Audit quality and inspection in the Netherlands: The importance of an intellectual approach to experiential learning and practice advancement[1]

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Summary/ Abstract

Recent reported failings of audit practice and the extent of fines and sanctions issued against major audit firms in the Netherlands have resulted in severe criticism of the Dutch accounting profession. This paper contemplates how a noted Dutch tradition of excellence in auditing has shifted to one dominated by notions of inadequacy. It considers the content of AFM inspection reports, analyses various elements of the profession's response to the criticisms being made of the quality of auditing, reflects on the scale and nature of identified problems, assesses the implications for the standing and future development of the auditing profession in the Netherlands and explores the scope for meaningful experiential learning and practice advancement.

Implications
The paper calls for a broadening of the intellectual space within which audit is discussed. Given the scale of the identified failings and challenges confronting audit practice, with the profession itself identifying 53 areas for reform and regulatory authorities still believing numerous 'wicked' problems have yet to be adequately addressed, any search for a 'scientific, cure all' solution looks both naive and destined to fail. Instead, the audit arena, whether on the part of its practitioners, regulators and educators, must embrace a greater diversity of thought and commit to learning more from success than failure. This in turn will stimulate an inspiring sense of the possibilities of practice while retaining a stern awareness of the myths of the past. In particular, the audit profession must open its doors to research intent on exploring the organisational and social functioning of audit and better illuminating the lived, practical experiences of audit practitioners.

1. Introduction

The historically high standing of the Dutch accounting profession (hereafter Dutch profession) is well established through the work of notable Dutch professionals such as Jacob Kraayenhof and his leadership at the time of the 1957 and 1962 International Congress of Accountants, Hans Burggraaff at the IASC, Henk Volten at NIvRA, Jules Muis at the World Bank and Arnold Schilder at the IAASB as well as by Dutch scholars like Theodore Limperg. Limperg's theoretical reflections on auditing, in particular his utilisation of the concept of a 'free profession', is an intriguing concept in a modern day context, inviting conceptual reflection on where the profession not just in the Netherlands but internationally stands in terms of its degrees of 'freedom'? The Dutch profession's pride in the quality of its work served in part to shape its historical reluctance to pursue international accounting harmonisation and convergence for fear that standards would converge at lower rather than higher levels of denomination. Its reputation for high standards (Stamp & Moonitz, 1978) had been built without the need for a formal, extensive set of auditing standards. For example, Meuwissen and Wallage (2006) pointed out there had been no need for specific auditing standards for almost 80 years in the Netherlands because of Limperg's normative theorising which stressed that, in meeting societal expectations, auditors give their opinions in ways that ensure all the relevant facts have been taken into account correctly and completely and that the presentation of any such facts is not misleading (p. 173). In noting how the Dutch profession had shifted from a state of complete self-regulation to one of regulation from the outside, Stamp and Moonitz (1978) concluded that the *"transition is still not complete but the Dutch have the skill, the knowledge and the tradition that should make it possible for them to enjoy the best of both worlds, a strong profession with high standards on the one hand and a national law to make it relatively easy for those standards to become operational"* (p. 95). The Dutch profession has moved from an evident historical resistance regarding the promotion of international standards to being active participants, with leading Dutch professionals and officials sitting on various international accounting and auditing standard setting bodies - a transition illustrated in detailed historical analyses (see Camfferman & Zeff, 2007; 2009; 2015; Zeff et al., 1992).[2]

However, in recent times, severe criticism has been directed at the Dutch profession, for example, through the various critical comments and resulting fines by the AFM in its

annual inspections of audit firms[3], the identification of tax and bribery scandals at KPMG in the Netherlands, the resignation of the chair of KPMG's management board in 2014 and the PCAOB's fining of Deloitte for claimed auditor independence violations in 2016. The depth and scale of the criticisms, and the extent of the reported failings of audit practice and fines/sanctions issued against major audit firms cannot be understated and one extract from the most recent AFM (2017a) inspection report, makes for gloomy reading in terms of evidenced levels of audit quality:

> *"The number of statutory audits performed that are qualified as 'inadequate' at each of the Big 4 audit firms is too high, similar to the previous regular inspection in 2014. The AFM qualified 19 of the 32 inspected statutory audits as 'inadequate': 3 at Deloitte, 4 at PwC and 6 at KPMG and EY. The quality safeguards at these audit firms have failed to prevent or detect this in a timely manner. The AFM notes that the most common deficiencies in the inadequately performed statutory audits are similar in nature to those identified in the previous regular inspection ... [and] are of such severity that the AFM concluded that the audit opinions with respect to the financial statements are issued without sufficient audit evidence to support the opinion."* (AFM, 2017a, p. 5)

When the report goes on to consider how such results compare internationally, again the picture is not a positive one:

> *"The findings are similar to the conclusions of the International Forum of Independent Audit Regulators (IFIAR), which concluded in its most recent report of March 2017[4] that the percentage of inspected audits with significant findings continued to be unacceptably high."* (AFM, 2017a, p. 5)

In short, things seem a long way from Limperg's notion of 'inspired confidence'. Such a reported scale of 'inadequate' audits can hardly be said to resemble a case of auditors performing their task in a way that meets expectations and it does not unjustly bolster societal expectations. It simply begs the question what has happened? How did a Dutch tradition for excellence in auditing transform into one of inadequacy? Was such a reputation for excellence more myth than reality? Have things been going wrong for a long time, as some would argue in comparing the 2003 Ahold scandal to that of Enron in 2001 (see Knapp & Knapp, 2007)? These, and other questions, are what we reflect on in this paper. This type of causal questioning is something that the AFM itself is publicly struggling to answer. As its 2014 report notes:

> *"At the request of the AFM, the Big 4 firms have for each of the inspected statutory audits prepared a list of what they consider the root causes of the deficiencies found. They have also set out the measures they will take in response to the results of the inspections ...The AFM finds that the root causes identified by the Big 4 firms vary considerably, in both substance and depth. Accordingly, the AFM regards several of the causes listed by the Big 4 firms primarily as symptoms.* ***The actual underlying causes of the lack of consistent quality assurance in statutory audits are not yet completely clear.****"* (AFM, 2014, p. 7, emphasis added)

While the audit firms and the profession more generally appear committed to a programme of change, it is clear from the AFM's 2017 inspection report that the AFM does not regard the scale of delivered change and the resolution of causal problems as having been sufficient:

> *"Based on the findings, the AFM concludes that the improvement programme at the PIE audit firms is progressing too slowly and that the quality of the inspected statutory audits by the Big 4 audit firms is not satisfactory."* (AFM, 2017a, p. 4)

In the discussion that follows, we look at why progress has been slow (section 2) and we note that a shift in outlook is required if the identified problems, which have been described as 'wicked', are to be alleviated (section 3). We reflect on the relative degree of trust placed in audit and in audit regulation (section 4) and question what can be achieved by debating the relative regulatory emphasis on rules and principles (section 5) or by searching for a, yet to be identified, 'scientific' solution (section 6). We emphasise the importance of contemplating how far we are willing to go to reform audit (section 7) and the value of a more socially focused form of audit education and experiential analysis (section 8) that exudes a willingness to learn from success and not just failure (section 9).

2. Why has progress been so slow? Competing perspectives

Why has progress been so slow is a question with no evidently clear and agreed set of answers. After all this inspection work, there must be a good deal more clarity at the AFM as to what is happening, not happening and why? Surely, the actual 'underlying causes' have to be getting clearer? You can certainly detect a more strident tone in the AFM's 2017 inspection report, especially in terms of statements that it:

> *"will continue to exert pressure on the audit firms to meet the requirements for the quality of statutory audits and implement change more expeditiously. The AFM will appropriately intervene in this respect, which could mean interventions may vary per PIE audit firm."* (AFM, 2017a, p. 5)

Gerben Everts' speech[5], in his position as a Board Member of the AFM at the June 2017 Foundation of Auditing Research (FAR) conference gave a very forthright impression that if the auditing firms/profession did not get their/its act together, the AFM would take action:

> "*I am not saying that existing business models should be turned upside-down from one day to the next. But we do need to look actively for alternatives. The challenge to deliver is enormous. And if the audit sector fails to deliver, alternatives need to be explored. The supervisor will certainly be focusing closely on the question of earnings models. But at the same time, it would be preferable for the sector itself to take a critical look at its own business model, put forward suggestions for improvements, test them diligently and then implement them. And always keep the public interest in mind.*" (p. 10)

In closing his speech, Everts placed emphasis on a spirit of cooperation and shared goals between the profession and its regulators but his residing frustration with the profession and the lack of progress was also clearly evident – and his speech certainly did not rule out more intrusive forms of regulatory action. In contrast, it was also not difficult to detect in the body language of several senior practising auditors in the audience (with some visibly 'slumping' back in their seats as Everts spoke) a residing sentiment that audit regulators essentially 'just don't get it' and that if regulators want more effective auditing, there are better ways of pursuing such a goal.[6]

Yet, for all such concern about the degree of faith being placed in audit regulation, the report by the Future of the Accountancy Profession working group (2014) (hereafter

referred to as the '**public interest report**') still managed to come up with 53 key areas where audit quality and auditor independence could be improved. 53?! These certainly give sufficient working scope for the newly established Accountancy Monitoring Committee, but such a scale of failures and difficulties begs the question - is auditing really that bad or, more worryingly, is a function with so many problems beyond repair? If someone went to buy a second hand car and the dealer told them that an inspection had revealed that it had 53 critical faults which were in the process of being fixed, would they ever really go back to buy the car? And if these faults applied across all of this make of car, who would go elsewhere to buy such a car? But this is what the auditing profession is currently telling us in the Netherlands (and to a lesser numerical extent in many other jurisdictions) – "Despite such problems, the car is still worth buying".

3. 'Wicked' problems require a shift in outlook

Identifying such a list of problems can be helpful, if you are allowed to keep providing the service (which a statutorily required, 'publicly interested' audit function is able to do) as, with so many problems, there are going to be plenty of opportunities to stress 'improvements' made and the importance of retaining 'faith' – instilling the sentiment that progress is being made but that change is complex and total reconciliation some way off. And, this, not surprisingly, is the tone that has characterised a number of the responses of the Big 4 audit firms to the AFM reports. For example, KPMG (2017)[7] state:

> *"Improving quality and the related change in our culture is our highest priority. We have achieved a lot over the last three years, but we are well aware that we are not there yet."* (p. 3)

However, there are strong grounds for suggesting that this is not the most effective way of conceptualising the situation. While it may seem hard to believe, the problem is apparently bigger than the identified 53 elements where the profession believed that change was needed. The Minister of Finance, Jeroen Dijsselbloem, reiterated, in his speech at the June 2017 FAR conference[8], that the Monitoring Commission on Accountancy had already concluded that the 53 proposals and new rules identified by the profession were not enough to solve the structural problems, with a number of 'wicked problems' still needing to be addressed, including "*the impact of the profession's business model on its corporate culture, the balance between private and public interests and the question what 'a high quality audit' actually means. Moreover, the Monitoring Commission stated that a more profound analysis is needed to address these problems, so the accountancy sector can change its culture and improve the quality of its work*"[9]. According to Dijsselbloem, a great deal of faith has been pinned on the FAR, which is charged with *"figuring out the underlying factors that determine the quality of audits. Or, to paraphrase Matt Damon in the film The Martian, the foundation is trying to 'science the hell out of the problem'. To that end, you've set up six research groups, in collaboration with eight different universities. Tackling a wide range of research questions, from the loss of talent to learning from mistakes. I think this will help to pin down more precisely where things go wrong and how to improve them. And that's a necessary step on the road to changing the corporate culture of audit firms. Because auditors need to show they are independent. Auditors need to show they have the public interest at heart, even when they are paid by an organisation with a private interest. To have that difficult conversation with a customer who may not be ready to hear what you have to say. Auditors need to*

show they deserve our trust." But much of this analysis begs the question as to whether the problem is really a scientific one rather than a cultural and political one?

The scientific representation of the problem tends to suggest that there are ready, ideal 'solutions' somewhere out there, just waiting to be found, identified and implemented. An oracle, a magic wand, a silver bullet. Gut instinct would tend to suggest that such solutions do not exist. This is especially so when you have an initial set of 53 proposals for reform, across seven core themes[10] that themselves rely on subjective terms and invite more questioning as to what is to be done in pursuing such proposals. We return to this issue later when we suggest an alternative 'social' science approach to the problem. Before this, it is worth reflecting further on the relationship between all of this strategic action and the intent of restoring confidence or faith/trust in auditing.

4. Trusting audit and audit regulation: Contemplating underlying presumptions

Conceptually, auditing can be said to exist because of a lack of trust between principals and agents. It is a function that is designed to enhance trust between such parties. So if there is a loss of trust in auditing, it can hardly be treated as the failing of a peripheral dimension. We trust auditors because we cannot trust others. If we cannot trust auditors, what really is the point and value of audit?

The notion of restoring trust has a close alignment with image enhancement. It is quite possible to conceive of a marketing campaign designed to bolster the image of a service or product but which changes little in terms of its impact on the underlying quality or value of the service or product. The counter approach would be to improve the service/product directly and then hope that people will trust it more? This latter approach depends very much for its impact on experiential effects. Can those on whose behalf auditing is being performed feel and recognise improvements in quality? Can they recognise an audit of superior quality? Or are we destined to be in a position where we are being told auditing is getting better but seldom can experience this improvement directly?

In audit, we have over the years (and this is where the case of the Netherlands is particularly illuminating) gone from a system where assumptions and guarantees of quality rested in the individual professionalism of auditors and the quality of their professional judgement to a system where quality assurances and affirmations largely hinge on demonstrable compliance with detailed sets of practice 'standards', overseen by the formalised monitoring activities of audit firms and external regulators. As Martin Bauman, chief auditor at the PCAOB, said in May 2014 when heralding a recent meeting of the IFIAR[11] attended by audit regulators from some 50 countries on auditing, audit quality and audit regulation: "*Audit self-regulation is dead and independent audit regulation and oversight, around the globe, is alive and well*" (p. 1).

The question that this set up invites is whether audit is getting better ... or is it a self defeating or inherently failing system? Bauman, for example, went on to note the press briefing given by IFIAR's then chair, Lewis Ferguson, in which he said that *"the high rate and severity of inspection deficiencies in critical aspects of the audit, and at some of the world's largest and systemically important financial institutions, is a wake-up call to firms and regulators alike."* He also highlighted the serious concerns of IFIAR's then Vice-Chair, Janine van Diggelen, regarding the growth in the firm's management consultant

practices and the extent to which audit quality suffers through different levels of profitability and different rates of growth in consulting services. And such concerns have not been one-offs but rather continuing expressions of concern over audit quality over many years. Will, for example, such concerns be alleviated following the Dutch Audit Profession Act which restricts the provision of non-audit services from 1 January 2013? Instead of asking such questions regarding the impact of consistent inadequacies in audit practice, Bauman chose merely to reiterate the vitality of audit to the efficient running of capital markets and that the historically significant and sustained scale of audit reforms is a direct reflection of the importance of audits to such markets and investors' confidence in the reliability of corporate financial reporting. In providing a really useful cataloguing of audit reforms stretching back over five decades, he stressed *"I won't dwell on what went wrong, or what was perceived to be wrong, in these various examples (of reform)"* (p. 1). Perhaps if he had done just that, and gone on to discuss what impact such reforms had, we could have been provided with a valuable insight as to why each set of reforms had failed to stem the tide of audit failures or the scale of concerns with audit quality. Bauman closed his speech with some reassuring words regarding the generally very good work that auditors do in often very challenging circumstances, but the received impression is that the quality of audit work over time is consistently problematic. Audit reform continues to happen only indirectly because of the supposed importance of audit – it directly happens because audit quality has been consistently exposed and shown in major cases and across major public corporations and public interest entities to be sub-standard. If audit quality matters so much and is so central to the work of audit firms, why has so much regulatory intervention been needed? If it matters, is it not capable of being fixed and fixed well?

There are, accordingly, a range of perspectives to contemplate here. For instance, does auditing and faith in auditing appear to be improving under contemporary regulatory regimes? Is faith in auditing likely to improve if the messages coming from audit inspections are consistently critical of the adequacy of audits and achieved levels of audit quality? What capacity do regulatory systems have to praise rather than just criticise audit quality? It is important in raising such questions to recognise that this is not a debate simply over whether self-regulation is better than external regulation/oversight. It is also not just a case of simply criticising the presence of external regulators, as much monitoring and inspection work is being done within firms through their internal processes of control. What is most critical is: (a) to explore the presumptions which underlie the systems and patterns of behaviour that we increasingly take as given in the audit practice and associated regulatory arena; (b) not to see audit as a static and abstract, externally defined, concept and/or set of practices but to view it more as a dynamic, socially constructed activity in terms of its remit, nature and operation; and (c) to ground discussions as much as possible in the lived realities of practice - examining what is being done in the name of audit quality and what is being eliminated and/or excluded from or losing legitimacy in terms of defining appropriate approaches and styles of audit, the conduct of audit related work and associated professional learning and educational development processes.

5. The solution to audit quality will not be found in the debate of rules over principles

In its response to the AFM's 2017 inspection report, KPMG was very explicit in terms of stressing that cultural change and translating improvement measures into daily practice

inevitably takes time, although it provided less direct discussion as to why a 'quality oriented' culture had previously been lacking in the field of audit. Its response, however, demonstrates (albeit quite subtly) that what comprises or characterises a 'quality' audit is not fixed and absolutely determined. KPMG chose to stress that too many rules can detract from the application of professional judgement, as can various external changes (such as mandatory audit rotation[12]) which can create significant start-up costs. There were clear hints that KPMG would regard a sanctions oriented, rules-based audit practice environment as constraining processes of learning and limiting the development and application of professional judgement. The question such a response invites is the extent to which the audit regulatory regime and the requisite responses of audit firms is not improving audit quality in any absolute, context-free, sense but is changing what is regarded as a 'quality' audit - for instance, by placing more emphasis on compliance with rules and detailed documentary confirmation of such compliance and decisions made throughout the audit process?

A similar tone of debate can be found in the profession's (2014) public interest report in which its '53' proposed reform measures were outlined. Here it was quite explicitly stressed that the proposals were not seeking to make the audit more regulated and to instil a form or working in which rules dominated principles:

> *"the working group in principle is not an advocate of further detailed regulation over the implementation of the audit itself. The working group has established that there is an increasing legalisation of society and is of the opinion that the profession must be alert to the risk of a fear-driven box-ticking culture in which accountants focus too much on compliance with formal requirements and form is elevated above substance. This is undesirable in the opinion of the working group since it has a negative influence on innovation, critical thought and the attractiveness of the profession to well-educated, financially-aware talents, whilst these are currently factors which are crucial to the sustainable development of the profession. Form and substance must be correctly balanced within the profession."* (Future of the Accountancy Profession Working Group, 2014, p. 31)

The principles vs. rules debate is not a new one and has been a standard, historical, response on the part of the profession in attempting to resist further regulatory intrusion into the professional practice domain. Any direct mapping or marrying of the principles vs. rules dichotomy on to debates about the respective merits of self vs. external regulation also needs to be cautioned against, not least because the auditing profession itself will acknowledge that it is an active player in the generation of practice-based rules and regulations (for further discussion, see Humphrey, 2013). Indeed, even in its 2014 public interest report, the Dutch profession readily admits this:

> *"the working group noticed that accountants impose upon themselves the vast majority of the rules which reinforce independence and quality (via the professional organisation the NBA) without legislation being brought to bear."* (Future of the Accountancy Profession Working Group, 2014, p. 16)

It also recognises that some of the basic failings of audit could have been avoided if there had been effective external supervision:

> *"The working group has also established that the booming economy in which current accountants developed professionally, combined with the lack of effective correction*

> *mechanisms such as external supervision, have led to a gradual neglect of elementary professional principles in some of those of that generation. The economic crisis and the arrival of a critical supervisory body have ensured that those days are definitely over."* (Future of the Accountancy Profession Working Group, 2014, pp. 24-25)

Further, when reference is made to the AFM's (2017a) inspection report wherein some audit firms have performance measurement 'dashboards' that show they are 'falling well short of expectations' on a multiplicity of dimensions (in one case, falling well short on 7 of 9 performance dimensions), it would appear that the problems and 'failings' of audit practice are of a scale that takes them well beyond abstract debate over principles and rules. The critical issue then becomes one of response, and more specifically, determining the most 'appropriate' response.

As noted above, the Dutch profession is certainly not short of proposed measures, although the sheer number is in itself a potential source of reputational damage. A counter argument here would be that now is the time to get all the problems out in the open so that they can be dealt with.

6. Questioning the search for a 'scientific' solution

It is also possible to argue that there is a deeper conceptual issue, that is of a much greater critical significance than just determining the precise or agreed number of professional/regulatory fixes.

This is indicated in the way that external supervision was labelled by the profession as an 'effective corrective mechanism' (Future of the Accountancy Profession Working Group, 2014, p. 34). While this report does venture, as we saw earlier, into some discussion as to whether external supervision is changing conceptions of 'appropriate' auditing, it struggles to push this to any fundamental practical assessment as to whether external supervision is 'effective' and how such 'effectiveness' should be judged.

One of the reasons for such a lack of questioning would appear to be that the 2014 public interest report is ultimately premised on a relatively absolute, if not fixed, view of audit. For instance, the report frequently utilises the word 'correct' in describing or assessing different reform goals or priorities. It, thus, talks of 'correct' clients, safeguards, incentives, basic attitudes, moral conduct, reporting, implementation, practice level, ethical values and conduct and boundary conditions. In a similar fashion, the word 'right' is invoked invariably without detailed explanation when discussing the importance of establishing the 'right' culture, conditions and context, securing the 'right people, following the 'right' motives, making the 'right' decisions and influencing in the 'right' way.

The report's reliance on 'scientific' research especially in terms of the construction and maintenance of a published set of audit quality indicators (Future of the Accountancy Profession Working Group, 2014, p. 72) likewise leans to an impression of audit and audit quality that is far more concrete than the lived, shifting and conflicting 'realities' of practice that the longstanding existence of an audit expectations gap reflects (see for example, Humphrey, 1997; Humphrey et al., 1992).

Why does this matter? Well it matters on various dimensions. At one level, it is incredibly optimistic to think after so many years of corporate scandals, audit reforms,

regulatory initiatives and endless discussions over audit quality, that there is a 'scientific', 'cure all' solution somewhere out there waiting to be discovered? If all this recent, detailed external inspection in the Netherlands and self-scrutiny by the profession has not managed to expand greatly on 'fundamental root-cause' issues, then is it realistic to expect that a scientific research institute (no matter how 'independent' it is hoped to be) will identify causes and remedies that (a) existing investigations have somehow missed and (b) will be accepted by all parties and (c) if/when implemented will have an undeniable transformative effect?

Is it more likely that the 'muddling through' chain of behaviour continues to be the practice equilibrium with renewed promises that the future is going to be brighter than the past until the next scandal hits or the next set of regulatory inspections prove to be equally disappointing in terms of the scale of identified inadequate quality audits?

There are some strong indications in the 2014 public interest report that the whole issue of audit quality and audit expectations is fundamentally political. Thus, even after identifying so many areas where change is needed, the overall received impression of the authors of the report was that the quality of the audit had not declined in recent decades as a result of the various identified behaviour trends and influences (p. 34). While not providing any evidence to sustain such an opinion, they came to the conclusion that achieved levels of audit quality no longer met current social needs and that *"improvement was necessary"* (p. 34). In essence, auditors need to respond to revised societal expectations and shift from their traditional view "*in which accountants have long adhered to the idea that criticism of the profession is mainly caused by the fact that society does not understand what we do, instead of the other way around."* (Future of the Accountancy Profession Working Group, 2014, p. 34).

However, when it comes to specifying what would be the appropriate professional response to revised societal expectations, the public interest report's conclusion appears to come very close to advocating something that looks remarkably similar to what we currently have in terms of a regulated audit market arena:

> *"The working group is of the opinion that the **right** combination of free market operation in which the accountant must continue to prove his added value to interested parties and statutory obligations for a specific group of legal entities with strict additional laws and regulations for organisations which are the most important to society, will lead to the **right** incentives for accountants to continue to fulfil their role in economic market activities."* (Future of the Accountancy Profession Working Group, 2014, pp. 64-65, emphasis added)

7. Audit reform – how far are we willing to go and how far have we gone?

Leaving to one side the almost tautological nature of a statement that the 'right' combination of free and regulated markets will generate the 'right' incentives for accountants to fulfil their role, the profession's 2014 public interest report places a good deal of responsibility on independent scientific research to come up with a specification as to what are the 'right' limits for the statutory compulsory audit and the 'right' form of associated regulatory requirements (p. 65). But there are some very telling indications in the report that any claimed 'rightness' will undeniably be a subjective, non-neutral judgement. At various points in the report, space is provided for the provision of stakeholder views (in insets labelled 'What Stakeholders Say"). On some occasions these

reveal a significant range of perspectives. Most notably, there are clear differences in opinions over the extent to which commercial imperatives dominate the actions and mindsets of auditors (pp. 45-46).[13] It is also worth stressing that this is an area of longstanding debate, even in the Netherlands, with its aforementioned historical reputation for high professional standards of practice in auditing. For example, Zeff et al. (1992, p. 375) in their detailed historical study of the Dutch profession, while noting its strong international standing, cautioned strongly against any tendency toward self congratulation and complacency. Of particular concern, even then, was the threats posed by a perceived increasing commercialism in the field of auditing and the leadership capacity of the profession with regards to the promotion of audit quality:

> *"In a number of countries, there are signs that the commercial interests of audit firms may have overtaken the traditional concern for the quality of company financial reporting. The raison d'étre of the audit, namely, to give users confidence in the credibility of the financial statements, may no longer be seen as the premier calling of the audit firm. Firms have seemed to become more inclined to accommodate client interests than to defend the interests of those on whose behalf the independent audit is conducted. The increasing commercialization of audit firms represents a potential threat to the vitality of an independent audit profession."* (Zeff et al., 1992, p. 377)

Zeff et al. (1992) went on to stress that in response to this increasingly commercial environment in audit firms, professional auditing organizations needed to take the lead and "invigorate the commitment to independence and integrity on the part of the audit profession" (p. 381).

In terms of contemporary debate and discussion in auditing circles in the Netherlands, there is a clear level of subjectivity as to how far different stakeholders are willing to push various audit reform processes and expand the level of regulatory involvement, or 'intrusion', in the market. While some criticise reform proposals for a lack of supportive evidence as to their merits and the significance of the problem being addressed, it is very evident that 'beliefs' in the current system are just that – 'acts of faith' that lack definitive evidential support that the current system is best. At times, the provided 'positive' views and impressions are such that one could question whether the scale of the supposed problems facing the audit function could ever have justified the undertaken level of inquiry.

Ultimately, and particularly in light of the above noted historical context, it could be argued that there is an inherent level of conservatism in the Dutch profession's 2014 public interest report. There are a number of occasions in the report where the advocacy of the application of constraints on the commercial interests, activities and structures of audit firms and their staff are rejected as being too draconian, with such rejection also being accompanied by assurances that 'free market' mechanisms are working well. At another level, there is a reluctance to legislate for any expansion in the role of the auditor – with any such development being left in the hands, again, of the free market, with a resort to legislation only being made when the added assurance function is demonstrably of great importance and when stakeholders cannot adequately regulate its provision:

> *"In the working group's opinion however restraint is appropriate here ...The requirement for an extension of the role of the auditor can be researched in a more in-depth stakeholder*

> *dialogue, but must in principle be left to the free market. Where stakeholders have a need for this role they can urge companies to engage an auditor on their behalf to provide this information with a degree of assurance ... In the opinion of the working group it is important that the accountancy profession continues to prove its added value for society in a market environment which is influenced by the needs of providers and users of information. Legal establishment must remain restricted to situations in which the added assurance provided by the auditor is of great importance and individual interested parties are not in a position to regulate the acquisition of that assurance independently."* (Future of the Accountancy Profession Working Group, 2014, p. 60)

Again, such a standpoint does appear to be taking somewhat as given that the reported levels of inadequate auditing and the continuing need over many years to reform audit regulation – and to instil a greater institutional concern with audit quality – are not sufficient to disturb the assumption (or what some may go so far as to classify as a myth) that the current statutory audit is of vital importance to society and is fulfilling its obligations in this regard. Indeed, this assumed importance of audit does sit rather uncomfortably with the willingness both in regulatory and professional circles to sanction repeated (and to even contemplate, in the public interest report, further) increases in the corporate threshold limits determining when an audit is compulsory. Furthermore, the reluctance to act in terms of extensions in the role and scope of auditing also sits uncomfortably with earlier claims in the report that the audit profession needed to respond to new/revised societal expectations regarding audit.

8. The potential role of a 'socially' focused education and experiential analysis in addressing concerns with audit

One area where the report does offer a sense of radicalism, albeit with a precursive apology to any apparent intrusion in the 'free market', is in the area of education and training, where it calls for a more expansive and critical focus:

> *"The tendency to stop difficult subjects in which reflection and discussion on the subject and dilemmas within the subject are important in short, intensive summer courses is undesirable however in the opinion of the working group and causes us concerns. Without wishing to interfere in free market operation, the working group proposes to guarantee from within the profession that sufficient training time is devoted to* ***all facets*** *of the subject to be absorbed."* (Future of the Accountancy Profession Working Group, 2014, p. 73, emphasis added)

Such comments strongly reinforce earlier criticisms of recruitment patterns in the audit profession, extending the issue of education to the university arena and the relationship between the academic and practice sides of the profession. It is very clear from the public interest report that recruitment is a key challenge in terms of the sustainability of the audit profession:

> *"It is also important that the accountancy profession remains an attractive profession to young accountants. Issues such as administrative pressure, excessive focus on sanctions, a negative image and an uneven relationship between risk and reward (liability, reputation) may lead to the profession losing its attraction. People who are desperately needed within the profession will choose other opportunities."* (Future of the Accountancy Profession Working Group, 2014, p. 36)

In this regard, the report is on very similar grounds to the findings of a recent research project conducted for the Institute of Chartered Accountants of Scotland (ICAS) and the Financial Reporting Council (FRC) in the UK (see Turley et al., 2016). This report raised serious questions as to the overall, functional competency of audit and on the basis of a lengthy reported list of concerns provided by senior audit practitioners and external stakeholders, it called for serious, critical self-reflection on the part of the profession:

> *"(I)f the firms that deliver 'traditional' audit services have lost a degree of social trust and have had questions asked of the social relevance and value of the statutory financial audit function that they have delivered for so many years, it is going to require a considerable level of effort and persuasion to convince society that audit is nowadays on an attractive and sustainable development path. Will auditing attract the right kind of recruit if the firms and the profession emphasise: the importance of compliance with international auditing standards and a degree of uniformity implied in the idea that 'an audit is an audit'; maintain rigid organisational control structures; fail to portray auditing as a long term career of choice; represent the audit training process as something that is primarily 'learning on the job'; and, in some countries, has a professional status that permits both entry and continuing audit registration post-qualification without any independent, higher educational study of the subject? The 'auditing' profession has to ask itself whether the current state of affairs, with respect to auditor education, training and practice is the best that can be done."* (Turley et al., 2016, p. 57)

Turley et al. (2016) called for a more deep-seated discussion regarding the social value and relevance of audit and highlighted the essentially negative intellectual space occupied by auditing, with it being a function whose history is inevitably told as a history of failure rather than a history of successes – just think of positioning terminology such as post-the Asian crisis, post-Enron, post-the global financial crisis. In this regard, we would go further, or be more specific than Minister of Finance Jeroen Dijsselbloem – rather than wanting to 'science the hell out of the problem' (of auditing), there is a need to 'social science' the hell out of auditing, to revisit the meaning of audit and its social role, both actual and potential; bringing in all fascinating dimensions and perspectives that disciplines such as politics, sociology, philosophy and anthropology offer. The problems that auditing faces are a wide mix of social, political and economic factors and forces and need to be studied in the broadest possible manner, whether in schools, universities, accounting firms (both pre- and post-qualification) and, especially so, in the newly established scientific institute that is FAR.

9. Focus on learning from success as well as failure

If the strategic priority of the profession is to restore trust in auditing, then, as noted earlier, this has to be more than a superficial, marketing campaign – it has to have substance and where better to start than by demonstrating operationally what is being done and achieved, on a day-to-day operational dimension by auditors ... and not just by those performing audits but also the significance of such work for those on whose behalf auditing is being undertaken. Especially, if as they say, the best form of marketing is by 'word of mouth'! This is also a point emphasised in the 2014 public interest report:

> *"There have also been too many negative examples of the performance of accountants in the news of late. Little is known however of the positive and important role fulfilled by accountants within the system of reporting and governance ... In general both negative and positive claims about the work of accountants are anecdotal in nature. The most value is attached to statements concerning the performance of accountants if these are made by*

> *parties other than accountants themselves. A significant party in that context is the AFM, as an independent supervisory body. But due to the nature of its role the AFM would be better to focus on pointing out shortcomings in the work of accountants than on the positive contributions of accountants within the system of reporting and governance."* (Future of the Accountancy Profession Working Group, 2014, pp. 74-75)

We would disagree with the above conclusions that negative claims regarding the quality of accounting (and auditing) work have been anecdotal. The 'inadequate' audits revealed (globally) by inspection reports, albeit having a vulnerability to challenge in terms of sampling bases[14], have now been present for a number of years – and their failure to reduce is an evident source of frustration if not dismay, on the part of inspectors. There are also potential questions to ask regarding what is defined as 'inadequate' and the extent to which failings are 'opinion significant' (in the sense that without the inadequacy, the auditor would have arrived at a different opinion). However, it also has to be borne in mind that many corporate collapses and related auditing 'scandals' are major events and the political realities of the circumstances invariably challenge the extent to which a defence of 'anecdotalism' can hold ... especially in cases, such as in the Netherlands, where the profession itself has come up with 53 reforms. Ultimately, this does not marry well with something being anecdotal.

We would also disagree with the assertion that the AFM is best restricting itself to pointing out only the shortcomings of the work of auditors, especially when it has been said (explictly in the public interest report) that the profession has not been good in terms of stimulating learning. As noted earlier, it is a limitation also evident in the work of IFIAR and its definitions of an inspection 'finding' (for more discussion, see Humphrey 2013). Certainly, things can be learned from failure (as we have indicated ourselves above regarding the impact of previous audit 'reforms') but how far do you need to go in responding to what the public interest report insists when stating that *"learning from mistakes must be more institutionalised"* (p. 11)?

How much more, for example, can also be learned from success? Think how many training programmes are premised on studying with and learning from the best, as typified by the concept of the 'Masterclass'? If you want to improve your prowess in many areas of life, you are more likely to want to study with a proven expert than by watching and analysing those who are poor performers or have failed.

The AFM's latest annual report (AFM, 2017b) is interesting in this regard on a number of counts. It profiles the establishment of its Innovation Hub (*"wherein businesses can test innovative concepts against legislation and regulation"*) and its central role in helping the AFM become a *"demonstrably ground-breaking supervisory authority by 2022"* (p. 12). In insisting that supervision is not an obstacle to innovation, it opens up questions as to what role the AFM's work in the field of auditing can play in terms of stimulating innovative practice developments – and the capacity to learn from evident areas of audit practice success and not just failure. With just under 50 staff employed directly in the supervision of auditors and reporting (AFM, 2017b, p. 73), and with its annual report entitled *"Intense Supervision in a Changed Playing Field"*, surely there has to be some supervisory space and scope to focus on examples of best and/or innovative audit practice?

Ultimately, though, much in the audit practice domain has to hinge on the capacity of the profession to embrace the spirit of experimentation year on year. Experimentation has certainly been championed (in the specific context of extended audit reporting) by people such as Arnold Schilder at the IAASB and recent years have seen much more visible usage of terms such as audit innovation by the big firms (especially in practice areas such as data analytics). However, with international audit firms typically categorising their practices as being compliant/in accordance with International Standards on Auditing (ISAs), it has to be asked just what is the scope for major, 'disruptive' innovation that fundamentally advances (if not rewrites) what is audit, what can be audit and what audit can do in helping to deliver a better society?

A major concern here is that the profession may well comprise (both now and in the immediate future) generations of auditors who have become conditioned to a working environment dominated by compliance with standards. We found very evident fears of this in our work for ICAS-FRC, to the extent that senior staff were openly questioning the technical competence of, and partnership material among, audit teams (see Turley et al., 2016, p. 52). Similar concerns are evident in the 2014 public interest report:

> *"A number of stakeholders refer to the change in the culture within firms in the last 30 years, partly due to the influence of international networks (Anglo-Saxon culture). They made references to the influence of growing consultancy practices (see also chapter 5) and how the role of professional expertise has declined over the same period. One of the stakeholders for example referred to the fact that in the past, firms were led by people who were leaders in the profession in terms of professional expertise, perhaps as a professor, but that* ***firms today are led by managers****. The lack of diversity within firms was also referred to; rational men with a strong financial focus dominate the profession."* (Future of the Accountancy Profession Working Group, 2014, p. 34, emphasis added[15])

10. Conclusion

The above comments stimulate thinking as to what currently comprises the Dutch profession and how it is set to develop and to be led. For instance, it could be argued that the profession is being led or at least driven to a significant degree by standard setters and regulators. While the big audit firms certainly have representatives on standard setting bodies, they also have substantial technical service centres tasked with interpreting and incorporating the latest official practice guidance in audit manuals and procedures, duly reinforced by 'audit quality' monitoring units and a panopoly of firm-based compliance and control mechanisms.

In this regard, it is a fascinating to contemplate how best to describe the auditing profession once standard setters and regulators have been extracted? What remains? Where, for example, are the practice leaders of today? Who has replaced the practice leaders of the past that so visibly characterised the Dutch profession? Is it just a coincidence that so many of the influential global figure heads from the Netherlands nowadays are people occupying senior standard setting and regulatory positions? Is it even realistic these days to regard audit partners as leaders and, if so, what should they be categorized as leading? Their firm, their firm's (audit) business, the wider profession? Or are they more accurately categorized as (very well) 'paid employees', providing an increasingly 'regulated' service? Or is there a danger of glorifying the past and downplaying what the profession may claim are more vivid contemporary

commitments to serving the 'public interest'? While provided answers here may well vary, the ease and scale of such questioning reinforces the importance of the issues at hand in terms of the current standing and future development of the auditing profession in the Netherlands, and beyond.

Jan Bouwens is quoted in the 2014 public interest report regarding his desire for the Dutch profession to show it is serious about dealing with the past and to seek to regain its world fame as of the time of Limperg (p. 74). Clearly, the opportunities are there for such development but some considerable hurdles also need to be overcome. The connection in the Netherlands between the academic and professional sides of the profession should be capable of offering a potentially strong foundation on which to build (including the development of FAR itself), but, as the public interest report suggests, this will require an opening up of the firms to research investigation at levels that have not been entertained in the past and for a revamped analysis of the working experiences of audit practitioners. International academic accounting journals are also calling on accounting researchers to undertake such work (see, for example, the European Accounting Review[16]). It is certainly not enough that practitioners' engagement in universities is restricted to teaching the latest professional practices (as suggested in the 2014 public interest report, p. 74) for the circumstances demand the exercising of (and being vocal about) much more reflective, critical, and creative, independent thinking. The above mentioned ICAS-FRC (2016) report concluded with a call for a broadening of the intellectual space within which the future of auditing is discussed – a discursive arena in which stakeholders can challenge the traditions, constraints and boundaries that surround and govern audit practice. Audit in this regard has to be treated 'intellectually'. Interestingly, this was a point also made very strongly, albeit in differing contextual circumstances, by Zeff et al. (1992) when calling for the development of a more independent academic accounting and auditing profession in the Netherlands[17].

Most importantly, the development here of 'intellectual' thought does not mean privileging the 'scientific'. Auditing research, given the organisational and social nature of the audit function, has to be a field of activity which willingly embraces different forms of analysis and reflection, inspiring a sense of the possibilities of practice and a stern awareness of the myths of the past. Overall, the depth of historical tradition and the polemics of today, suggest that the challenges for the audit function are tough ones, whether viewed from an academic, practice, regulatory and/or public policy perspective. Hopefully, though, there is enough in the Dutch accounting tradition to embrace such challenges in ways that leave audit stakeholders optimistic for the future. Or put more directly, to start again to institutionalise learning from 'success' and not just living with 'failure'!

Notes

[1] This paper utilises but substantively expands the text of a published interview that Christopher Humphrey undertook with Margreeth Kloppenburg reflecting on his personal participation in the 2017 FAR research conference. The interview was published in Kloppenburg and Jansen (2017). Particular thanks are due to Margreeth

and Thijs for their inspiration and encouragement in pursuing the issues addressed and for giving permission to reproduce text from the interview in this paper.

[2] For example, Arnold Schilder has chaired the IAASB since 2009 and has most recently pushed the whole notion of experimentation in longer form audit reporting under ISA 700 and accompanying standards. Hans Hoogervorst has chaired the IASB since 2011. In terms of broader international regulatory oversight and inspection, Stephen Maijoor (ex head of the Dutch AFM) heads the European Securities and Markets Authority (ESMA); Janine van Diggelen, head of the Audit Firm Oversight division of the AFM, chairs the Independent Forum of Independent Audit Regulators (IFIAR) since 2015; and Gerben Everts chairs the Monitoring Group, which comprises a number of leading international financial institutions and regulatory bodies formally "committed to advancing the public interest in areas related to international audit standard setting and audit quality" (see https://www.iosco.org/about/?subsection=monitoring_group).

[3] In March 2016, the AFM imposed fines on the Big 4 audit firms totaling 6.13m euros following significant identified shortcomings in AFM-inspected audits, leading the AFM to conclude that the firms had not complied with their requisite duty of care. For more details, see https://www.afm.nl/en/nieuws/2016/mrt/boete-big4.

[4] *See IFIAR's report of 3 March 2017 entitled '2016 Inspection Findings Survey. (https://www.ifiar.org/activities/annual-inspection-findings-survey/). The survey is a collection of the reported findings of 36 international supervisors between 30 June 2015 and 30 June 2016 with respect to the six largest international audit firms.*

[5] For a full transcript of Everts' speech, see https://www.accountant.nl/contentassets/bac1e89865b147f29970cb9ccf923c83/everts-speech-foundation-audit-research-8-june-final.pdf

[6] The difficult nature of the profession's position was well highlighted by Canning & O'Dwyer (2013; 2016) in their studies of professional accounting bodies' reactions to the initial threat of independent audit regulation in Ireland. The profession's preference for maintaining the status quo of self-regulation was seen to reflect some of the internal dynamics of 'moral seduction' (Moore et al., 2006) wherein professionals become unconsciously biased, deny the 'reality' of the gradual accumulation of pressures over an extended period, and fail "to appreciate the extent to which the strategies they adopted actually exhibited extreme self-interest even if they themselves may have perceived them as reasoned and balanced" (Canning & O'Dwyer, 2013, p. 189).

[7] Accessible at https://www.afm.nl/en/nieuws/2017/juni/kwaliteitslag-oob.

[8] Accessible at https://www.government.nl/documents/speeches/2017/06/08/speech-by-minister-of-finance-jeroen-dijsselbloem-at-the-foundation-for-auditing-research.

[9] It is also worth noting that at the same conference, Gerben Everts, in his aforementioned speech also agreed with the Monitoring Committee for Accountancy (MCA) that proposed reform measures are unlikely to be sufficient to eliminate causal structural problems (p. 9). So, now, what about that car?

[10] These themes in the 2014 public interest report include: the pursuit of robust governance; making 'competing on quality' the basis for the earnings model; establishing a remuneration and assessment policy with the right incentives; ensuring constant quality monitoring and improvement; giving due attention to measuring culture and communication; and ensuring an effective reporting and audit chain.

[11] Accessible at https://pcaobus.org/News/Speech/Pages/05292014_USF.aspx.

[12] Under the Dutch Audit Profession Act mandatory audit form rotation became effective in the Netherlands from 1 January 2016.

[13] For example, some see the profit orientation as dangerously dominant (even including former senior public accountants such as Jules Muis), others see the profit incentive as being good for quality or a claimed problem that lacks supportive evidence and verification. Some view high levels of remuneration as vital to the recruitment of highly skilled staff, others want remuneration processes stripped of perverse incentives. Some see market interest and the common interest as fundamentally conflicting, others see them as mutually compatible. Some regard reputational risk as a sufficient counter to temptations to conduct lower quality audits, others see quality as having become a less significant driving force in the commercialised modern audit world (Future Accountancy Profession Working Group, 2014, pp. 45-46).

[14] Such matters have been brought into high profile with very recent events in the Netherlands, which saw, in December 2017, two of the large accounting firms succeed with a direct legal challenge to the legitimacy of the AFM's fines on the firms for inadequate auditing (see https://www.accountant.nl/nieuws/2017/12/everts-afm-uitspraak-rechter-is-grote-stap-terug-in-de-tijd/). The Rotterdam District Court concluded that the AFM could not adequately form a judgement on the firms' duty of care on the basis of inspecting a limited number of audits and associated working papers – and stressed that there was a material difference in drawing conclusions on the adequacy of the practices and judgements of individual audit partners and the firms more broadly. At the time of writing, it is anticipated that the AFM will appeal such a judgment. A follow up piece in the (Dutch) Accountant magazine has vividly demonstrated that the judgment could have a range of unforeseen consequences and lead to an expansion rather than a reduction in the scale and burden of inspection work (see https://www.accountant.nl/opinie/2018/1/pwc-en-ey-behalen-pyrrusoverwinning-op-afm/).

[15] Such an expressed concern on the part of the Dutch profession regarding the decline in the individual status and significance of audit professionals does appear to stand in some contrast to the premises on which the December 2017 judgment of the Rotterdam District Court appear to have been based (i.e., that audit files are primarily a reflection of the work of individual 'partners' rather than the firm itself).

[16] See http://www.eaa-online.org/r/EAR_Special_Issues for a call for research on *new directions in auditing research.*

[17] "In the Netherlands, an independent voice from academe has largely been missing, since the great majority of accounting and auditing professors are full-time partners in audit firms. Moreover, in much of their published work, they address practical issues as would audit partners who have no university affiliation. Practical research is important, especially in a practical field. But accounting and auditing are also disciplines of study with a rich intellectual tradition. One can query whether part-time accounting and auditing professors can be expected to engage in the kind of fundamental research – which provides a platform for the advancement of the field – that one associates with the mission of the university." (Zeff et al., 1992, p. 377).

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