



# Report

## Collaboration in the performance of statutory audits requires safeguards

September 2022

### An exploratory study of methods of collaboration by audit firms with a regular licence

#### 1. Development in collaboration among regular licensees prompts an exploratory study

The Dutch Authority for the Financial Markets (AFM) has observed a development among audit firms holding a regular Wta-licence whereby they are considering or have already entered into collaborative relationships with other audit or accounting firms<sup>1</sup>, with the aim of improving the quality of their statutory audits.

The AFM exercises direct supervision of audit firms with a regular licence since 1 January 2022. To obtain further insight into how this collaboration is structured and the associated opportunities and risks, the AFM has conducted an exploratory study among regular licence holders.

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<sup>1</sup> Reference to 'audit firms' in this report concerns firms holding a regular Wta-licence. Reference to 'accounting firms' concerns firms without a Wta-licence.

### 1.1 Insights into forms, opportunities and risks of collaboration

The AFM has conducted an exploratory study involving 16 audit firms. The study did not include any testing with respect to statutory or other standards. The AFM obtained insight into the opportunities presented by collaboration, the various ways in which the collaboration takes place, the risks to quality involved and the safeguards implemented by the audit firms. These insights can be used by audit firms with an existing collaborative relationship or firms entering into such relationships in the future to further ensure the quality of their statutory audits.

### 1.2 Document structure

In this report, the AFM lists the insights obtained from the recurring themes in its study. The yellow boxes concern practical examples selected by the AFM. These examples describe an actual application by the audit firms in the study of the requirements under the Audit Firms Supervision Act (*Wet toezicht accountantsorganisaties*, or Wta), the Audit Firms Supervision Decree (*Besluit toezicht accountantsorganisaties*, Bta) and the Regulation on the Independence of Auditors in Assurance Engagements (*Verordening inzake onafhankelijkheid van accountants bij assurance-opdrachten*, or ViO).

Section 2 lists the opportunities presented by collaboration and how collaboration is structured by holders of a regular licence. Section 3 describes the risks to quality and the quality safeguards in case of far-reaching collaboration. In section 4, the AFM states its views of collaboration by audit firms. Lastly, section 5 describes how the study was conducted.

## 2. Regular licence holders see opportunities for improving the quality of their statutory audits through collaboration and working together in various ways

The exploratory study shows that audit firms are looking for collaboration in order to (continue) safeguard the quality of their statutory audits.

### 2.1 Three key opportunities for improving the quality of statutory audits

The regular licence holders consider that collaboration presents three key opportunities.

#### 1. Scale benefits.

Sufficient scale allows an audit firm to invest in promoting quality in the performance of statutory audits. For example, investments in audit software, audit methodology, audit tooling, standardisation and training. In 2021, the AFM concluded on the basis of [data analysis](#) that there was a significantly greater chance that the statutory audits by audit firms performing less than 15 statutory audits per year would be of insufficient quality. Collaboration would potentially be a solution whereby audit firms performing less than 15 statutory audits per year could achieve sufficient scale to (further) ensure the quality of their statutory audits.

#### 2. Building sufficient expertise, experience and specialisation.

Many smaller audit firms do not possess the experience, expertise and specialist knowledge of all aspects of auditing financial statements in the increasingly complex environment in which the auditor operates.<sup>2</sup> Collaboration could offer a solution for these firms. They can make use of the expertise, experience and specialist knowledge available in the collaborative relationship and do not have to acquire this on their own and in-house.

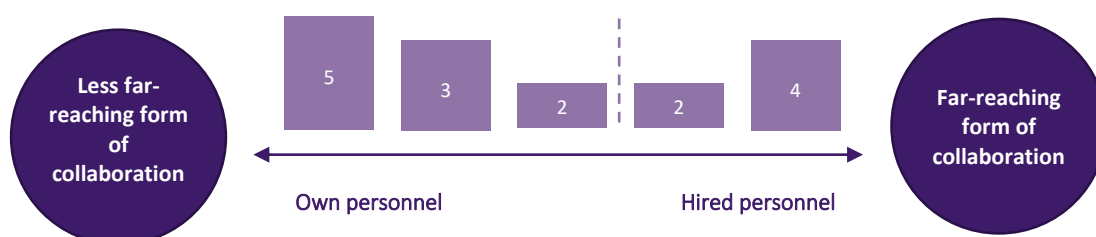
#### 3. Reduced independence risk.

The broad range of services that audit firms can provide to audit clients may lead to independence risks, such as threat of self-assessment in case of provision of both audit and non-audit services. A collaborative relationship in which a regular licence holder performs statutory audits and another accounting firm provides the non-audit services ensures that assurance engagements are separated from other services. Collaboration can be an option to reduce these independence risks.

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<sup>2</sup> Due to increasing complexity of audit clients and their environment, the increasing complexity of legislation and regulation and other developments such as increasing digitalisation, and the associated increasing or changing (IT-related) risks.

Figure 1: The extent to which audit firms engage personnel and the extent to which audit clients are introduced varies from one firm to another



## 2.2 Regular licence holders differ in the form of collaboration

The study shows that audit firms use various forms of collaboration. Generally speaking, these collaborative relationships take two forms:

1. 10 of the 16 audit firms apply a **less far-reaching form of collaboration**. Here, the collaboration is primarily about the introduction of a statutory audit to the regular licence holder. The regular licence holder then performs the statutory audit independently.
2. 6 audit firms apply a **far-reaching form of collaboration**. In this approach, partner firms<sup>3</sup> or independent professionals<sup>4</sup> are used (to a greater or lesser extent) for the performance of statutory audits.

### *Less far-reaching form of collaboration*

In the less far-reaching form of collaboration, a (strategic) firm refers a statutory audit to a regular licence holder.

In most cases, the regular licence holder then performs statutory audits independently and agrees with the introducing firm that the licence holder will not provide any other services to the audit client. These agreements are usually made orally and are based on trust.

Figure 2: Less far-reaching form of collaboration



There is one case in which these agreements between the regular licence holder and the introducing firm are contractually concluded. This mainly concerns a formal confirmation by the regular licence holder that it will not provide any non-audit services to the related audit client(s).

This study did not identify any payments or other counter services by the audit firms for the referral of audit clients.

### *Advantages of the less far-reaching form*

The strict separation between statutory audits and non-audit services in this variant is an important safeguard against independence risks resulting from concurrence of services. In this variant, statutory audits are performed by the regular licence holder and non-audit services are provided by the introducing firm.

<sup>3</sup> Also named participating firms or member firms.

<sup>4</sup> A registered auditor or accounting consultant with certification authority.

According to the regular licence holders, the audit evidence they receive is of good quality due to the involvement of the introducing firm in non-audit services. For instance, if the introducing firm provides support to the audit client in the preparation of its financial statements, the provision of audit evidence or answering questions from the external auditor.

This implies less adjustment by the regular licence holder is needed during the audit of the financial statements and the statutory audits can be performed more efficiently and effectively.

*Disadvantages of the less far-reaching form*

The regular licence holders also cite disadvantages. The licence holders sometimes experience pressure from the introducing firms. In the experience of the regular licence holders, the introducing firms adopt the position of the client, and criticise the number of the procedures performed by the external auditor. This occasionally leads to discussions about sample sizes, audit differences or the time taken to perform statutory audits.

In the profession, this less far-reaching form of collaboration is also known as ‘audit only’. It may be the case that the regular licence holder in question provides only assurance services or that the regular licence holder offers audit-only services as part of its full-service portfolio. In the latter case, the regular licence holder could offer non-audit services, but refrains from doing so due to its agreements with the introducing firm. The regular licence holder may also be structured as an audit-only label of a full-service audit firm. These regular licence holders with an audit-only label have little to no personnel of their own and use the personnel of the full-service audit firm for performing statutory audits.

*Far-reaching form of collaboration*

In the far-reaching form of collaboration, the regular licence holder uses to a greater or lesser extent external auditors and employees from partner firms for performing statutory audits.

Figure 3: Far-reaching form of collaboration



In this variant, the regular licence holder may not have employees of its own and may engage external auditors and employees from partner firms. It may also be the case that the regular licence holder’s audit team is supported by employees from partner firms. The 6 audit firms applying a far-reaching form of collaboration perform around 500 statutory audits a year, with the number of statutory audits per regular licence holder varying from 8 to 180. The number of participating firms or independent professionals ranges from 2 to 22.

The allocation of costs and income from statutory audits also varies. There are audit firms that receive a fixed percentage of the revenue from statutory audits performed from the participating firms. In other cases, audit firms receive a fixed annual payment from partner firms and pass on the costs and revenue to the partner firm concerned. In addition, partner firms receive a share of the result of the audit firms in their role of shareholders.

*Advantages of the far-reaching form*

In the far-reaching form of collaboration, the partner firm can (continue to) perform statutory audits, with support from the central organisation of the regular licence holder in the form of quality-enhancing measures. These measures consist for example of the facilitation of an electronic audit file, including standardised and firm-specific working programmes and templates, audit tooling, providing training courses and professional consultation or support from an engagement quality control reviewer. In this form therefore, the partner firm enjoys the scale benefits from the collaboration. The partner firm can thus use any available expertise, experience and specialist knowledge at partner firms in the collaborative relationship.

### *Disadvantages of the far-reaching form*

This far-reaching form of collaboration involving hiring to a greater or lesser extent external auditors and other employees from other firms also involves risks. For instance: How does the regular licence holder maintain control of the employees engaged, or how is the independence of these employees safeguarded? Quality safeguards are needed for these risks.

### **3. The far-reaching form of collaboration requires quality safeguards**

The study shows that the far-reaching form of collaboration involves risks to quality that can be mitigated by means of safeguards. The method and depth of these safeguards at the audit firms in this study vary. The following gives a (non-exhaustive) description of the risks and the safeguards in place at the audit firms applying a far-reaching form of collaboration. The measures stated are not an exhaustive list and serve as examples of potential safeguards in current or future forms of collaboration.

#### **3.1 Collaboration involves risks as well**

The AFM notes that collaboration with other audit firms, in which external auditors and other employees are hired, presents risks as well as opportunities with respect to inadequate expertise, independence and uniform application of the quality control system. These risks may affect the quality of statutory audits.

#### *Risk of insufficient expertise*

Participating firms usually do not hold a Wta-licence and frequently provide non-audit services (compilation, advice) to clients. This increases the risk that fewer measures will be taken to ensure the expertise of the auditors and other employees performing statutory audits, that employees have less experience with performing statutory audits and that an audit mindset may be lacking.

#### *Risk of 'illusory' independence*

In this far-reaching form of collaboration, statutory audits are performed by the regular licence holder and non-audit services are provided by the participating firm. If the regular licence holder engages external auditors and employees from the participating firm for the performance of statutory audits, or in case of a network as described in the Wta and the ViO, concurring services may be provided. This concurrence may not be visible to users of the financial statements, as it appears that the regular licence holder performs only statutory audits.

### *Risk of inadequately uniform application of the quality control system*

Various participating firms are involved in the collaboration. This poses the risk that the auditors and employees at these firms apply their own working methods either fully or to some extent, and do not (or not sufficiently) follow the quality control system of the Wta-licence holder.

The AFM calls on audit firms that apply a form of collaboration or intend to do so to devote attention to this.

#### *Safeguards in place*

The audit firms in the study have implemented various safeguards to mitigate risks to quality. The safeguards generally applying to this form of collaboration are as follows:

- Safeguards at the start of the collaboration relating to expertise.
- Safeguards for the engagement of personnel relating to independence.
- Safeguards to ensure uniform application of the quality control system.

#### **3.2 Safeguards at the start of the collaboration relating to expertise**

##### *Requirements for participation and expertise*

Audit firms using a far-reaching form of collaboration set requirements for participation of an accounting firm or independent professional in the collaboration.

For instance, they require screening of candidate firms or independent professionals based on expertise (diplomas, permanent education, professional qualities, CVs), references and motivation. They also include completed audit files and budgets in the assessment or use a probational period before acceptance. They may also require membership of an industry association (such as the SRA).

A participating firm may also be required to join the board of the audit firm. This creates a collective board by the participating firms, which encourages a long-term relationship.

### **Practical example: An audit firm follows a standard admission procedure**

One audit firm follows a standard working programme for its admission procedure:

- Checking public registers.
- Conducting an orientation interview focusing on motivation, reputation and risk profile.
- Reviewing additional documentation, such as internal and external tests and incidents.
- Performing audit file reviews.

The board is given a recommendation on this basis. A unanimous decision is required for admission.

### *Agreements regarding the collaboration and separation of services are recorded*

Audit firms using a far-reaching form of collaboration conclude arrangements in a (collaboration) agreement. Some audit firms also conduct a structured regular evaluation of the collaborative relationship.

Two of the six audit firms have agreed with their participating firms that the audit firm performing the audit will not be exposed to any commercial risk. This is borne by the introducing party. Reducing commercial incentives can contribute to a focus on quality.

All the audit firms using a far-reaching form of collaboration make a separation between assurance and other services. The audit firms provide assurance services, while non-assurance services are provided by the partner firms. These agreements are usually recorded in the collaboration agreement.

### **3.3 Safeguards for the engagement of personnel relating to independence**

#### *The engagement of external auditors and employees requires additional safeguards relating to independence*

To a greater or lesser extent, the audit firms engage personnel from the participating firms for the performance of statutory audits. The external auditor is usually employed by one of the participating firms and is also affiliated<sup>5</sup> to the overall entity holding the Wta-licence. If personnel are engaged, safeguards are needed, as statutory audits are performed by employees of the participating firms (most of which do not hold a Wta-licence).

The audit firms record independence confirmations at organisation, employee and audit file level. Statutory audits within a network may involve a more onerous procedure with a separate memorandum. In one case, the compliance officer assesses all statutory audit files annually for integrity and independence. Some audit firms also plan conducting internal quality reviews of independence. In addition, an annual statement of non-audit services provided by the participating firm is prepared.

### **Practice example: The audit team applies a structured procedure for assessing the team composition and the EQC reviewer tests the actual team composition**

The audit firm has a standard form for assessing the independence and professional competence of the team members. They assess the CVs of the team members and the records of their permanent education. This form is included in the audit file. If there are changes to the audit team, the team has to notify the compliance officer accordingly.

Furthermore, the engagement quality control (EQC) reviewer tests the adequacy of the records and whether the assessment corresponds to the actual composition of the team.

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<sup>5</sup> Reference here to external auditors employed by an audit firm is to auditors who are in employment. Reference to external auditors affiliated to an audit firm is to auditors performing audits on the basis of a contract other than an employment contract with the audit firm.

### 3.4 Safeguards to ensure uniform application of the quality control system

*Collaboration requires the involvement of the board and an in-depth evaluation of the quality control system*

The audit firms require the approval of the board for acceptance of statutory audit engagements. Their board then appoints an external auditor to perform the engagement.

The audit firms in the study have various safeguards in place for monitoring the quality of their statutory audits. In most cases, an engagement quality control review (EQCR) is conducted. Some audit firms conduct an EQCR for every new audit client. On average, an EQCR is conducted for a quarter of the statutory audits performed. In some cases, audit firms also apply audit engagement coaching.

It is notable that the EQCRs are generally conducted by external parties. An EQCR conducted by an external party can offer a fresh view and lead to new insights.

Audit firms also facilitate training courses and professional consultations in order to further develop auditors' expertise.

*Conduct an in-depth evaluation of the quality control system*

All audit firms carry out the mandatory annual evaluation of their quality control systems (Section 9a Bta). Variations in the depth of this evaluation can be observed. Most audit firms' evaluations are based on the findings and areas of improvement identified in their internal quality review (IQR).

The audit firms could benefit from the [good practices](#) in de IQRs at PIE audit firms identified by the AFM.

A few audit firms include the quality and independence of the participating firms and the employees used in their evaluations.

#### **Practical example: One audit firm regularly evaluates the collaboration**

One of the audit firms evaluates its quality control system yearly using an evaluation plan. This is a structured programme with requirements for elements of the quality control system. The evaluation plan is assessed annually by the board and revised as necessary. The audit firm reports annually on the evaluation it has conducted. The report sets out the procedures applied in the evaluation, as well as the findings, conclusions, and recommendations. The audit firm thereby distinguishes between specific items of attention for the affiliated firm in question and themes affecting the entire organisation. The report also includes a response from the board, including an evaluation of progress on implementation of improvements.

## 4. Collaboration can be effective under the right conditions

The AFM has explored how audit firms cooperate in the performance of statutory audits. Its study includes 16 audit firms. The study shows that 6 audit firms apply a far-reaching form of collaboration, and 10 audit firms apply a less far-reaching form of collaboration.

### 4.1 Collaboration can contribute to the quality of statutory audits

The AFM understands the challenges faced by (relatively small) audit firms and considers efforts by audit firms to achieve increased scale with respect to the performance of statutory audits to be a logical development. This makes the required investment in quality easier to bear.

The AFM also endorses the potential benefits cited by the audit firms in the study with respect to scale, expertise and independence. Collaboration can be a solution for audit firms and/or accounting firms to further increase the quality of their statutory audits.

In the less far-reaching form, statutory audits are generally performed by employees of the de audit firm itself. This form can also provide an additional safeguard of independent performance of statutory audits if the audit firm only performs statutory audits and does not provide non-audit services.<sup>6</sup>

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<sup>6</sup> The report 'Audit and advice at audit firms' of 28 June 2022 prepared for the special envoys for the future of the audit sector is relevant in this context.

On the other hand, the engagement of personnel requires adequate safeguards. The AFM notes that the 6 audit firms in the study with a far-reaching form of collaboration have generally done this with the aim of improving the quality of their statutory audits. The AFM supports initiatives to improve quality. To ensure independence, it is important that the Wta-licence holder and the participating firm make proper agreements with respect to the performance of statutory audits and the provision of non-audit services.

#### **4.2 The Wta-licence holder is responsible for quality**

It is important that the Wta-licence holder fulfills its responsibility with respect to safeguarding quality at its affiliated firms and/or independent professionals. The AFM therefore considers a situation in which a collaborative relationship is used to continue to perform statutory audits under the aegis of a larger entity with a Wta-licence when the level of quality is insufficient to be undesirable. Based on this study, the AFM does not observe any concrete indications in this respect.

#### **4.3 Audit firms expect future growth**

The number of statutory audits performed by the 6 audit firms with a far-reaching form of collaboration has increased by around 39% in the past three years (2019: 348; 2020: 410; 2021: 485).<sup>7</sup>

The audit firms in the study state that they are aiming to achieve further growth, but that this is often not responsible due to the lack of personnel. The audit firms also state that they often have issues with new clients that are introduced. Despite this, the audit firms expect to achieve growth in the years to come.

#### **4.4 AFM continues to monitor developments**

The AFM will continue to monitor the development of the number and size of audit firms in collaborative relationships in the future and will include the risks identified in this study in its risk-driven supervision.

## **5. About this study**

The AFM conducted its exploratory study in the period from 1 January 2022 to 30 June 2022 at 16 audit firms with a regular licence based on the following three questions:

1. How is collaboration involved in the performance of statutory audits?
2. What are the risks to quality in this respect?
3. How do the audit firms address these risks to quality?

### **5.1 Findings based on documentary analysis and interviews**

The AFM received completed questionnaires from the 16 audit firms. For 6 of these firms, the AFM assessed additional documentation relating to the admission procedure, governance, the responsibilities in the performance of statutory audits and the quality control system. The AFM held interviews to discuss the questionnaires and other submitted documentation with all 16 audit firms.

### **5.2 The study has certain limitations**

The AFM has carried out an exploratory study and has not assessed whether the 16 audit firms have adequate safeguards in place to permanently ensure the quality of statutory audits.

The study did not include any testing with respect to statutory or other standards. The study was not designed to obtain a comprehensive overview of all forms of collaboration and thus has limitations. The study focused on collaborative relationships with respect to the performance of statutory audits in the Netherlands and not on these relationships in national or (inter)national networks.

In its study, the AFM focused on the research questions. The common themes and practical examples should be seen in this context.

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<sup>7</sup> Based on the AFM Monitor of 2019, 2020 and 2021.





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