounting & Reporting;
8) Supervisory Board (in Dutch: Raad van Commissarissen);
9) Managing Board (In Dutch: Raad van Bestuur);
10) Shareholders.

The research also shows (see §7.4) that Shareholders (the formal/legal principal of the external financial auditor) play a very limited role in the selection process. In fact, the role of the Shareholder is seen as a formality (in Dutch: een hamerstuk). It also shows that stakeholders such as the CFO and/or CEO play a larger role in the selection process than the formal/legal principal.

The research also shows (see §7.4) that the stakeholders involved in the process for selecting the external financial auditor mostly have different objectives in relation to the services
delivered by the external financial auditor and that several of these stakeholders can be identified as a type of principal of the external financial auditor.

- The CFO is formally focused on receiving an unqualified opinion and confirmation that the financial statements present a true and fair view. At the same time, the CFO wants to show that the company risk framework is operating professionally and is meeting the required standards. The CFO is also focused on confirming that management is “in control” and uses the external financial auditor as a sparring partner.
- The formal objectives of the CEO are aligned with the objectives of the CFO. The CEO will also use the external financial auditor to obtain a view of the performance of the Finance Department and the company CFO.
- The Audit Committee is focused on testing the risk control framework of the company by receiving an unqualified opinion on the figures. In addition, the Audit Committee focuses on the performance of company management and obtaining insight into the quality of the finance organisation to ensure its own position is secure.
- The Internal Audit Director is focused on managing risks within the company. It is focused, in the selection of the external financial auditor, on cooperation, because the IAD wants to use the knowledge of the external financial auditor to improve its own service. In addition, the IAD will focus on establishing clear agreements on the scope of work to ensure the position of the IAD within the company is secured.
- The Corporate Controller is focused on using an external financial auditor who best suits the company and delivers the highest quality at a fair price. The Corporate Controller focuses in the selection process on the relationship and cooperation to ensure that the Corporate Controller can make use of the external financial auditor’s knowledge to improve its own services.
- The CPO will focus on realising the company’s procurement objectives such as running a formal professional selection process and realising cost savings.
- The Shareholders are, according to the research, focused on obtaining insight into the company’s actual performance and business risks. They use the services provided by the external financial auditor to build trust in the company and the management of the company. However, the research suggests that Shareholders would like to see a high dividend payment and/or increase in share price.

These different objectives may be caused, according to the principles of the Principal Agent Theory (see §4), by the following factors.

Stakeholders have a “self-interest” in the services delivered by the external financial auditor. Although the research does not provide an all-inclusive answer on the “self-interest” of each of the stakeholders involved, the research shows that some “self-interest” exists for all stakeholders.

For instance, the CFO and CEO want to show the external environment of the company that they are in control of the company and do not want to show compliance issues, while the Audit
Committee and Shareholders are more interested in the risks and compliance issues. The same can be said for the Corporate Controller and the IAD. They use the knowledge of the external financial auditor to improve their own services and ensure their departments can play a larger role in the company’s external financial audit and therefore they may be focused on taking over certain roles of the external financial auditor to improve their position within the company.

The research shows that “bounded rationality” could cause a difference between the stakeholders involved. Internal stakeholders such as the CEO, CFO, IAD, Corporate Control and Procurement have their own resources to obtain an insight into the company’s (financial) risks. The Audit Committee and Shareholders do not have these resources and insights to analyse the company’s risks and instead use the external financial auditor to obtain these insights.

The research also shows that “utility of information” received from the external financial auditor is different. A CEO or CFO for instance uses the information of the external financial auditor to improve the business while an IAD or Corporate Controller uses the information to build better technical skills and the Shareholders or Audit Committee use the information to obtain an insight into the company.

The research also suggests that the stakeholders involved in the process of selecting the external financial auditor can have “goal conflicts”. For instance, a CFO wants to reduce costs while a Shareholder wants to increase the scope of the external financial audit to ensure business risks are managed appropriately.

As such, the findings of this research show that in practice the number of principals and/or stakeholders involved in the selection process is much greater than the theory (Audit Quality Forum (2005)) and legislation states. At the same time this research shows that the audit performance gap (see §2.2.2) exists between the stakeholders involved in the process of selecting the external financial auditor. These different objectives will, as identified by Jones et al. (2007), influence the selection process and will lead to different requirements which will be translated into selection criteria (see §7.6). These criteria will not all be aligned with the objectives of the formal and delegated principals and as a result it is unlikely that the external financial auditor will provide the services required by the formal and delegated principals.

At the same time, the research shows that the external financial auditor operates during the selection process in a complex relationship which can be compared to a triadic relationship (see §5.6) as presented below in figure 21; while Tate et al. (2009) already concluded that this complexity could influence supplier performance because the external financial auditor will try to interpret the objectives of the different stakeholders involved in the selection process.
8.3.4 How do the stakeholders involved in the selection process classify the services provided by the external financial auditor?

It can be concluded that the services provided by the external financial auditor, based on Kraljic’s (1983) purchasing portfolio, are considered to be a nuisance service/product. This means that the objectives of the professional buyer include obtaining a low price, achieving efficient processing (e.g. low transaction costs) and/or individual ordering according to Gelderman et al. (2003).

At the same time, it can be concluded that Kraljic’s purchasing portfolio (1983) (see §7.5.2) does not fit the services provided by the external financial auditor, because the services provided by the external financial auditor can have a large impact on the value of the company. If an external financial auditor is not willing to provide an unqualified opinion due to the fact that misstatements are identified, it is most likely that the company’s share price will fall, impacting the company’s financing and funding capabilities, which would in turn indirectly have an impact on business growth, profit and even going-concern status. As such, it can be concluded that theory of Kraljic (1983) and additional research by Goonatlike (1990), Das et al. (1997), Razzaque (1997), Svensson (2000) and Andersson et al. (2002) did not take “impact on value of the company” into consideration in determining profit risk.

In addition, this research also concludes that in comparison to earlier research, the “reputation of the supplier” especially when linked to the reputation of the company, should also be added as criterion for determining supply risk.
The services provided by the external financial auditor also cannot be fitted into the buyer-seller interaction model as defined by Wynstra et al. (2006). However, Wynstra et al. (2006) already assumed that not all services would fit the picture. Therefore the model should be used only as a guideline in determining the buyer-seller interaction. Based on the assumptions of the model, the assurance services that are being purchased by the company should be directly delivered to the end customer, i.e. the Shareholder, without any alterations being made within the company. Therefore, the assurance service could best fit the classification of a component service, with the understanding that the customer of the assurance service is different from the customer of the buying company, and that the assurance service is also being used by the company.

The “advice” function, although it will not affect the company’s primary process directly according to the respondents, permanently improves the organisation and can be considered an investment in intellectual capital. At the same time, it does not fit the description of a consumption good as defined by Wynstra et al. (2006) and as such, the advice function could best fit the classification of an instrumental service.

If we were to follow the classification as determined above, the interaction between external financial auditors and buyers as shown in table 38 could apply.

<table>
<thead>
<tr>
<th>Objective</th>
<th>Critical supplier capabilities</th>
<th>Critical customer capabilities</th>
<th>Supplier representatives</th>
<th>Customer representatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>“Assurance services” component</td>
<td>Provide the public interest parties with assurance about the company’s figures</td>
<td>Understanding the requirements of shareholders and other public interests</td>
<td>The audit lead partner</td>
<td>The Audit Committee as delegated principal of the Shareholder</td>
</tr>
<tr>
<td>“advice” function Instrumental</td>
<td>Report on “significant deficiencies in the design or the operation of the internal control structure that, in the auditor’s judgment, could adversely affect the organisation’s ability to record, process, summarise, and report financial data consistent with the assertions of management in the financial statements”</td>
<td>Understanding the actual situation of the customer and being up to date on the internal control issues</td>
<td>Understand how suggested improvements relate to other processes in the company</td>
<td>The audit lead partner</td>
</tr>
</tbody>
</table>

Table 38: Buyer-seller interaction for external financial audit services.
8.3.5 What kind of selection process do the stakeholders in the selection process use for selecting an external financial auditor?

The research shows that the companies use a professional selection process (see §5.2) to select the external financial auditor as defined by Reijniers et al. (2009). The research also shows however that the strategy development step of the selection process as developed by Reijniers et al. (2009) receives lesser attention than the other steps of the selection process.

If the strategy development step of a selection process had been conducted properly, strategic principles and frameworks would have been developed to provide guidance to the stakeholders involved in the selection process. This would have created a common view of the client of the external financial auditor and the deliverables provided by the external financial auditor. However §8.3.1 and §8.3.2 clearly show that this is not the case.

The research has also shown, see §7.8, that the stakeholders in the selection process do not used performance-based procurement processes to select the external financial auditor. The stakeholders involved in the selection process tend to use the selection process as defined by Reijniers et al. (2009) with either a very open approach or a very closed approach. In an open approach, the external financial auditors are invited to conduct interviews and have meetings with representatives of the company to ensure a proposal is fit for purpose.

The companies who use a closed approach see the services of the external financial audit firms as comparable and do not want to invest in giving the external financial auditors more insight in the company. At the same time the research shows that the criteria specified by the GAO (1987) are at too high a level and too generic to conduct a professional selection process and that more guidance is needed on the involvement of the correct stakeholders in the selection process.

8.3.6 What are the roles of the stakeholders in the process?

Based on the findings of the research (see §7.7), table 39 can be created outlining the roles of the stakeholders in the selection process:
The Harvey balls in this table are ordered from completely filled, which means that most of the interviewees mention that this stakeholder is responsible for this task, to no fill, which means no interviewees mention that this stakeholder is involved. The green Harvey balls are the stakeholders mentioned most by the interviewees.

Table 39: Responsibilities of the stakeholders during the selection process.

Table 39 shows that the process for selecting the external financial auditor is a process in which responsibilities are shared between the CFO and the Audit Committee and that these responsibilities are influenced by supporting roles from within the company such as Internal Audit, Corporate Control and Procurement.

The Audit Committee is only in the leading role for three steps of the selection process but the main driver of the process is the CFO. At the same time, the Audit Committee has delegated the selection process to the CFO who has to run it on their behalf.

The outcome of the research (see §7.7) also shows that the Shareholders have the view that the Audit Committee plays a more determining role in the selection process and that the influence of the other stakeholders is limited. At the same time the Shareholders state that they should play a stronger role in the process for selecting the external financial auditor while the research shows that their role is limited and often seen as a formality (In Dutch: een hamerstuk).

Figure 22 shows how activities are delegated during the selection process.
If figure 22 is translated based on the RACI model which according to Smith and Erwin (2005) can help ensure that all parties both have input into and are aware of the duties expected of them, compared with the legislation (see §2.3), the following comparison starts to appear.

<table>
<thead>
<tr>
<th>RACI</th>
<th>According to legislation</th>
<th>According to outcome research</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder (i.e. principal)</td>
<td>Accountable(^1)</td>
<td>Informed</td>
</tr>
<tr>
<td>Audit Committee (i.e. delegated principal)</td>
<td>Responsible(^2)</td>
<td>Accountable</td>
</tr>
<tr>
<td>CFO</td>
<td>Consulted (^3)</td>
<td>Responsible</td>
</tr>
<tr>
<td>CEO</td>
<td>Consulted</td>
<td>Consulted</td>
</tr>
<tr>
<td>IAD</td>
<td>Informed (^4)</td>
<td>Consulted</td>
</tr>
<tr>
<td>Corporate Controller</td>
<td>Informed</td>
<td>Consulted</td>
</tr>
<tr>
<td>Corporate Accounting &amp; Reporting</td>
<td>Informed</td>
<td>Consulted</td>
</tr>
</tbody>
</table>

Table 41: RACI model and the persons/roles involved in the selection process.

\(^1\) Accountable: The person/role who is ultimate responsible and approves the results of the selection process (only one person/role can be accountable).
\(^2\) Responsible: The persons/roles who are responsible for the execution of the selection process report to the person/role accountable.
\(^3\) Consulted: The persons/roles which give direction to the result and which are consulted prior to the outcome of the process. These persons/roles influence the selection process.
\(^4\) Informed: The persons/roles informed on the outcome of the selection process.
Table 41 shows that too many internal stakeholders influence the selection process because they are “Consulted” while they should be “Informed”. On the other hand, the Shareholder who should be “Accountable” for the selection process as principal of the external financial auditor is only “Informed” in the current selection process used by OOBs.

8.3.7 Which selection criteria will be used by the stakeholders of the selection process and how do these compare to the audit quality criteria?

The research shows (see §7.6) that the following selection criteria, in order of importance, will be used to select the services provided by the external financial auditor:

1) Quality of lead partner;
2) Relevant industry expertise;
3) Quality of the team;
4) Reputation of supplier;
5) Audit fee;
6) Audit approach;
7) Global reach & coverage.

This order is not aligned with outcome of the research performed by Deumes et al. (2012) and Boon et al. (2008). However Deumes et al. (2012) analysed the selection criteria that would be used by Audit Committee members only while this research clearly has shown (see §8.3.3 and §8.3.6) that other stakeholders play a large role in the selection process and the criteria used. As such, this research provides an overview of the selection criteria used by OOBs during the process for selecting an external financial auditor.

The outcome of this research is not aligned with the findings of Boon et al. (2008) because Boon et al. (2008) identified the relationship with the current auditor in addition to audit quality, specifically technical competence and auditor reputation as the main criteria used when appointing a new auditor. Although some of the criteria such as technical competence seem to be aligned, criteria such as the relationship with the current external financial auditor cannot play a role within the selection process because it is mandatory for OOBs to rotate external financial auditors.

The research also identified some new selection criteria in comparison to earlier research such as “continuity of the team” or “acceptance of accounting policies”. These new criteria seem to be driven by the fact that the Netherlands has implemented a mandatory rotation of the external auditor. The companies use these criteria to minimise the effects, both operational and financial, of changing the external financial auditor.
The research also shows that the indirect audit quality measurement “number of hours spent" is not seen as a selection criteria.

8.3.8 How does the selection process impact the perceived quality of the external financial audit and what is the impact of the new Dutch legislation?

The outcome of the research shows that stakeholders involved in the process for selecting the external financial auditor do not have a common view of how to determine the quality of the external financial audit. Even the indirect measures to measure audit quality (see §8.3.7) are not mentioned regularly by the persons interviewed as a measure to determine audit quality.

As such, the outcome of this research is aligned with the research by Causholli et al. (2012) who stated that the services provided by the external financial auditor can be characterised as a credence good. This will result in the fact that stakeholders involved in the selection process tend to focus on the lowest audit fee because this is the only thing on which the buyer has information. According to Causholli et al. (2012), this can lead to under-auditing.

The research also shows that companies (see §7.5.1.17) are lowering the scope of the external financial audit as one of the methods of reducing external financial audit costs.

This is happening while at the same time the stakeholders involved in the selection process (see §7.9.4) state that the quality of the audit cannot be assured if the price is low, and that the Shareholders have to trust the management of the company and/or the judgment of the external financial auditor which seems contradictory when the purpose of the external financial auditor is to objectively check the work of the management.

In addition the research shows that the objectives of the stakeholders involved in the selection process (see §7.4) are not aligned and that the quality of the external financial audit will decline due to this misalignment. As such, the focus will shift away from the “advice” function to receiving an “unqualified opinion” which might not be aligned with the objectives of Shareholders of the company.

In addition, most stakeholders believe (see §7.9.3) that the selection process does not need to change to increase perceived audit quality. However, Shareholders believe that a larger involvement of the Shareholder, the formal principal, will lead to an increase in perceived audit quality.

Based on these findings, it can be concluded that the current process for selecting the external financial auditor, without the involvement of the Shareholder, leads to a decrease in the quality of the external financial audit as perceived by the Shareholder.
As the same time the research shows (see §7.9.5) that the new Dutch legislation will cause a decrease in perceived audit quality. This decrease will be caused by the fact that the selection process will probably cause a reduction in scope, combined with the fact that the new external financial auditor will have to build knowledge of the company and its processes which cannot be done overnight and for which the company is not willing to pay additional fees.

8.3.9 **How does the selection process impact the perceived independence of the external financial auditor and what is the impact of the new Dutch legislation?**

Auditor independence is primarily the responsibility of the external financial auditor, however the research shows (see §7.10.1) that the perceived auditor independence is not impacted by the selection process due to the segregation of duties of the stakeholders involved in the selection process and the fact that the companies run a professional selection process.

The stakeholders involved in the selection process (see §7.10.2) state that the selection process does not have to be changed to increase the auditor’s independence while Shareholders believe that the Audit Committee or Shareholders need to have a greater involvement in the selection process.

At the same time the research shows that companies are using selection criteria (see §7.6), such as “acceptance of accounting policies” which can impact auditor independence when external auditors are pushed to accept certain policies as part of a commercial process.

Based on this it can be concluded that the perceived auditor independence can be impacted negatively by the selection process used by OOBs.

The research also shows (see §7.10.3) that this research is not conclusive about whether mandatory rotation will increase perceived auditor independence. The perceived auditor independence will grow due to the fact that the selected external financial auditor is no longer allowed to provide non-audit services. On the other hand, auditor independence will decrease because the mandatory rotation will limit the number of suppliers available to a company. The linkage between the companies and the suppliers of external financial audit services for other purposes such as tax services, due diligence services, mergers & acquisitions and other advisory services are such that it is difficult to select truly independent parties which have not performed these services prior to becoming the external financial auditor. As such, it can be concluded that the mandatory transition requirement under the new legislation will not improve perceived auditor independence.

8.4 **Conclusion**

Based on the answers to the research questions it can be concluded that the selection process used by OOBs for selecting the services provided by the external financial auditor will cause a
decrease in the perceived audit quality and that it can have a negative impact on auditor independence.

At the same time, it can be concluded that the new Dutch legislation will not improve this situation. Of course, the new legislation ensures that the external financial auditor is not allowed to provide non-audit services, which according to Lindberg et al. (2002) affects the public’s perception of independence negatively, but the mandatory rotation will decrease the number of available suppliers and this may introduce larger independence threats. This because the external financial audit companies, which are not the current supplier, almost all provide non-audit services to the large listed OOBs.

The decline in perceived audit quality and the impact on perceived auditor independence is caused by the fact that the stakeholders involved in the selection process have different perspectives on the client of the external financial auditor. For instance, the CFO is identified as the most important client while the Shareholder, the formal principal, is almost not identified as a client.

At the same time the stakeholders involved in the selection process, which according to Jones et al. (2007) “will profoundly influence the decision-making process”, all have different objectives that seem to be mainly driven by self-interest and information asymmetry. A CFO for instance already has the information and systems needed to manage and understand a company’s risks and is more focused on “ticking the box” while an Audit Committee uses the external financial auditor to obtain an insight into the risks and performance of the company’s management. As such, an audit performance gap as identified by Porter (1993) exists between the stakeholders involved in the selection process.

In addition, the stakeholders involved in the selection process also do not have a common view on how to measure audit quality, which is in line with the findings of Causholli et al. (2012). As a result, more focus is put on audit fees because this is the only selection criterion that can be measured objectively.

This research also shows that the stakeholders involved in the selection process tend to use a sequential selection process instead of a performance-based selection process. Due to the use of this selection method, external financial auditors cannot differentiate their services and a large focus is put on selecting an external financial auditor based on lower audit fees.
Lowering audit fees can be achieved either by reducing audit rates\textsuperscript{35} or by reducing the scope of the external financial audit. A reduction in the scope of the external financial audit might not be aligned with the requirement of the Shareholder, however the involvement of the Shareholder in the selection process is limited and is seen by the other stakeholders as a formality (\textit{een hamerstuk})\textsuperscript{36} and as such the Shareholder does not have control over the scope of the audit.

In addition, the external financial auditor has to operate within at least a quadratic relationship between itself, the Shareholder, Audit Committee/Supervisory Board and CFO as shown in figure 23. Such a structure can be very complex and could lead, as confirmed by Tate \textit{et al.} (2009), to a reduced supplier performance.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure23.png}
\caption{The quadratic relationship of the external financial auditor.}
\end{figure}

The research also shows, although auditor independence is the responsibility of the external financial auditor, that companies use selection criteria, or even knockout criteria, in the selection process for instance “acceptance of accounting policies” which could impact the perceived auditor independence.

Finally, the research shows that the Shareholder is almost not involved at all in the selection process and that the Audit Committee delegates large parts of the selection process to the CFO. The CFO also delegates parts of the selection process and as such, the selection process is mostly driven by stakeholders within the company. Given the existing audit performance gap, this will have an impact on the entire selection process, the selection criteria used, the roles of

\textsuperscript{35} The hourly rate charged by the external financial audit firm.

\textsuperscript{36} Een hamerstuk
the stakeholders during the selection process, the scope of the audit requested and in the end the audit engagement contracted and the external financial auditor selected. However all these internal stakeholders are audited by the external financial auditor and some of them do not always benefit from a strict external financial audit. As such, the current selection process used by OOBs feels, as stated by an Audit Committee member, like “A turkey voting for Christmas”.

9 Discussion, practical & theoretical implications

Chapter 9 is the discussion chapter. Here, the practical & theoretical implications will be presented as well as the limitations of the research as well as topics for future research.

9.1 Practical and theoretical implications

This research provides insights into the way OOBs select the services provided by the external financial auditor under legislation where mandatory rotation is applied from a purchasing point of view. As such, this research provides theoretical input for further research both in the way of new findings like selection criteria usage, roles of stakeholders in the selection process, the relevance of purchasing theory and the relationship between Principal Agent Theory, purchasing theory and the services provided by the external financial auditor. The impact from a practical point of view might even be greater. The research will give the external environment a better understanding of the selection process used by companies to select a new external financial auditor. This insight will enable the external environment, including Shareholders, to ask the questions during Shareholder meetings to ensure their position is optimised. It will also enable companies to create a process for selecting an external financial auditor that fits the perceptions better. It will also enable the legislator to review the current legislation because the research indicates that the current legislation is not meeting its’ stated objectives of increasing audit quality or auditor independence.

9.1.1 Practical implications

This research provides insights into the way OOBs select the services provided by the external financial auditor under a legislation where mandatory rotation is applied from a purchasing point of view. From this point of view, I would like to point out some practical implications for the process of selecting the external financial auditor and for the Shareholders, Owners and/or interested parties involved in the services provided by the external financial auditor.

The research has shown that the stakeholders involved in the selection process transfer the responsibility of dealing with the external financial auditor such as audit quality or auditor independence to the external financial auditor (see §7.9 and §7.10). However, in a buyer-seller relationship it is not only the seller who is responsible for the services delivered. The buyer should at least take responsibility for ensuring that the correct services in terms of quality and quantity are delivered because at the end of the day you get what you pay for (in Dutch: Je krijgt wat je betaalt).

The research also has shown that large parts of the selection process are delegated by the Audit Committee and/or Supervisory Board to representatives within the company (see §8.3.6). Audit Committees and/or Supervisory Boards should understand that the outcome of a selection
process can be influenced in many different ways, which is why they should take a more prominent role in the selection process, as the delegated principal of the Shareholder.

9.1.1.1 Practical implications for Audit Committees & Supervisory Boards

In order to conduct a successful selection process and to optimise buyer-seller interaction, Audit Committees and Supervisory Boards are advised to involve the Shareholders in the selection process more strongly. The following steps should therefore be included in the selection process as presented in figure 24.

Figure 24: Van Weele (2005) purchasing model including additional phase identified by Reijniers et al. (2009).

Develop strategy:

Step 1) The Audit Committee/Supervisory Board should ensure that the stakeholders involved in the selection process know the objectives of the services delivered by the external financial auditor;

Step 2) The Audit Committee/Supervisory Board should ensure that the stakeholders involved in the process for selecting the external financial auditor all have a common understanding and agreement on who is the client of the services provided by the external financial auditor.

Only after internal alignment can the specification step can be conducted.

Define Specification:

Step 3) These objectives as defined in step 2 should be translated into a selection briefing document for the General Meeting of Shareholders (In Dutch: Algemene Vergadering van Aandeelhouders (AVA)). This briefing document should contain:

- The scope of the external financial audit that the Audit Committee would like to receive from the external financial auditor compared to the current scope of the external financial audit;
- The selection criteria that the Audit Committee would like to use for the selection of the external financial auditor, the way the selection criteria would be evaluated and the weight each selection criterion would have in the overall tally;
- The persons/representatives that will be involved in the selection of the external financial auditor, the role of these representatives and the way the selection process would be conducted;
- The external financial audit firms that will be invited to participate in the selection process and why certain firms are included and/or excluded.
Step 4) At the General Meeting of Shareholders, prior to the selection of a new external financial auditor, the Audit Committee and Supervisory Board should obtain approval from the Shareholders for the following items:

- The scope of the external financial audit that they would like to receive from the external financial auditor in comparison to the current scope. This would include the number of hours spent by the current external financial auditor and an explanation on the depth and width, which not only means which entities of the company would be included and excluded in the scope but also which services the Audit Committee, Shareholders and company would like to receive;
- The selection criteria that the Audit Committee would like to use for the selection of the external financial auditor, the way the selection criteria would be evaluated and the weight each selection criterion would have in the overall tally;
- The persons/representatives that will be involved in the selection of the external financial auditor, the role of these representatives and the way the selection process will be conducted;
- The external financial audit firms that will be invited to participate in the selection process and why certain firms are included and/or excluded.

Only after the approval of the Shareholder is received can the selection process be continued.

**Contracting:**

Step 5) Audit Committees or Supervisory Boards should present, after the conclusion of the selection process and negotiation, the outcome of the tender to the General Meeting of Shareholders to obtain approval for engaging the external financial auditor. This presentation should contain the subjects previously mentioned but also the deviations from the agreement given by the Shareholders so that the Shareholders can check whether the selection process was conducted according the approval given.

Step 6) Audit Committees or Supervisory Boards should invite the selected external financial auditor to present during the General Meeting of Shareholders. During this presentation, the external financial auditor should confirm that it will conduct an external financial audit with the proposed scope and that it is capable of doing this for the contracted amount.

Only after approval of the Shareholder is received can the external financial auditor be contracted.

**Evaluation:**

Any company can change and as such, the services provided by the external financial auditor can also change. This impact should be made clear to the Shareholders in the annual report and therefore the following should take place:
Step 7) Audit Committees or Supervisory Boards should include in the annual report, as well as the fees paid, additional information such as (where relevant):

- The scope of the external financial audit initially contracted;
- The scope actually delivered by the external financial auditor in the respective year;
- Explanation of why the scope contracted is different from the scope delivered;
- The number of hours spent by level of employees of the external financial auditor involved in the delivery of the external financial audit.

Step 8) Audit Committees or Supervisory Boards should prepare a document to be presented during the General Meeting of Shareholders which proposes the scope of the external financial audit for the following year including the hours needed and the audit fee of the external financial auditor.

Following step 8, steps 5 and 6 should be repeated to obtain approval from the General Meeting of Shareholders on the external financial audit for the following year, or until a decision is made to select a new external financial auditor, whichever is appropriate.

The eight steps presented above are included in the combined purchasing model of Van Weele (2005) and Reijniers et al. (2009), see figure 25, and are described in detail in Appendix D: Checklist for external financial audit.

![Purchasing process by Reijniers et al. (2009) including additional steps added to ensure buyer-seller interaction is optimised.](image)

9.1.1.2 Practical implications for Shareholders, representatives of Shareholders and regulatory bodies

The research has shown (see §2.3) that the Shareholder is the formal principal of the external financial auditor and although the Audit Committee/Supervisory Board should lead the selection process, the Shareholder should also put more emphasis on the way the selection process is conducted to ensure their objectives are met.
It may be the case that individual Shareholders do not have the knowledge and/or capabilities to understand the ins and outs of the selection process and therefore Shareholders’ representatives such as VEB and Eumedion are advised to put more emphasis on how selection processes are conducted and verify whether the selection process ensures that the objectives of the Shareholders are met.

In addition, regulatory and supervisory bodies who monitor the services provided by the external financial auditor should test the selection process, especially during the years of rotation, but also if the number of hours used by the previous auditor and the new external auditor substantially deviate. A large deviation in hours could indicate a deviation in scope and this could influence the services delivered.

**9.1.1.3 Practical implications for other stakeholders involved in the selection process**

The research has shown (see §7.3) that the stakeholders involved in the selection process do not have a common view of the services provided and the clients of the external financial auditor.

Therefore, stakeholders involved in the selection process, especially stakeholders from within the Company, are advised to develop a better understanding of the role of the external financial auditor, the services they deliver and the clients they service.

**9.1.1.4 Practical implications for the legislator**

The research has shown (see §7.9.5 and §7.10.3) that the new legislation, especially the mandatory rotation does not have a positive impact on the perceived audit quality and the perceived auditor independence.

Therefore, the legislator is advised, to re-evaluate the current legislation and try to develop legislation that meets the requirements of the Shareholder and public in a better way, by for instance prohibiting selection criteria that can have an impact on auditor independence such as “acceptance of accounting policies”.

The legislator is also advised to change the reporting obligations of the external financial auditor as they relate to the company’s annual report.

The external financial auditor should include, at a minimum and in addition to the fees paid to the external financial auditor, the following information:

- The scope of the external financial audit initially contracted;
- The scope of the external financial audit actually delivered by the external financial auditor in the respective year;
- An explanation why the scope contracted is different from the scope delivered;
9.1.2 Performance-based procurement process for external financial audit services

As stated in §8.4 the sequential selection process used by stakeholders could lead to lowering audit fees which could lead to lower audit quality. An alternative approach for selecting a financial auditor could be a performance-based approach. However before conducting this approach an agreement should be reached (see §9.1.1.3) on the objective and the clients of the services that have to be provided by the external financial auditor.

As stated in §7.4, the Shareholder would like to receive assurance as a starting point for the performance-based selection process. Based on this starting point the following process could be conducted:

Step 1) The audit committee/supervisory board set a budget they are willing to pay for the services of the external financial auditor.

Step 2) The audit committee/supervisory board could ask the external financial audit firm to prepare a proposal in which they ask the external financial auditors “how they could provide assurance to the Shareholders of the company within the given budget?”. The proposal should at minimum consist of:

- A document that describes the external financial audit that will be proposed by the external financial auditor. This proposal should at a minimum conclude:
  - The materiality the external financial audit proposes;
  - The scope of the external financial audit;
  - The number of hours used to conduct the external financial audit;
  - The risks the external financial audit firms have identified, based on industry knowledge and understanding of the company, and the way they will ensure that these risks are analysed to provide assurance;
  - The risks the external financial audit firms have identified but which will not be part of the external financial audit;
  - The risks the external financial auditor has identified in conducting the external financial audit and the way these risks can be mitigated;

- A document in which the external financial auditor describes the different additional services that the external financial auditor can offer to increase the assurance of the Shareholders.

9.1.3 Theoretical implications

This research provides insights into the way OOBs select the services provided by the external financial auditor under legislation where mandatory rotation is applied from a purchasing point
of view. From this point of view, I would like to point out some theoretical implications that have been identified during the research.

9.1.3.1 Selection criteria

Different researchers, Deumes et al. (2012), Boon et al. (2008) and the GAO (1987) have identified selection criteria that could be used for selecting an external financial auditor.

Deumes et al. (2012) only researched the criteria used by Audit Committees while Boon et al. focused on criteria used in a mandatory tendering situation. The GAO (1987) defined some technical criteria that could be used to select an external financial auditor.

This research has identified the selection criteria that will be used during the process for selecting the external financial auditor by all stakeholders involved in the selection process under mandatory rotation as presented in table 42.

<table>
<thead>
<tr>
<th>Which selection criteria are used by stakeholders to select an external financial auditor?</th>
<th>Mentioned in the RFPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quality of lead partner</td>
<td>✓</td>
</tr>
<tr>
<td>Audit approach</td>
<td>✓</td>
</tr>
<tr>
<td>Reputation of supplier</td>
<td>✓</td>
</tr>
<tr>
<td>Relevant industry expertise</td>
<td>✓</td>
</tr>
<tr>
<td>Audit fee</td>
<td>✓</td>
</tr>
<tr>
<td>Cooperation with Internal Audit Department</td>
<td>✓</td>
</tr>
<tr>
<td>Global reach &amp; coverage</td>
<td>✓</td>
</tr>
<tr>
<td>Cooperation with the business</td>
<td>✓</td>
</tr>
<tr>
<td>Cultural fit</td>
<td>✓</td>
</tr>
<tr>
<td>Transition plan</td>
<td>✓</td>
</tr>
<tr>
<td>Relationship between lead partner and management</td>
<td>✓</td>
</tr>
<tr>
<td>Continuity of the team</td>
<td>✓</td>
</tr>
<tr>
<td>Independence</td>
<td>✓</td>
</tr>
<tr>
<td>Quality of team</td>
<td>✓</td>
</tr>
<tr>
<td>One of the Big 4</td>
<td>✓</td>
</tr>
<tr>
<td>Expertise of Accounting and Auditing</td>
<td>✓</td>
</tr>
<tr>
<td>Acceptance of accounting policies</td>
<td>✓</td>
</tr>
<tr>
<td>Tender process performance</td>
<td>✓</td>
</tr>
<tr>
<td>Feedback from other clients</td>
<td>✓</td>
</tr>
</tbody>
</table>

Table 42: Selection criteria used by external financial auditors.

Some of these criteria were also identified by an analysis of the RFPs put onto the market by OOBs (see §5.3.2) and were confirmed by the empirical research. A definition of the different selection criteria can be found in §7.6. In addition, some specific selection criteria were identified which are specifically used to ensure the position of the company which has to change external financial auditor. These new selection criteria are:

- Acceptance of accounting policies;
- Continuity of the team.
The acceptance of accounting policies is a criterion which is created by companies (see §7.6.1.13) to minimise the impact of the rotation on the financial statements of the company. A new external financial auditor might have some other thoughts on for instance the valuation of goodwill and by adding this criterion, companies are ensured that they do not need to restate their figures due to the new external financial auditor.

Continuity of the team is a criterion which is created by the companies, as explained in §7.6.1.9, to ensure that the proposed team of the external financial auditor is not moved to another company if a more interesting client is found. This criterion is mainly introduced to decrease supply risk because of competitive demand in the market due to the large number of companies that will have to rotate external financial auditor at the same time.

The research also has identified which criteria the stakeholders involved in the selection process would prioritise (see §7.6.2) and the selection criteria that would be used if all the stakeholders involved in the selection process were to have an equal say in determining the selection criteria used. These criteria would be, in order of importance:

1) Quality of lead partner;
2) Relevant industry expertise;
3) Quality of the team;
4) Reputation of supplier;
5) Audit fee;
6) Audit approach;
7) Global reach & coverage.

It is expected that the selection criteria above will play a major role in the selection of the external financial auditor.

9.1.3.2 External audit services and the Kraljic Matrix (1983)

According to the research, the services provided by the external financial auditor (see §7.5.2) are initially identified as nuisance products. According to Gelderman et al. (2003) the correct purchasing strategy should be “pooling of requirements” to reduce costs or “individual ordering with a focus on optimising processing costs”.

As such, companies who buy these services can be expected to focus on procuring the services for a low price and ensuring that the transition costs are minimised, which is in line with the findings of the research.

However the services provided by the external financial auditor are set by law (see §2.2) so a company cannot pool requirements to move the services into the commodity quadrant. What is
left, according to Gelderman et al. (2003) is individual ordering with a focus on minimising administrative costs including transition costs.

The research also shows however that the external financial audit services do not fit the Kraljic Matrix (1983) because it is most likely that business growth, profit and going-concern status would be impacted if the external financial auditor were to give an unqualified opinion. As such, one should wonder whether the impact on “company value” should not be added as one of the criteria for determining profit impact.

9.1.3.3 Reputation of the supplier is considered a supply risk

Several criteria (see §5.4.2) are identified to determine the supply risks of a company. In addition to these criteria, this research clearly identified that “reputation of the supplier” should also be considered as a supply risk criteria. This is especially the case were supplier reputation and company reputation are closely linked.

9.1.3.4 Triadic relationships

This research has identified that the external financial auditor operates, in comparison to other services, in at least a quadratic relationship instead of a triadic relationship, while parties such as regulatory and/or controlling bodies are even not taken into consideration.

This quadratic relationship can have a major impact on the supplier performance due to all the mixed messages.

9.1.3.5 Buyer-seller interaction

The research has shown that services provided by the external financial auditor also do not fit the buyer-seller interaction model as defined by Wynstra et al. (2006).

Based on the assumptions of the model, the assurance services that are being purchased by the company should be directly delivered to the end customer, i.e. the Shareholder, without any alterations being made within the buying company. However, the service cannot be seen as complementary to the existing offerings.

Therefore, the assurance service could best fit the classification of a **component service**, with of course the understanding that the customer of the assurance service is different from the customer of the buying company, and that the assurance service is also used by the company.

The “advice” function, although it does not directly affect the company’s primary process according to the respondents, permanently improves the organisation and can be considered an investment in intellectual capital. At the same time, it does not fit the description of a consumption good as defined by Wynstra et al. (2006) and as such, the advice function could best fit the classification of an **instrumental service**.
However, given the objective of the services provided by the external financial auditor, one would expect that a “representative service” could be added to the classification of Wynstra et al. (2006). The purpose of this addition would be to capture services that represent a company to parties other than an end customer such as a Shareholder, Legislator, Lawyer or Tax Authority. All these services require a different buyer-seller interaction, which should be based on the objective of the service in relation to the end user or receiver of services.

If this was added to the classification rules of Wynstra et al. (2006), figure 26 could be created.

Figure 26: Buyer-seller interaction model for services by Tros (2014).

### 9.2 Limitations

Every research has limitations. The main limitation of this research is that it completely focuses on listed OOBs and, as such, it is unclear whether this research could be extrapolated to other countries with similar corporate governances or other companies within the Netherlands. However given the fact that the outcome of this research is aligned with the outcome of other research by Deumes et al. (2012), Lindberg et al. (2002) and Hollingsworth et al. (2012), it is feasible that the outcome of this research can be extrapolated to other environments in which rotation of the external financial auditor is mandatory.
Another challenge could be the timing of the research. This research was started in 2010 when there was no mention of mandatory rotation and/or mandatory tendering of the services provided by the external financial auditor.

However, in 2010, when M. Barnier was appointed as EU Commissioner for Internal Market and Services, discussions started on changing the market of external financial auditors. The Netherlands made a show of virtue in contrast to most of the EU and implemented new legislation which stated that, with effect from 1 January 2016, an external financial audit firm may serve as a OOBs external financial auditor for a maximum of ten years. After this period, the external financial audit firm must be rotated. As a result, almost every OOB has selected or is currently in the process of selecting and/or preparing to select a new external financial auditor, and therefore the different respondents have different experience levels which could have influenced the outcome of the research.

Another challenge could be that the respondents did not show their true colours during the interview and held back in answering. In general, it was felt that all the interviewees provided clear and open answers and did not hold back during the interviews and as such, the results can be translated to the actual situation. In some cases, the interviewees provided the actual RFP used to select the new external financial auditor.

Finally, the format of the checklist may constitute a methodological limitation. Although the checklist was sufficiently tested during the interviews, additional effort was needed to explain the background of question 8 on the checklist, see Appendix C: Checklist for the qualitative interviews. Once this was explained, every interviewee was able to provide an answer and as such, it is expected that the research was not limited.

**9.3 Future research**

There is of course room for future research and this paragraph will present three possibilities.

Firstly, an additional angle could be to examine what a Shareholder really expects from an external financial auditor. Epstein et al. (1994) already identified that 70% of investors believed that an external financial auditor should provide assurance that there are no material misstatements or fraud in the financial statements. If this is also the case in the Netherlands, a different format of the selection process might be more applicable. However, do the Shareholders really value the services provided by the external financial auditor and do the Shareholders really know why an external financial auditor is appointed on their behalf?

A second approach could be to test if the finding of this research can be adapted and applied in other countries where mandatory rotation of the external financial auditor is in place such as,
for instance, Italy or Brazil. This general application would enable Shareholders who invest internationally to manage their portfolio risks in a better way.

A third and final additional approach could be to examine the impact of the mandatory rotation on the actual change in scope of the external financial audit and the hours spent by the external financial auditors in providing assurance. This research has focused on the buying side of companies, whereas this additional approach could focus on the sales side, i.e. the external financial audit firms and the impact of this sales process on the audit quality perceived/received by Shareholders. This would mean that both clients and external financial audit firms would be willing to share this data.
Dutch Summary (Nederlandse samenvatting)

Inleiding, achtergrond, aanleiding en onderzoeksdoelstelling

Een externe accountant voert een door de wet bepaalde controle, een financiële audit of accountantscontrole, uit op de financiële verantwoording van een organisatie. Het doel van deze accountantscontrole is om verschillende belanghebbenden en gebruikers van deze financiële cijfers, zoals huidige en toekomstige aandeelhouders, medewerkers, schuldeisers of investeerders, zekerheid te verschaffen over de betrouwbaarheid van de gepubliceerde financiële informatie (de jaarrekening).

Vanuit dit perspectief werd ik gevraagd, als directeur van business development, om een team van mijn toenmalige werkgever te ondersteunen bij het winnen van een accountantscontrole-tender. Mijn werkgever was de zittende externe accountant van deze klant en had dus een kennisvoorsprong en inzage in de activiteiten die uitgevoerd dienden te worden voor de financiële audit. De klant had echter een Request For Proposal (RFP) uitgebracht waarin een smallere scope van de financiële audit opgenomen was dan de scope die op dat moment toegepast werd.

Op basis van deze smallere scope werden de verschillende externe accountants gevraagd door de klant om een offerte in te dienen. Elke externe accountant diende de geoffreerde uren en tarieven uit te splitsen naar de verschillende business units van de klant.

Op een gegeven moment werd ik, met de verantwoordelijke partner, uitgenodigd voor een presentatie door de inkoper van de klant. In het bijzijn van de CFO legde de inkoper de volgende sheet aan ons voor (zie figuur 27).

| Business Unit A | # Uren | Gemiddeld tarief | | Business Unit B | # Uren | Gemiddeld tarief | | Business Unit C | # Uren | Gemiddeld tarief | | Totaal | # Uren | Gemiddeld tarief |
|-----------------|--------|------------------||-----------------|--------|------------------||-----------------|--------|------------------||-----------------|--------|------------------||-----------------|--------|------------------|| Externe accountant A | 750 | EUR 160,00 | | 600 | EUR 180,00 | | 250 | EUR 160,00 | | 166,000 | 1600 | EUR 167,50 |
| Externe accountant B | 700 | EUR 160,00 | | 450 | EUR 180,00 | | 300 | EUR 180,00 | | 1450 | 1400 | EUR 167,69 |
| Externe accountant C | 800 | EUR 155,00 | | 700 | EUR 160,00 | | 315 | EUR 180,00 | | 1830 | 1815 | EUR 167,81 |
| Externe accountant D | 625 | EUR 160,00 | | 700 | EUR 170,00 | | 250 | EUR 140,00 | | 194,500 | 1315 | EUR 146,79 |

Het laagste aanbod in uren of gemiddeld tarief aangeboden door de externe accountants.

Figuur 27: Voorbeeld van de sheet die gepresenteerd werd door de inkoper van de klant.
Op basis van de aanbiedingen van de externe accountants had de inkoper een targetprijs berekend. Deze targetprijs was gebaseerd op de laagste ururtarieven en het laagste aantal benodigde uren zoals geoffereerd door de externe accountants. Uiteindelijk werd door de inkoper aangegeven dat de externe accountant die de targetprijs en het aantal uren accepteerde de opdracht voor de financiële audit zou krijgen.

Ik had geleerd dat het aantal uren dat benodigd is voor het uitvoeren van een externe financiële audit van invloed is op de kwaliteit van de accountantscontrole. In dit geval leek het alsof de betreffende klant, door het verlagen van het aantal uren, indirect vroeg om de kwaliteit van de accountantscontrole te verlagen.

Ik herkende de inkoopmethodiek zoals gebruikt door de betreffende klant vanuit inkoopprocessen voor IT, Schoonmaak en Catering. Ik had, als voormalig inkoper van deze diensten, geleerd dat het minimaliseren van de prijs en de reikwijdte (scope) van de verschillende diensten vaak leidt tot een lagere kwaliteit van dezelfde diensten die eerder door de klant ontvangen werden, hetgeen bevestigd werd door Reijniers en Ledder (2011).

Vanuit dit perspectief vroeg ik mijzelf af wat er zou kunnen gebeuren met de accountantscontrole van een beursgenoteerde onderneming als de externe accountant gedurende een inkoopproces onder commerciële druk werd gezet?

Gedurende het onderzoek werd de initiatiefwet ‘De accountancy na de crisis’ van Plasterk, Irrgang en Braakhuis (2012) en De Vliet (2012) aangenomen. Het doel van deze initiatiefwet is om zowel de kwaliteit van de accountantscontrole als de onafhankelijkheid van de externe accountant te versterken. Daartoe zullen Organisaties van Openbaar Belang (OOB) gedwongen worden om hun externe accountant ten minste om de acht jaar te wisselen. Daarnaast zegt de inmiddels aangenomen wet dat het niet meer is toegestaan om niet-

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36 Een ‘Organisatie van Openbaar Belang’ (OOB) is, volgens de Wet toezicht accountantsorganisaties, een entiteit die door haar omvang of activiteiten een grote invloed op het publieke domein kan hebben. Ter verduidelijking, een OOB is normaal gesproken een Public Interest Entity (PIE), maar een PIE is niet altijd een Organisatie van Openbaar Belang.

37 In december 2013 is het Europese parlement overeengekomen dat er elke tien jaar een verplichte aanbesteding zal moeten plaatsvinden voor de dienstverlening van de externe accountant en dat een bedrijf een optie heeft om de opdracht met dezelfde externe accountant voort te zetten gedurende nog eens maximaal tien jaar. Als gevolg hiervan wordt er verwacht dat de periode van acht jaar gewijzigd gaat worden in tien jaar.

38 Een verplichte rotatie.
auditdiensten, waaronder fiscale diensten en adviesdiensten, te ontvangen van de zittende externe accountant.

Voor dit onderzoek zijn de jaarverslagen van de Nederlandse beursgenoteerde ondernemingen die op 31 december 2012 genoteerd waren aan zowel de AEX, AMX als AScX geanalyseerd. Uit dit onderzoek blijkt dat negen van deze 75 beursgenoteerde ondernemingen tussen 31 december 2008 en 31 december 2012 gewisseld zijn van externe accountant en dat de overige OOB’s langdurige relaties hebben met de externe accountant. Door de inmiddels aangenomen wet zullen 61 Nederlandse beursgenoteerde OOB’s tussen 1 januari 2013 en 1 januari 2016 van externe accountant dienen te veranderen. Tevens zullen de overige niet beursgenoteerde OOB’s ook van externe accountant dienen te wisselen.

Vanuit bovenstaande ontwikkelingen is de doelstelling van dit onderzoek om *kennis van en inzicht te krijgen in de manier waarop de diensten van de externe accountant worden geselecteerd door beursgenoteerde OOB’s in Nederland en hoe deze selectieprocessen, volgens de betrokken partijen in het selectieproces, de gepercipieerde onafhankelijkheid van de accountant en de gepercipieerde kwaliteit van de accountantscontrole beïnvloeden zoals gepercipieerd door de aandeelhouders.*

**Theoretisch onderzoek**

Op basis van deze doelstelling beschrijven hoofdstukken 2, 3, 4 en 5 van dit onderzoek de context van de externe accountant, de kwaliteit van de accountantscontrole en onafhankelijkheid van de externe accountant, de principal agency-theorie en de inkooptheorie die gebruikt zijn om dit onderzoek uit te voeren.

**De context van de externe accountant**

Uit hoofdstuk 2 blijkt dat volgens de Wet toezicht accountantsorganisaties (Wta), aandeelhouders van een bedrijf er recht op hebben dat de financiële gegevens van een bedrijf gecontroleerd worden door een onafhankelijke externe accountant. Als zodanig is de aandeelhouder dan ook de formele opdrachtgever van de externe accountant en wordt de Raad van Commissarissen of het Auditcomité gezien als de gedelegeerde opdrachtgever van de externe accountant. Op basis van dit uitgangspunt zou je verwachten dat de aandeelhouder

39 Totaal 75 ondernemingen.
40 Niet alle beursgenoteerde ondernemingen zijn OOB’s.
en/of Raad van Commissarissen of het Auditcomité leidend zijn in het selectieproces van de externe accountant en daarom wordt dit getoetst in het onderzoek.


Tevens blijkt dat de externe accountant ook een ‘natuurlijke’ adviesfunctie heeft. Deze functie, die niet wettelijk verplicht is, heeft betrekking op het verstrekken van advies over een breed scala van onderwerpen zoals het risicobeleid, de boekhouding en de efficiëntie van het bedrijf. Ook wordt verwacht dat de externe accountant andere zaken die gedurende het uitvoeren van de opdracht naar boven komen meeneemt in het advies. De ontvangers van deze ‘natuurlijke’ adviezen zijn onder andere de Raad van Bestuur, de Raad van Commissarissen en het Auditcomité. Gebleken is dat niet ieder gremium dezelfde diensten ontvangt van de externe accountant. Dit kan impact hebben op het selectieproces en wordt daarom getoetst in het onderzoek.

Tot slot heeft hoofdstuk 2 aangetoond dat de externe auditmarkt kan worden gekarakteriseerd als een oligopolie met vier externe audit firms\[^{41}\] die de markt domineren. Door de nieuwe initiatiefwet zal de keuze van OOB’s, indien zij gebruik willen blijven maken van één van de grote externe accountants, beperkt worden tot twee of drie partijen\[^{42}\] en daarom wordt getoetst waarom OOB’s graag gebruikmaken van de grote externe accountants.

**De kwaliteit van de accountantscontrole en onafhankelijkheid van de externe accountant**

Hoofdstuk 3 omvat een meer gedetailleerde analyse van de kenmerken van de kwaliteit van de accountantscontrole.


\[^{41}\] Deloitte, EY, KPMG en PwC.

\[^{42}\] Door de verplichte rotatie valt de zittende externe accountant af, waardoor er nog maar drie overblijven. Wanneer één van deze drie partijen de huidige belastingadviseur is, blijven er nog maar twee over waaruit de OOB kan kiezen.
DeAngelo (1981) definiert de kwaliteit van de accountantscontrole als ‘de kans dat een externe accountant een fout in de financiële rapportage van een klant ontdekt en dat de externe accountant de ontdekte fout ook rapporteert’.

Uit deze definitie blijkt dat volgens DeAngelo (1981) de kwaliteit van de accountantscontrole en de onafhankelijkheid van de accountant twee afzonderlijke kenmerken zijn die sterk met elkaar verbonden zijn. Daarom worden deze kenmerken beide meegenomen in dit onderzoek.

Uit de analyse is gebleken dat er een aantal directe maatregelen zijn om de kwaliteit van de accountantscontrole te meten, zoals het aantal faillissementen (Geiger en Raghunandan (2002)), kwaliteitscontrolebeoordelingen (Deis en Giroux (1992)), bureaubeoordelingen (O’Keefe en Westort (1992)) en SEC-handhavingsacties (Dechow, Sloan en Sweeney (1996)).


Een aantal van deze indirecte maatregelen, zoals ‘onafhankelijkheid en expertise van de leden van het Auditcomité’ of ‘de duur van de auditrelatie’ kunnen niet beïnvloed worden door een inkoopproces. Daarom zal getoetst worden of de selectiecriteria die gebruikt worden door de betrokkenen in het selectieproces gekoppeld kunnen worden aan de overige indirecte maatregelen, die wel beïnvloed kunnen worden door een inkoopproces, om de kwaliteit van de accountantscontrole te meten.
Ook is gebleken, volgens Nadere Voorschriften Onafhankelijk (NVO (2006))\(^{43}\), dat een externe accountant ten eerste onafhankelijk is wanneer hij of zij de mogelijkheid heeft om onafhankelijke beslissingen te nemen. Ten tweede moet een externe accountant ook in schijn onafhankelijk te zijn.

Uit verschillende onderzoeken, DeAngelo (1981), Dart (2011), Hollingsworth en Li (2012), blijkt dat de gepercipieerde onafhankelijkheid van de externe accountant aangetast wordt door de levering van niet-auditdiensten en de daaraan verbonden honoraria. Echter, de nieuwe wetgeving in Nederland zorgt ervoor dat de externe accountant, conform Plasterk, Irrgang en Braakhius (2012) en De Vliet (2012), geen niet-auditdiensten mag leveren. Derhalve is deze bedreiging als zodanig niet langer van toepassing op de Nederlandse situatie en daarom wordt getoetst, zoals blijkt uit de researchvragen, of het selectieproces van invloed is op de gepercipieerde onafhankelijkheid van de externe accountant.

**De principal agency-theorie en de impact ervan op de externe accountant**

Hoofdstuk 4 geeft aan dat op basis van de principal agency-theorie de aandeelhouder van een onderneming de opdrachtgever, de principal, is van de externe accountant en dat de externe accountant als zodanig optreedt als agent voor rekening van de aandeelhouder. Ook blijkt dat de principal agency-theorie gebruikt kan worden om de doelstellingen beter te definiëren. Daarom wordt in het onderzoek getoetst hoe de principal agency-theorie van toepassing is op de betrokkenen in het selectieproces.

**De inkooptheorie**


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\(^{43}\) Sinds 2014 is in Nederland de Verordening Inzake de onafhankelijkheid van accountants bij assurance-opdrachten (ViO) van toepassing op Nederlandse externe accountants. De ViO was echter nog niet van toepassing gedurende de uitvoering van dit onderzoek en daarom wordt deze niet beschouwd als input voor dit onderzoek.
Volgens Causholli et al. (2012) kunnen de diensten van de externe accountant gezien worden als een ‘credence good’, omdat de kopers te weinig informatie hebben om de kwaliteit te kunnen bepalen. Als gevolg hiervan zullen kopers volgens Causholli et al. (2012) waarschijnlijk kiezen voor de meest efficiënte accountant (i.e. de goedkoopste), omdat de prijs het enige criterium is dat objectief gemeten kan worden. Daarom wordt gedurende het onderzoek getoetst welke selectiecriteria het belangrijkst zijn en hoe de kwaliteit van de accountantscontrole gemeten wordt door de betrokkenen.

Daarnaast maakt hoofdstuk 5 duidelijk dat er nog geen onderzoek is gedaan naar de selectiecriteria die gebruikt worden in een situatie waarin bedrijven verplicht zijn om te wisselen van externe accountant. Tevens blijkt dat de externe accountant functioneert binnen ten minste een triade, een accountant heeft meerdere opdrachtgevers, en dat een triade impact kan hebben op de kwaliteit van dienstverlening, omdat een leverancier tegemoet wil komen aan de doelstellingen van meerdere opdrachtgevers, zelfs als deze niet overeenkomen.

Tot slot blijkt uit hoofdstuk 5 dat de diensten van de externe accountant niet passen in het buyer-seller interaction model zoals geëntoerd door Wynstra et al. (2006). Dit wordt voornamelijk veroorzaakt door het feit dat de aandeelhouder de belangrijkste klant is van de accountantscontrole. De aandeelhouders als klant komt echter niet overeen met de definitie zoals gebruikt door Wynstra et al. (2006) die het model gebaseerd heeft op een eindklant, een klant die diensten of producten koopt van de onderneming. Op basis hiervan lijkt het erop dat het buyer-seller interaction model aangepast dient te worden, hetgeen onderzocht wordt in het onderzoek.

**Opzet van het onderzoek**

Hoofdstuk 6 beschrijft de onderzoeksmethodieken die gebruikt zijn voor het onderzoek.


Op basis van de doelstelling van dit onderzoek, om kennis en inzicht te krijgen in de manier waarop de diensten van de externe accountant worden geselecteerd door beursgenoteerde OOB’s in Nederland en hoe de selectieprocessen, volgens de betrokken partijen in het selectieproces, de gepercipieerde onafhankelijkheid van de accountant en de gepercipieerde kwaliteit van de accountantscontrole beïnvloeden zoals gepercipieerd door de aandeelhouders en de bevindingen uit het literatuuronderzoek, zijn de volgende researchvragen opgesteld:
1) Welke diensten worden volgens de betrokkenen in het selectieproces geleverd door de externe accountant?

2) Wat zijn volgens de betrokkenen in het selectieproces de klanten van diensten van de externe accountant?

3) Welke stakeholders zijn betrokken bij het selectieproces van de accountant en wat zijn de doelstellingen van deze betrokkenen?

4) Hoe classificeren, in lijn met de inkooptheorieën, de betrokkenen in het selectieproces de dienstverlening en de markt van de externe accountant?

5) Wat voor selectieproces gebruiken de betrokkenen in het selectieproces om een externe accountant te kiezen?

6) Welke rollen vervullen de betrokkenen in het selectieproces van de externe accountant?

7) Welke selectiecriteria worden gebruikt door de betrokkenen in het selectieproces en hoe zijn deze gerelateerd aan de kwaliteitscriteria die gebruikt worden om de kwaliteit van de financiële audit te bepalen?

8) Wat is de invloed van het selectieproces, volgens de betrokkenen in het selectieproces, op de kwaliteit van de accountantscontrole zoals die ervaren wordt door de aandeelhouder en wat is de impact van de nieuwe wetgeving?

9) Wat is de invloed van het selectieproces, volgens de betrokkenen in het selectieproces, op de gepercipieerde onafhankelijkheid van de externe accountant en wat is de impact van de nieuwe wetgeving?

Ook wordt in hoofdstuk 6 aangegeven dat er gebruikgemaakt wordt van de Matrixmethode. De Matrixmethode is volgens Groenland et al. (2010) ‘een analysebenadering voor procesanalyse op basis van eenmalige interviews. Dat wil zeggen: de verschillende stappen in het besluitvormingsproces die in het conceptuele model worden beschreven, worden in de interviews deels op basis van gedrag en ervaring in het verleden en deels op basis van hypothetisch toekomstig gedrag nagevraagd’.

Tevens wordt aangegeven hoe het conceptuele model, een gestileerde voorstelling van de wereld en de data die verzameld dienen te worden, gebruikt is om een checklist (een lijst met gespreksthema’s, vragen en aanwijzingen voor de interviewer) te ontwerpen die gebruikt wordt voor de dataverzameling. Daarnaast wordt aangegeven dat de data verzameld zijn op basis van 30 half gestructureerde interviews, waarbij er ruimte is voor onvoorziene antwoorden van de personen die geïnterviewd worden.

Tot slot wordt uitgelegd hoe de data van de interviews uitgewerkt worden in een datamatrix en dat de analyses gepresenteerd worden d.m.v. Harvey balls zoals gepresenteerd in figuur 28.

Figuur 28: Harvey balls.
De resultaten van de interviews

In hoofdstuk 7 worden de verschillende resultaten op de vragen uit de checklist (zie Appendix C: Checklist for the qualitative interviews), conform het onderzoeksmodel weergegeven. De belangrijkste bevindingen van het onderzoek zijn:

1) De verschillende betrokkenen in het selectieproces van de externe accountant hebben een andere perceptie ten aanzien van de dienstverlening van de externe accountant.

2) De verschillende betrokkenen in het selectieproces van de externe accountant hebben een andere perceptie ten aanzien van de klanten van de dienstverlening van de externe accountant.

3) De betrokkenen in het selectieproces hebben verschillende doelstellingen en deze doelstellingen zijn van invloed op:
   a. de selectiecriteria die gebruikt worden in het selectieproces;
   b. de rollen die de betrokkenen innemen in het selectieproces.

4) De betrokkenen in het selectieproces maken gebruik van selectiecriteria die een transitie van externe accountant versnellen. Tevens worden selectiecriteria, zoals ‘het aantal uren dat de externe accountant gebruikt’, gebruikt om de kosten van de externe accountant te verlagen en niet om de kwaliteit van de accountantscontrole te verhogen.


6) De betrokkenen in het selectieproces weten niet goed hoe ze de kwaliteit van de accountantscontrole kunnen vaststellen.

7) De betrokkenen in het selectieproces hebben geen eenduidig beeld van de wijze waarop het selectieproces de gepercipieerde kwaliteit van de accountantscontrole gaat verhogen. Tevens blijkt dat de aandeelhouders verwachten dat zij een grotere betrokkenheid in het selectieproces krijgen om de gepercipieerde kwaliteit van de accountantscontrole te verhogen.

8) De meeste betrokkenen in het selectieproces zijn van mening dat de nieuwe wetgeving de gepercipieerde kwaliteit van de accountantscontrole gaat verlagen.

9) De meeste betrokkenen zijn van mening dat het selectieproces geen negatieve impact heeft op de gepercipieerde onafhankelijkheid van de externe accountant. Echter, op hetzelfde moment verwachten de aandeelhouders door een grotere betrokkenheid van het Auditcomité en de aandeelhouders in het selectieproces de gepercipieerde onafhankelijkheid van de externe accountant te verhogen.

10) De betrokkenen in het selectieproces hebben geen eenduidig beeld van hoe de nieuwe wetgeving de gepercipieerde onafhankelijkheid van de externe accountant gaat verhogen.
De conclusie van het onderzoek

Hoofdstuk 8 beschrijft de conclusie van dit onderzoek. Op basis van de resultaten op de onderzoeksvragen kan geconcludeerd worden dat het selectieproces dat OOB’s gebruiken voor het selecteren van de externe accountantsdiensten een daling van de gepercipieerde kwaliteit van de accountantscontrole kan veroorzaken. Tevens blijkt dat het selectieproces mogelijk een negatieve invloed heeft op de gepercipieerde onafhankelijkheid van de externe accountant gezien de selectiecriteria die gebruikt worden door de OOB’s om de transitie van externe accountants te versnellen.

De daling van de gepercipieerde kwaliteit van de accountantscontrole en de impact op de gepercipieerde onafhankelijkheid van de accountant kunnen worden veroorzaakt doordat de betrokkenen in het selectieproces allemaal verschillende perspectieven hebben ten aanzien van de dienstverlening en de klanten van de dienstverlening van de externe accountant.

Tegelijkertijd kan worden geconcludeerd dat de nieuwe Nederlandse wet de gepercipieerde kwaliteit van de accountantscontrole en/of de gepercipieerde onafhankelijkheid niet verbetert. Natuurlijk zorgt de nieuwe wetgeving ervoor dat de externe accountant geen andere diensten mag leveren, maar de verplichte rotatie zal het aantal beschikbare leveranciers verminderen en dit kan een bedreiging voor de gepercipieerde onafhankelijkheid van de externe accountant vormen.

Dit onderzoek toont ook aan dat de belanghebbende betrokkenen in het selectieproces een sequentiële selectieproces gebruiken in plaats van een op prestatie-inkoop gericht selectieproces. Door gebruik te maken van een sequentiële selectiemethode kunnen de belanghebbenden beperkt onderscheid maken tussen de diensten van de verschillende externe accountants met als gevolg dat er een grote focus ligt op het selecteren van een externe accountant op basis van de laagste kosten.

Het verlagen van accountantskosten wordt door de betrokkenen onder andere bereikt door het verlagen van audittarieven of door het verminderen van de reikwijdte (scope) van de externe audit. Een vermindering van de omvang van de externe controle is mogelijk niet in lijn met het belang van de aandeelhouder. Echter, de betrokkenheid van de aandeelhouder in het selectieproces is beperkt en wordt door de andere betrokkenen als een formaliteit (een

44 Conform de nieuwe wet
hamerstuk) gezien. Het gevolg hiervan is dat de aandeelhouder geen controle heeft over de reikwijdte van de externe audit.

Daarnaast is gebleken dat de externe accountant dient te opereren in een complexe relatie met minimaal drie opdrachtgevers: aandeelhouder, Auditcomité/Raad van Commissarissen en CFO. Een dergelijke structuur kan zeer complex zijn en zou kunnen leiden, zoals bevestigd door Tate et al. (2009), tot verminderd functioneren van een leverancier omdat al deze opdrachtgevers andere, soms tegenstrijdige (zoals blijkt uit het onderzoek), doelstellingen kunnen hebben en het voor een leverancier moeilijk is om aan al deze doelstellingen te voldoen.

Tot slot toont dit onderzoek aan dat de werkzaamheden van de betrokkenen in het selectieproces ook gecontroleerd worden door de externe accountant. Als zodanig gaf een Auditcomité-lid tijdens het interview aan dat het huidige selectieproces geclassificeerd kan worden als “A turkey voting for Christmas // Een kalkoen die voor Kerstmis kiest”.

Praktische en theoretische implicaties

In hoofdstuk 9 wordt een aantal aanbevelingen gedaan ten aanzien van het selectieproces voor de dienstverlening van de externe accountant. Zo wordt er geadviseerd om het selectieproces anders vorm te geven en om de aandeelhouders sterker te betrekken in het selectieproces zoals weergegeven in figuur 29.

Figuur 29: Inkoopproces door Reijniers et al. (2009) inclusief additionele stappen om de buyer-seller interaction te optimaliseren.

Dit proces is verder uitgewerkt in Appendix D: Checklist for external financial audit selection.

Ook wordt er geadviseerd om meer gebruik te maken van prestatie-inkoop om ervoor te zorgen dat de kwaliteit van de accountantscontrole en het onderscheidend vermogen van de externe accountants een belangrijkere rol spelen in het selectieproces. Er wordt een aantal handvatten gegeven om een dergelijke prestatie-inkoop in te voeren in het selectieproces.

Elk selectieproces staat of valt echter met de aanwezigheid bij de betrokkenen van een eenduidige visie op de dienstverlening van de externe accountant en de klanten die deze dienstverlening ontvangen. Zolang de betrokkenen in het selectieproces geen eenduidig beeld
hebben, zal het selectieproces niet leiden tot een optimale gepercieerde kwaliteit van de accountantscontrole.

Belangrijke theoretische implicaties van het onderzoek zijn:

1) De selectiecriteria die gebruikt worden in een situatie van een verplichte accountantsrotatie zijn anders dan in een situatie van verplicht tenderen. Selectiecriteria bij een accountantsrotatie zijn onder andere ook gefocust op het effectief wisselen van een externe accountant waarbij de risico’s voor de onderneming geminimaliseerd worden.

2) De selectiecriteria die gebruikt worden door alle betrokkenen in het selectieproces kennen een andere volgorde dan de selectiecriteria in eerdere onderzoeken. Dit wordt veroorzaakt door het feit dat dit onderzoek kijkt naar alle betrokkenen in het selectieproces en de overige onderzoeken een focus hadden op een subgroep van betrokkenen in het selectieproces.

3) De accountantscontrole beïnvloedt zeer waarschijnlijk de winst en de going-concern status van een onderneming indien de externe accountant geen goedkeurende verklaring bij de jaarrekening afgeeft. Als zodanig zou ‘impact op waarde van de onderneming’ toegevoegd kunnen worden als een van de ‘profit impact’-criteria van de Kraljic Matrix (1983).


**Biography**

John Tros is 45 years young, married to Ylze and they have two children, Lyzanne (14) and Karlyn (12). In his spare time, as well as spending time with his family, John likes good food, skiing and especially riding his mountain bikes. In wintertime, he likes to participate in bicycle matches on the beach and ski in the Austrian Alps.

John is a partner with KPMG in the Netherlands and he is responsible for the Strategic Sourcing & Procurement advisory practice in the Netherlands. He is also part of the KPMG Global Strategic Sourcing & Procurement Team.

As part of his Dutch role, he is responsible for providing Strategic Sourcing & Procurement services to clients who like to extract more value out of their supply base. As such, John and his team have supported numerous clients both in indirect and direct spending in different industries such as Telecoms, Chemicals, Retail, Banking, Insurances, Transport & Logistics, Energy & Utilities and finally Production & Manufacturing.

John previously worked for PwC, where he spent three years as Business Development Director for Europe and the Middle East. He led, as part of this role, many commercial bid processes such as external financial audit, tax and consultancy proposals. John also worked for three years for Delta Lloyd Group as Chief Procurement Officer and for 10 years at ABN AMRO Bank in different roles such as Global Category Manager for Professional & HR services, Payments & Cash Management Consultant and Project Manager.

John was initially educated at the Royal Naval Academy (KIM), which he left after two years. John graduated from the Higher Institute of Trade & Economics in Alkmaar in 1995 after which he completed an MBA (coming third in his class) at Nyenrode Business University in 2000.
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Appendix A: List of Dutch listed companies

Auditor changes by listed companies (AEX)\(^{45}\)

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✓ = Mandatory auditor change before 1 January 2016  
... = Auditor change  
*= Does not constitute a Dutch OOB

### Auditor changes by listed OOBs (AMX)\(^{46}\)

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✓ = Mandatory auditor change before 1 January 2016
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= Does not constitute as an OOB

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Auditor changes by listed OOBs (AScX)\(^{47}\)

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<tr>
<td>64</td>
<td>Kardan</td>
<td>E&amp;Y</td>
<td>E&amp;Y</td>
<td>✓</td>
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<tr>
<td>65</td>
<td>Kas Bank</td>
<td>KPMG</td>
<td>KPMG</td>
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<td>66</td>
<td>Kendrion</td>
<td>KPMG</td>
<td>KPMG</td>
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<tr>
<td>67</td>
<td>LBI International</td>
<td>-</td>
<td>PWC</td>
<td>✓</td>
</tr>
<tr>
<td>68</td>
<td>Macintosh Retail</td>
<td>E&amp;Y</td>
<td>E&amp;Y</td>
<td>✓</td>
</tr>
<tr>
<td>69</td>
<td>Nedap</td>
<td>KPMG</td>
<td>KPMG</td>
<td>✓</td>
</tr>
<tr>
<td>70</td>
<td>Ordina</td>
<td>PWC</td>
<td>PWC</td>
<td>✓</td>
</tr>
<tr>
<td>71</td>
<td>Pharming Group</td>
<td>E&amp;Y</td>
<td>PWC</td>
<td>✓</td>
</tr>
<tr>
<td>72</td>
<td>RoodMicrotec</td>
<td>Mazars</td>
<td>Mazars</td>
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<tr>
<td>73</td>
<td>Sligro</td>
<td>KPMG</td>
<td>KPMG</td>
<td>✓</td>
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<tr>
<td>74</td>
<td>TKH Groupx</td>
<td>Deloitte</td>
<td>Deloitte</td>
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</tr>
<tr>
<td>75</td>
<td>Xeikon</td>
<td>BDO</td>
<td>BDO</td>
<td>✓</td>
</tr>
</tbody>
</table>

✓ = Mandatory auditor change before 1 January 2016

... = Auditor change

... = Does not constitute as an OOB

# Appendix B: List of persons interviewed

<table>
<thead>
<tr>
<th>Name</th>
<th>Date</th>
<th>Role</th>
<th>Company</th>
<th>Auditor</th>
<th>Included in empirical research</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marcel Pheijffer</td>
<td>18 July 2012</td>
<td>Professor</td>
<td>Nyenrode</td>
<td>N/A</td>
<td>No*</td>
</tr>
<tr>
<td>Geert Kosten</td>
<td>23 July 2012</td>
<td>Lawyer at VEB NCVB</td>
<td>VEB</td>
<td>N/A</td>
<td>No*</td>
</tr>
<tr>
<td>Marianne van der Zijde</td>
<td>24 July 2012</td>
<td>Manager</td>
<td>AFM</td>
<td>N/A</td>
<td>No*</td>
</tr>
<tr>
<td>Emiel Roozen</td>
<td>19 June 2013</td>
<td>CFO</td>
<td>Delta Lloyd</td>
<td>EY</td>
<td>Yes</td>
</tr>
<tr>
<td>Gosse Boon</td>
<td>15 July 2013</td>
<td>CFO</td>
<td>Nutreco</td>
<td>KPMG</td>
<td>Yes</td>
</tr>
<tr>
<td>Fred Arp</td>
<td>16 August 2013</td>
<td>CFO</td>
<td>TMG</td>
<td>Deloitte</td>
<td>Yes</td>
</tr>
<tr>
<td>Reinier Vree</td>
<td>12 July 2013</td>
<td>CFO</td>
<td>Arcadis</td>
<td>KPMG</td>
<td>Yes</td>
</tr>
<tr>
<td>Rolf Kooijman</td>
<td>16 July 2013</td>
<td>CFO</td>
<td>Kasbank</td>
<td>KPMG</td>
<td>No**</td>
</tr>
<tr>
<td>Ronald Merckx</td>
<td>14 June 2013</td>
<td>CFO</td>
<td>Wessanen</td>
<td>Deloitte</td>
<td>Yes</td>
</tr>
<tr>
<td>Dirk Anbeek</td>
<td>29 August 2013</td>
<td>CEO</td>
<td>Wereldhave</td>
<td>PWC</td>
<td>Yes</td>
</tr>
<tr>
<td>Erik van der Meijden</td>
<td>28 June 2013</td>
<td>CEO</td>
<td>Exact</td>
<td>KPMG</td>
<td>Yes</td>
</tr>
<tr>
<td>Rob Zandbergen</td>
<td>21 August 2013</td>
<td>CEO</td>
<td>USG People</td>
<td>PWC</td>
<td>Yes</td>
</tr>
<tr>
<td>Taco de Groot</td>
<td>20 June 2013</td>
<td>CEO</td>
<td>Vastned</td>
<td>Deloitte</td>
<td>Yes</td>
</tr>
<tr>
<td>Vincent de Bok</td>
<td>9 July 2013</td>
<td>CEO</td>
<td>Neways</td>
<td>EY</td>
<td>Yes</td>
</tr>
<tr>
<td>Jan Voskuilen</td>
<td>16 July 2013</td>
<td>IAD</td>
<td>Kasbank</td>
<td>KPMG</td>
<td>No**</td>
</tr>
<tr>
<td>Marjo van Ool</td>
<td>17 July 2013</td>
<td>IAD</td>
<td>Akzo</td>
<td>KPMG</td>
<td>Yes</td>
</tr>
<tr>
<td>Michel Kee</td>
<td>27 August 2013</td>
<td>IAD</td>
<td>TNT</td>
<td>PWC</td>
<td>Yes</td>
</tr>
<tr>
<td>Paul Grimmelkhuizen</td>
<td>9 July 2013</td>
<td>IAD</td>
<td>PostNL</td>
<td>PWC</td>
<td>Yes</td>
</tr>
<tr>
<td>Piet Vrolijk</td>
<td>13 August 2013</td>
<td>IAD</td>
<td>KPN</td>
<td>PWC</td>
<td>Yes</td>
</tr>
<tr>
<td>Vincent Moolenaar</td>
<td>27 August 2013</td>
<td>IAD</td>
<td>Ahold</td>
<td>PWC</td>
<td>Yes</td>
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<tr>
<td>Fredrick Spalcke</td>
<td>8 July 2013</td>
<td>CPO</td>
<td>Philips</td>
<td>KPMG</td>
<td>Yes</td>
</tr>
<tr>
<td>Jan Fokke van den Bosch</td>
<td>17 July 2013</td>
<td>CPO</td>
<td>ING Bank</td>
<td>EY</td>
<td>Yes</td>
</tr>
<tr>
<td>John Werry</td>
<td>10 July 2013</td>
<td>CPO</td>
<td>Ziggo</td>
<td>EY</td>
<td>Yes</td>
</tr>
<tr>
<td>No.</td>
<td>Name</td>
<td>Date</td>
<td>Position</td>
<td>Company/Institution</td>
<td>Consultant</td>
</tr>
<tr>
<td>-----</td>
<td>-----------------------------</td>
<td>---------------------</td>
<td>-----------------------------------------</td>
<td>----------------------------------------------------------</td>
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<tr>
<td>24</td>
<td>Wim Bloks</td>
<td>18 September 2013</td>
<td>CPO</td>
<td>Vopak</td>
<td>PWC</td>
</tr>
<tr>
<td>25</td>
<td>Mark Lindeman</td>
<td>12 September 2013</td>
<td>Global Category Manager</td>
<td>Heineken</td>
<td>KPMG</td>
</tr>
<tr>
<td>26</td>
<td>Monique Beersma &amp; Ton Geurst</td>
<td>12 September 2012</td>
<td>Head of Indirect Spend/CPO</td>
<td>AKZO</td>
<td>KPMG</td>
</tr>
<tr>
<td>27</td>
<td>Ben van der Veer</td>
<td>13 August 2013</td>
<td>Audit Committee member</td>
<td>Aegon, Reed Elsevier NV, TomTom</td>
<td>EY Deloitte</td>
</tr>
<tr>
<td>28</td>
<td>Henk van Dalen</td>
<td>11 July 2013</td>
<td>Audit Committee member</td>
<td>Macintosh Retail Group</td>
<td>EY</td>
</tr>
<tr>
<td>29</td>
<td>Jan van den Belt</td>
<td>16 July 2013</td>
<td>Audit Committee member</td>
<td>Accell Group, Fugro</td>
<td>Deloitte</td>
</tr>
<tr>
<td>30</td>
<td>Tom de Swaan</td>
<td>4 September 2013</td>
<td>Audit Committee member</td>
<td>DSM, Ahold</td>
<td>EY PwC</td>
</tr>
<tr>
<td>31</td>
<td>Dirk Lindenbergh</td>
<td>12 September 2013</td>
<td>Audit Committee member</td>
<td>Docdata, BE Semiconductor Industries, DPA Group</td>
<td>KPMG KPMG</td>
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<tr>
<td>32</td>
<td>Felix Lanters</td>
<td>11 October 2013</td>
<td>Head of Long-term Equity Strategy</td>
<td>PGGM</td>
<td>N/A</td>
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<tr>
<td>33</td>
<td>Geert Jan Hoppers</td>
<td>25 September 2013</td>
<td>Portfolio Manager – Equities</td>
<td>Delta Lloyd Group</td>
<td>N/A</td>
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<tr>
<td>34</td>
<td>Geert Koster</td>
<td>16 September 2013</td>
<td>Lawyer</td>
<td>VEB</td>
<td>N/A</td>
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<tr>
<td>35</td>
<td>Rients Abma</td>
<td>6 September 2013</td>
<td>Director</td>
<td>Stichting Eumedion</td>
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<td>36</td>
<td>Frederik van Beuningen</td>
<td>25 October 2013</td>
<td>Owner</td>
<td>Teslin Capital Management</td>
<td>N/A</td>
</tr>
</tbody>
</table>

*) Was part of the theoretical research.
**) Interview was conducted together and as a result could not be seen as mutually exclusive.
***) Was seen as an expert interview to test some findings.
<table>
<thead>
<tr>
<th>No.</th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Which services are delivered by the external financial auditor?</td>
</tr>
<tr>
<td>2</td>
<td>What are the formal objectives of the services provided by the external financial auditor?</td>
</tr>
<tr>
<td>3</td>
<td>What are the informal objectives of the services provided by the external financial auditor?</td>
</tr>
<tr>
<td>4</td>
<td>Who are the clients of the services provided by the external financial auditor?</td>
</tr>
<tr>
<td>5</td>
<td>What are the formal objectives of these clients regarding the services provided by the external financial auditor?</td>
</tr>
<tr>
<td>6</td>
<td>What are the informal objectives of these clients regarding the services provided by the external financial auditor?</td>
</tr>
<tr>
<td>7</td>
<td>What is the order of importance of these clients and why?</td>
</tr>
<tr>
<td>8</td>
<td>Which of the following criteria are applicable to the external financial auditor market and why?</td>
</tr>
<tr>
<td></td>
<td>a) Is there a shortage of qualified personnel in the external financial auditor market?</td>
</tr>
<tr>
<td></td>
<td>b) Do duty regulations impact or limit the market?</td>
</tr>
<tr>
<td></td>
<td>c) Can you substitute the services of the external financial auditor?</td>
</tr>
<tr>
<td></td>
<td>d) Is the reputation of the supplier important?</td>
</tr>
<tr>
<td></td>
<td>e) Do the services contain a storage risk?</td>
</tr>
<tr>
<td></td>
<td>f) Is on time delivery important?</td>
</tr>
<tr>
<td></td>
<td>g) Is there a competitive demand in the market?</td>
</tr>
<tr>
<td></td>
<td>h) Is logistical knowledge important?</td>
</tr>
<tr>
<td></td>
<td>i) Are there cultural differences and do they play an important part in the selection?</td>
</tr>
<tr>
<td></td>
<td>j) Does a company have “make or buy” opportunities related to the services of the external financial auditor?</td>
</tr>
<tr>
<td></td>
<td>k) Do payment conditions impact the market?</td>
</tr>
<tr>
<td></td>
<td>l) Can supply interruptions occur and do they impact a selection?</td>
</tr>
<tr>
<td></td>
<td>m) Are there enough suppliers?</td>
</tr>
<tr>
<td></td>
<td>n) Do the services of the external financial auditor have an impact on business growth?</td>
</tr>
<tr>
<td></td>
<td>o) What is the percentage of a company’s total costs?</td>
</tr>
<tr>
<td></td>
<td>p) Do the services of the external financial auditor have an impact on product quality?</td>
</tr>
<tr>
<td></td>
<td>q) Do you expect a growth in demand and/or a volume purchased?</td>
</tr>
<tr>
<td></td>
<td>r) Are there other market conditions that affect the market?</td>
</tr>
<tr>
<td>9</td>
<td>Is the reputation of an external auditor important for a company? How do you define important?</td>
</tr>
<tr>
<td>10</td>
<td>Have the services provided by the external financial auditor an impact of the reputation of the company? Why?</td>
</tr>
<tr>
<td>11</td>
<td>Where would you position the services provided by the external financial auditor in the Kraljic Matrix?</td>
</tr>
<tr>
<td>12</td>
<td>Which selection criteria would you use to select the external financial auditor?</td>
</tr>
<tr>
<td>13</td>
<td>What is the order of importance of these selection criteria and why?</td>
</tr>
<tr>
<td>14</td>
<td>Which parties are involved in the buying process of the external financial auditor?</td>
</tr>
<tr>
<td>15</td>
<td>What are the formal objectives of the services of these parties?</td>
</tr>
<tr>
<td>16</td>
<td>What are the informal objectives of the services of these parties?</td>
</tr>
<tr>
<td>17</td>
<td>Describe the buying process you would use to buy the services of the external financial auditor?</td>
</tr>
<tr>
<td>18</td>
<td>Who of these parties will determine how the external financial auditor will be bought? Why?</td>
</tr>
<tr>
<td>19</td>
<td>Which of the parties decides on the specification of the external financial auditor?</td>
</tr>
<tr>
<td>20</td>
<td>Which of these parties will determine which selection criteria will be used and why?</td>
</tr>
<tr>
<td>21</td>
<td>Which of these parties will prepare the documents that will be used in the buying process and why?</td>
</tr>
<tr>
<td>22</td>
<td>Who of these parties will facilitate the buying process and why?</td>
</tr>
<tr>
<td>23</td>
<td>Which of the parties will determine which external financial auditors are allowed to participate in the selection process (i.e. the long list) and why?</td>
</tr>
<tr>
<td>24</td>
<td>Which of the parties will determine which external financial auditors are allowed to participate in the selection process (i.e. the shortlist) and why?</td>
</tr>
<tr>
<td>25</td>
<td>Which of the parties will enter into the financial negotiations and why?</td>
</tr>
<tr>
<td>26</td>
<td>Who of the parties involved will determine which external financial auditor will be selected?</td>
</tr>
<tr>
<td>27</td>
<td>How does the buying process described contribute to auditor independence?</td>
</tr>
<tr>
<td>28</td>
<td>What would you like to change to the buying process to increase auditor independence?</td>
</tr>
<tr>
<td>29</td>
<td>How do you measure audit quality?</td>
</tr>
<tr>
<td>30</td>
<td>How does the buying process described contribute to the quality of services perceived by the Shareholder?</td>
</tr>
<tr>
<td>31</td>
<td>What would you like to change in the buying process to increase the quality of services perceived by the Shareholder?</td>
</tr>
<tr>
<td>32</td>
<td>How would Shareholders be assured of the quality of services if the price of the external financial audit were to be reduced?</td>
</tr>
<tr>
<td>33</td>
<td>How will new audit legislation change the described buying process?</td>
</tr>
<tr>
<td>34</td>
<td>What is the impact of the new legislation on auditor independence?</td>
</tr>
<tr>
<td>35</td>
<td>What is the impact of the new legislation on the quality of services received by the Shareholder?</td>
</tr>
<tr>
<td>36</td>
<td>Why do listed OOBs select a Big4 firm?</td>
</tr>
</tbody>
</table>
## Appendix D: Checklist for external financial audit selection

<table>
<thead>
<tr>
<th>Phase of selection process</th>
<th>Step</th>
<th>Document</th>
<th>Description</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategy development</td>
<td>1</td>
<td>Roles &amp; responsibilities</td>
<td>A document that clearly describes the roles and responsibilities of the stakeholders involved in the selection process</td>
<td>Audit Committee</td>
</tr>
<tr>
<td></td>
<td>2</td>
<td>Market analyses</td>
<td>Analysis of the supply market and a description of services that might be bought</td>
<td>Audit Committee</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>What are the services provided by the external financial auditor</td>
<td>Ensure that the stakeholders involved in the selection process know the objectives the external financial auditor should meet in order to meet the objectives of the clients for the external financial auditor’s services</td>
<td>Audit Committee</td>
</tr>
<tr>
<td></td>
<td>4</td>
<td>Who is the client of the services delivered by provider</td>
<td>Ensure that the stakeholders involved in the process for selecting the external financial auditor all have a common understanding and agreement on the client of the services of the external financial auditor</td>
<td>Audit Committee</td>
</tr>
</tbody>
</table>

**Do not proceed to the next step before all stakeholders in the selection process have agreement on steps 3 and 4.**

### Define specification

<table>
<thead>
<tr>
<th>Step</th>
<th>Document</th>
<th>Description</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Functional requirement set</td>
<td>A document that describes clearly the scope of the services that the company wants to buy</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>6</td>
<td>Purchasing strategy</td>
<td>A document that describes, based on the market analyses and functional requirement set, the purchasing strategy &amp; selection process that will be implemented and used to buy the services</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>7</td>
<td>Selection criteria</td>
<td>A document that describes the selection criteria that will be used in the selection process</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>8</td>
<td>Long list</td>
<td>A list of potential suppliers, based on the market analysis, that will be invited to participate in the selection process</td>
<td>Audit Committee</td>
</tr>
</tbody>
</table>
| 9    | Selection briefing document | Prepared document for selection approval for the General Meeting of Shareholders. The document should contain:  
- The scope of the external financial audit which the Audit Committee would like to receive from external financial auditor in comparison to the current scope of the external financial audit;  
- The selection criteria that the Audit Committee would like to use for the selection of the external financial auditor, the way the selection criteria would be evaluated and the weight each selection criteria would have in an overall weighing;  
- The persons/representatives that will be involved in the selection of the external financial auditor, the role of these representatives and the way the selection process would be conducted;  
- The external financial audit firms that will be invited to participate in the selection process and reasons why certain firms are included and/or excluded. | Audit Committee |
| 10   | Approval of General Meeting of Shareholders | Obtaining approval from the General Meeting of Shareholders to conduct the selection process according the selection briefing document | Audit Committee |

**Do not proceed to the next step before the General Meeting of Shareholders has approved selection briefing document.**

### Select supplier

<table>
<thead>
<tr>
<th>Step</th>
<th>Document</th>
<th>Description</th>
<th>Responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>11</td>
<td>Request for information (RFI)</td>
<td>A document used by buyers to obtain more information on the supply market and product/services available and to make a first selection of possible suppliers</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>12</td>
<td>RFI answer document</td>
<td>A document that contains all questions received by potential suppliers during the RFI and which is shared with all potential suppliers during the selection process</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>13</td>
<td>RFI evaluation</td>
<td>A document that consists of an analysis of the proposals received by potential suppliers based on the selection criteria defined earlier and that determines the potential suppliers that will receive a RFP</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>14</td>
<td>Shortlist</td>
<td>A list of potential suppliers that will be invited to participate in the RFP phase of the selection process</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>15</td>
<td>RFP</td>
<td>A document used by buyers to obtain more information on the supply market and to make a first selection of possible suppliers</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>16</td>
<td>RFP answer document</td>
<td>A document that contains all the questions received by potential suppliers during the RFP and which is shared with all potential suppliers during the selection process</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>17</td>
<td>Pre-selection</td>
<td>A document that consists of an analysis of the proposals received by potential suppliers based on the selection criteria defined earlier and that determines the potential suppliers that will be invited to participate in a contracting phase</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>18</td>
<td>Negotiation strategy</td>
<td>A document that describes the approved negotiation strategy</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>19</td>
<td>Selection</td>
<td>A document that consists of an analysis of negotiation process and that determines the suppliers to be contracted</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>20</td>
<td>Selection presentation by Audit Committee</td>
<td>After the selection process is concluded the outcome of the process should be presented to the General Meeting of Shareholders to receive approval to contract the external financial auditor. This presentation should contain the subjects as mentioned in step 9 but also should include the deviations from the agreement given by the Shareholders in step 10 so that the Shareholder can check if the selection process is conducted according to the approval given</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>21</td>
<td>Selection presentation by external financial auditor</td>
<td>The selected external financial auditor should present during the General Meeting of Shareholders the outcome of the selection process. During this presentation the external financial auditor should confirm that it will conduct an external financial audit given the proposed scope and that it is capable of doing this given for the contracted amount</td>
<td>Audit Committee</td>
</tr>
<tr>
<td>22</td>
<td>Approval of General Meeting of Shareholders</td>
<td>Gain approval of the General Meeting of Shareholders to contract the selected external financial auditor</td>
<td>Audit Committee</td>
</tr>
</tbody>
</table>

Do not proceed to the next step before the General Meeting of Shareholders has approved selection document

| 23 | Contract | Contract the selected external financial auditor | Audit Committee |
| 24 | Reporting in annual report | Preparing information that needs to be included into the annual report:  
- The fees of the external financial auditor;  
- The scope of the external financial audit initially contracted including materiality used;  
- The scope actually delivered by the external financial auditor in the respective year including materiality used;  
- Explanation why the scope contracted is different from the scope delivered;  
- Number of hours spent by level of employees of the external financial auditor involved in the delivery of the external financial audit | Audit Committee |
| 25 | Approval for next year’s external financial audit | Prepare a document which will be presented during AVA which proposes the scope of the external financial audit for next year including the hours needed and the audit fee of the external financial auditor | Audit Committee |

Proceed to step 22 to receive approval from the General Meeting of Shareholders.
Appendix E: Revenues and audit fees of AEX listed companies

<table>
<thead>
<tr>
<th>Company</th>
<th>Audit fee as % of revenues</th>
<th>2011</th>
<th>Audit fee as % of revenues</th>
<th>2010</th>
<th>Audit fee as % of revenues</th>
<th>2009</th>
<th>Audit fee as % of revenues</th>
<th>2008</th>
<th>Audit fee as % of revenues</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aegon</td>
<td>0.66%</td>
<td>€ 8,619,900</td>
<td>0.50%</td>
<td>€ 7,491,400</td>
<td>0.57%</td>
<td>€ 6,694,900</td>
<td>0.60%</td>
<td>€ 6,291,400</td>
<td>0.63%</td>
<td>€ 5,996,900</td>
</tr>
<tr>
<td>Ahed</td>
<td>0.15%</td>
<td>€ 360,000</td>
<td>0.14%</td>
<td>€ 360,000</td>
<td>0.14%</td>
<td>€ 362,000</td>
<td>0.15%</td>
<td>€ 360,000</td>
<td>0.15%</td>
<td>€ 360,000</td>
</tr>
<tr>
<td>AirFrance-KLM</td>
<td>0.31%</td>
<td>€ 37,400</td>
<td>0.37%</td>
<td>€ 37,400</td>
<td>0.37%</td>
<td>€ 37,400</td>
<td>0.37%</td>
<td>€ 37,400</td>
<td>0.37%</td>
<td>€ 37,400</td>
</tr>
<tr>
<td>Alza Nobel</td>
<td>0.93%</td>
<td>€ 7,500</td>
<td>0.72%</td>
<td>€ 7,500</td>
<td>0.72%</td>
<td>€ 7,500</td>
<td>0.72%</td>
<td>€ 7,500</td>
<td>0.72%</td>
<td>€ 7,500</td>
</tr>
<tr>
<td>ArcelorMittal</td>
<td>0.93%</td>
<td>€ 29,400</td>
<td>0.61%</td>
<td>€ 29,400</td>
<td>0.61%</td>
<td>€ 29,400</td>
<td>0.61%</td>
<td>€ 29,400</td>
<td>0.61%</td>
<td>€ 29,400</td>
</tr>
<tr>
<td>ASML</td>
<td>0.18%</td>
<td>€ 5,000</td>
<td>0.12%</td>
<td>€ 5,000</td>
<td>0.12%</td>
<td>€ 5,000</td>
<td>0.12%</td>
<td>€ 5,000</td>
<td>0.12%</td>
<td>€ 5,000</td>
</tr>
<tr>
<td>Borskies</td>
<td>0.29%</td>
<td>€ 2,200</td>
<td>0.01%</td>
<td>€ 2,200</td>
<td>0.01%</td>
<td>€ 2,200</td>
<td>0.01%</td>
<td>€ 2,200</td>
<td>0.01%</td>
<td>€ 2,200</td>
</tr>
<tr>
<td>Cono</td>
<td>1.22%</td>
<td>€ 3,000</td>
<td>0.01%</td>
<td>€ 3,000</td>
<td>0.01%</td>
<td>€ 3,000</td>
<td>0.01%</td>
<td>€ 3,000</td>
<td>0.01%</td>
<td>€ 3,000</td>
</tr>
<tr>
<td>DSM</td>
<td>0.79%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
</tr>
<tr>
<td>Fugro</td>
<td>0.83%</td>
<td>€ 1,500</td>
<td>0.01%</td>
<td>€ 1,500</td>
<td>0.01%</td>
<td>€ 1,500</td>
<td>0.01%</td>
<td>€ 1,500</td>
<td>0.01%</td>
<td>€ 1,500</td>
</tr>
<tr>
<td>Heineken</td>
<td>0.30%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
</tr>
<tr>
<td>ING Group</td>
<td>0.66%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
</tr>
<tr>
<td>KPN</td>
<td>0.68%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
<td>0.01%</td>
<td>€ 5,000</td>
</tr>
<tr>
<td>Philips</td>
<td>0.86%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
<td>0.01%</td>
<td>€ 2,500</td>
</tr>
<tr>
<td>Randstad Holding</td>
<td>0.31%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
</tr>
<tr>
<td>Reed Elsevier</td>
<td>0.19%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
</tr>
<tr>
<td>Royal Dutch Shell</td>
<td>0.10%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
</tr>
<tr>
<td>Unilever</td>
<td>0.40%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
</tr>
<tr>
<td>Wolters Wover</td>
<td>0.64%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
<td>0.01%</td>
<td>€ 1,000</td>
</tr>
</tbody>
</table>

The table above provides an overview of all the companies, including OOBs, listed on the AEX between 1 January 2008 and 31 December 2011. Companies that were split, added or deleted during the period such like TNT, DE Masterblenders, Aperam or PostNL are therefore excluded of the calculation. The information about the group revenues and the audit fees was retrieved from the annual reports which were published on the websites of the companies. The audit fee as a percentage of the revenues has been calculated by dividing the audit fees for a year by the group revenues of the same year corrected with the exchange rate.
Selection Process affects Perceived Auditor Independence and Perceived Audit Quality

How External Financial Audit Services are selected by Dutch Listed OOBs and how this selection process affects Perceived Auditor Independence and Perceived Audit Quality.