

The reasons clients change audit firms and the client's perceived value of the audit service: a qualitative study in Canada

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SUMMARY

Audit firms are concerned that clients perceive the audit service as a commodity, with very little value added, resulting in the client switching to firms that offer lower fees. Standard setters are also concerned that if audit fees continue to decline, the quality of the audit service could suffer. The problem is that most of the research investigating why clients switch auditors is conducted using survey and archival data. As a result, there is very little direct evidence from the client as to why they would change audit firms and what value they perceive in the audit service. Therefore, we conducted an in-depth interview study with twenty financial managers to determine why they would switch audit firms and what value they perceive in the audit service. Our results suggest that clients value relationship characteristics (such as communication and trust) over economic ones (such as audit fees including extra billing). Interestingly, price became more important, when communication and trust were absent. Surprisingly, clients also told us that they value auditor independence. Our results contribute theoretically by supporting the audit concept of the value-added audit and the marketing concept of customer perceived value (CPV). For audit practitioners, our results demonstrate that the relationship with the audit partner and the on-site manager is the best way for the audit firms to prevent losing clients. For Canadian regulators, our results show that audit firms can build close relationships without pressure from the client to reduce (threaten) auditor independence.

Keywords: auditor switching, audit Fees, relationships, auditor independence, customer perceived value, qualitative interviews.

INTRODUCTION (tense ? Beattie exemplar ?, and cooper article?...intro important !)

We interviewed two marketing directors in a Big-4 audit firm who expressed concern about client loyalty: clients from both private and public companies were switching audit firms for lower prices elsewhere. The marketing directors questioned whether clients were switching only for better pricing, or was there something else that the audit firms could do (other than lowering prices) to add value to clients. Additionally, in this interview, we discussed concerns by the Canadian Public Accountability Board (CPAB) about pressure on audit firms to lower fees which could negatively affect audit quality (CPAB, 2010). This interview showed us that there was a practical need to directly question clients to determine their perspective on reasons for leaving audit firms and their perspective on what the audit firm could do to further add value (?re ook at this sentence).

This same switching question (or concern) was investigated in the audit literature.....and conclusions differ.....????, there is extensive research questioning why clients switch audit firms. The literature provides some insight into this question; however, conclusions are contradictory indicating a need for further research. Moreover, most of the results from this research come from indirect archival data along with a few surveys. Audit researchers are requesting more direct in-depth qualitative research from inside the audit practice (Bédard et al. 2012); and more precisely, audit researchers are requesting interviews with clients to provide additional insight into behavioral reasons for auditor change (Beattie and Fearnley, 1998).

Link???????

We take an innovative approach to this study by adding a marketing perspective regarding customer perceived value. To the best of our knowledge, research in the switching literature into why clients switch audit firms does not include a marketing perspective to help explain causes of why clients would switch firms. This is important because the concept of client loyalty and disloyalty has been studied in the marketing literature and this knowledge could help explain the client's auditor switching behavior. For example, client perceived value (CPV) is shown to affect a buyer-seller relationship (Grönroos, 2000).

Therefore, we take an innovative approach and we add the CPV to provide a theoretical framework and to help interpret our results. Furthermore, service marketing research is requested by audit researchers in order to provide new insights into buyer behaviors (Beattie, 2001).

Therefore, the purpose of our research which is to determine why audit clients would change audit firms. In addition, we seek to determine what value clients would like to receive from their audit firm.

To answer these research questions, we first interviews two marketing executives form a big-4 audit firm which provided us with the audit practice's concern with client loyalty and switching behaviour. conducted This interview provided us the practical foundation of our study and helped us develop a questionnaire. We then conducted twenty face to face interviews with Financial Directors (CFOs and Directors of Finance). We used structured interviews with open ended questions. Our sample of companies has diverse characteristics, such as size and type of industry, and includes both private and public corporations.

We found interesting results. Price was an important switching factor for some clients, but when questioned further, the importance of the relationship with the auditor seemed to reduce the importance of price for the client. The relationship with both the audit partner and audit manager (supervisor) could possibly delay the client's decision to switch (due to price) or stop the decision outright. These results are consistent with our proposition that client's should value relationship characteristics over price. The relationship characteristics most important for the client are communication and trust. Surprisingly, the client also sees values in auditor independence.

Our study is innovative because we started with the service provider (big-4) before going to the field to interview clients (dyadi) and we bring the audit literature a marketing perspective (more precisely the customers perceive value....careful capital CPV or small....be consistentexemplify client or customer in cpv.....be consistent)

Our paper is organized as follows. In the following section we present a literature review that includes a conceptual framework of the auditor-client relationship and a theoretical framework from the marketing literature. In the subsequent section we present our interview method and the results of the

interviews. In the final section we discuss our results and highlight the important contributions of our study, theoretical and practical, along with future research and our study's limitations. .

LITERATURE REVIEW

In this literature review we review the audit switching literature, which provides insight into why clients would change audit firms. We then present the auditor client relationship and highlight its unique characteristics (our conceptual framework) along with two theoretical perspectives that help predict how the client could perceive the value of the audit service. Finally, we present the Customer Perceived Value (CPV) model from the marketing literature, which provides us with a theoretical framework. The CPV is important for our study since perceived value has been shown to affect switching behavior.

Auditor Switching

Stefaniak et al. (2009) conducted an extensive review of the audit literature to help answer different questions regarding auditor switching. One of these questions was why do clients change audit firms. The researchers presented 57 studies that investigated the causes of auditor switching from the client perspective. They identified ten main causes of client initiated switching: Opinion Shopping, Audit Fees, Audit Firm Characteristics, Auditor Solicitation, Client Satisfaction, Mergers and Consolidations, Accounting Practices and Disputes, Client Characteristics, Shareholders' Preferences and Client-Disclosed Reasons. Amid the 57 studies, 49 relied on archival data. The remaining seven studies included data collected directly from the client: seven mail surveys and one interview study.

Therefore, most of the research that Stefaniak et al.(2009) present relies on data indirectly from archival data. Very little evidence is obtained directly from the client either with surveys or interviews.

Furthermore, the direct evidence that is presented shows conflicting results..

For instance, Beattie and Fearnley (1998) received survey responses from 328 companies that mostly cited audit fees as the reason for changing audit firms. In addition, Beattie and Fearnley (1995) found similar results: the level of audit fees were the most important stated reason for considering auditor change. Conversely, Magari and Baldacchino (2004) found that clients changed audit firms more due to behavioral reasons (such as the auditor-client relationship) than economic ones. These authors conducted a mail survey to 250 companies from which they received 97 valid responses. .

Apart from research cited in the literature review by Stefaniak et al. 2009, other empirical studies show conflicting results. Addams and Davis 1994 surveyed INC. 500 companies to determine why they hired and fired auditor firms. Fees were cited below other issues such as problems with personal relationships and lack of responsiveness. However, Brazel and Bradford (2011) found that fees were cited as the number one reason for switching, equal to dissatisfaction with the service, after surveying 175 IMA members. In addition, Whisenant (2003) looked at 1135 auditor changes over a five year period and lower audit fees were the main reason for client-initiated switching

In other research, Brandon et al. 2012 report causes and consequences of recent auditor switching. Among the research they cite, Ettredge and Scholz, 2007 sampled 4944 companies and results showed companies that reported higher fees were more likely to dismiss their auditors. Similarly, Addams and Davis (1996) present reasons for switching in both private and public companies. The switching reasons were fees followed by not being proactive and lack of responsiveness. The authors conclude that communication by audit firm personnel is critical.

This section of the literature review highlights that the majority of the documented causes of why clients switch auditors comes from indirect evidence and mostly from publicly listed companies. Furthermore, the studies that did obtain direct evidence with client surveys obtained conflicting results. Therefore, we determined that there was a need to conduct in-depth interviews with audit clients with open-ended questions to obtain their perspective on reasons for switching.

In addition, Beattie and Fearnley (1998) stress the importance of using in-depth interviews in future

studies with clients to provide additional insight into behavioral reasons for auditor change. Similarly, four audit academics made presentations at this past year's American Accounting Association Midyear audit meeting, stressing the need for further qualitative field studies in audit in order to get more in-depth direct evidence from inside the audit practice (AAA, 2012).

Before we present our theoretical framework, we provide a brief overview of the auditor-client relationship in order to highlight the unique characteristics of this relationship. This is important in order to better understand what value clients would perceive from the audit service.

The Audit-Client Relationship

The client-auditor relationship is different from other typical buyer-seller relationships primarily because clients pay for a service of which they are not the intended user. This relationship is presented in Figure 1. The intended users of the audit service provided by auditors are external users such as bankers and investors; and the value of the auditor's report for the external users is based on an independent auditor (Arens et al, 2011).

Insert Figure 1 here

The fact that the client is not the intended user of the audit service and that the client needs to remain at a certain distance from the auditor raises the question of what value the audit provides the client. The accounting literature provides insightful yet conflicting answers to this question.

Goldman and Barlev (1974) (G & B) argue that even though the auditor does solve some non-routine issues, most of the auditor work is routine and does not solve a problem. In addition to routine work, the beneficiary of the audit service is not the paying client. As a result of these two issues (routine service and a beneficiary other than the client) the client would not perceive the audit service as valuable (Goldman and Barlev, 1974)¹

In contrast to the G & B model, Beattie et al. (2000) argue that clients don't rely on the core audit service but rather the additional advice from the auditor which is referred to as the added-value audit. This

¹ Goldman and Barlev (1974) argue that this explanation is why the power is in the hands of clients, which makes it easy to fire auditors, creating problems for auditor independence.

added-value audit goes beyond the standard audit advice related to the year-end management letter, advice on fraud and internal controls; and this is not to be confused with fee based consulting services. The added-value audit is additional and informal business advice (Beattie et al. 2000; Eilifsen et al. 2001). Given that most of the value of the audit service for the client would seem to be derived from additional advice, we draw on a marketing model that describes how value for customers arises from additional services beyond the core service offering; and this value predicts switching behavior.

Customer Perceived Value (CPV)

Paulin et al (2000) use the concept of customer perceived value as a dependent variable because it helps explain repeat purchase behavior, brand loyalty and relationship commitment. We noted that what is missing in the auditor switching literature is a theoretical explanation of why clients would switch or not switch (stay loyal) to an audit firm. A theoretical framework such as a customer perceived value seems important in order to help explain switching behavior..

Marketing scholars warn that there is no consensus on one model that can capture all of the factors of a customer's perceived value; it depends on the purpose of the research (Paulin, 2000). For the purpose of this research we borrow the Customer Perceived Model (CPV) conceptualized by Grönroos (1997) because it is modeled as a value measure which leads to customer loyalty. Therefore, since we are interested in understanding why clients switch audit firms, questioning clients on their perceived value of the audit service helps us achieve our objective. In addition, the CPV is a model that includes the measure of value for a core service and additional services, which is consistent with the value-added audit (core audit service and additional advice, Beattie, 2000).

Gronroos (1997; 2000) explain the CPV as follows: $CPV = \frac{\text{Core Solution} + \text{Additional Services}}{\text{Price} + \text{Relationship Costs}}$. We do not use this model to quantitatively calculate the CPV; instead, we rely on it to conceptually understand perceived value. In the numerator of the CPV, the Core Solution is the basic (or core) service provided by the seller. Additional Services are anything the seller provides beyond the core service, which could include additional advice, personal attention, support, and other relationship attributes (Crosby et al. 2002; Gronroos, 2000). In the denominator of the CPV, the Price is

the agreed upon price for the core service. The Relationship Costs are the costs for the customer to enter into a relationship with the service provider. Price has a short term notion and Relationship Costs are longer term and occur during the life of the service delivery. How does this model help us predict perceived value for the audit client?

For the audit client, the Core Solution would be the actual audit service and Additional Services would be any additional advice by the audit firm. The Price would be the price agreed upon in the engagement letter and the Relationship Costs would be the cost for the client to pay staff to deal with auditors and also cost overruns due to delays. Therefore, since it is theorized that the core audit service is for the benefit of external users, based on the CPV, the client would perceive value from an increase in additional advice. However, for perceived value to increase, the additional advice cannot be accompanied with increased Relationship Costs such as extra or hidden billing.

Supported by this literature review, our research objectives are to determine why clients would switch audit firms and what value does the client want from the audit firm. Our proposition², based on Beattie et al (2000), Goldman and Barlev (1974) and the CPV is that the audit client would switch audit firms due more to additional services, including advice, and relationship issues such as personal care than economic reasons such as audit fees

METHOD.....mention meeting with Deloitte

To answer our research questions and verify our proposition, we chose a qualitative approach due to the lack of in-depth data directly from the audit client in the audit literature. We used a purposeful sampling which is recommended when certain criteria for participation is required and when the purpose of the research is an in-depth understanding and not generalization (Patton, 2002). For the purpose of our research, our criteria was that each participant needed to be in a financial position in a private or public company that used audit services of a Big-4 or non Big-4 audit firm. Each participant needed to be

² We do not present a hypothesize, since we do not conduct statistical testing. We do, however, present a proposition to guide our interviews and help interpret our results (Yin 2003)

involved in the decision to hire, dismiss, and maintain the relationship of the audit firm.

Patton (2002) suggests various strategies of purposeful sampling, one of which is maximum variation sampling, recommended for small sample sizes such as ours. The participants in our sample vary in respect to their position, their company characteristics, and their role in the decision making process.

We stopped our sampling after we conducted 20 interviews, because we stopped obtaining new information.. In purposeful sampling it is recommended to terminate sampling when information is maximized, referred to as the point of redundancy (Lincoln and Guba, 1985).

We developed a standardized open-ended interview guide. This type of guide is recommended to keep the interviews focused to assure that the interviewee's time is used efficiently (Patton, 2002). This was important for us, since most of our interviewees were initially not willing to give us more than 30 minutes. We were able to conduct some of the interviews in 30 minutes, but others ranged from 30-60 minutes, depending on the length of participants' answers.

We asked open-ended questions in order to obtain in-depth answers. In addition, we asked questions about future intentions and not about past actual behavior. The reason we did not target companies that had been involved in a past auditor switching decision was because we did not want to restrict our sample due to this criteria, especially given the debate on the predictability of past behavior on future behavior. Ajzen (1991) argues that intentions are an effective predictor of future behavior and the role of past behavior on future behavior is debatable. Sommer et al. (2011) present a future behavior model that does include past behavior, but as an antecedent to intentions. More precisely, regardless of the role of past behavior, it is well documented that intentions are a good predictor of future behavior. In conclusion we asked questions about intentions. It should be noted that even though we asked about intentions, customers did provide reasons for actual past auditor switching in which they were involved.

We developed three parts in our interview guide and our questions were based on our research objective, our literature review, and our theoretical framework (see Questionnaire annex 1) The interview guide was pretested by academics and professionals and subsequently modified for clarity.

The interview guide was then sent to our University's Ethics Committee along with the details of

our interview procedures. We received a certificate from the ethics committee and each participant was made aware of our process (we mostly reassured the participants about the confidentiality of each interview). It was made clear to each participant prior to the interviews that their names, company names, audit firm names or any other information that could reveal their identity, would not be disclosed.

With the approval of each candidate, we audio taped the interviews and they were subsequently transcribed by a local company. The transcribers at the company signed confidentially agreements which were sent to us. Lastly, each participant gave us verbal contentment to use their interviews in our research.

We conducted the interviews in both French and English based on the preference of the participant. The transcription company transcribed the interviews in the language of the interview. We translated the French transcriptions into English for the sake of this article.

To analyze the data we used content analysis and we followed the recommended steps by Creswell (1994; 2005) to code the data. For the first part of our research where we asked reasons why clients would change audit firms, three main themes emerged: audit fees, business knowledge, and relationship issues. For the second part of the interview where we asked about what value the client would want, and three main themes also surfaced: relationship issues, additional services, and auditor knowledge. In the third part of the questionnaire we asked certain demographic questions. In the following section, we present our findings.

FINDINGS³

The important findings of our interviews are that clients want a strong relationship with their auditor, which includes open communication and trust. In addition, the client perceives value more from the additional services and not from the actual audit. However, there is evidence that clients value the core audit service as it provides the validation of their work by a knowledgeable, independent auditor (and this is especially important given accounting complexities such as IFRS). A surprising result surfaced: the client values the importance of independence and clients believe they are also responsible for the maintenance of independence and not only the auditor.

Reasons for changing audit firms (see Table 1)

When we asked clients what would cause them to change audit firms, three main themes emerged: *audit fees*, *relationship issues*, and *business knowledge*. Under audit fees we also include the economic issue of *extra billing*, and the theme *business knowledge* encompasses industry and corporate knowledge. The most cited reason for which clients would change audit firms was relationships issues with the audit firm. Even when factors such as audit fees including extra billing were cited as reasons for auditor change, further discussion highlights relationship issues as the trigger that motivated the client to price shop.

³ We have taken a subjectivist perspective versus a positivist perspective in our data analysis. In a subjectivist perspective we are not interested in finding common themes among our participants. We are more interested in the in-depth data of each participant. For further discussion on these perspectives, Yin (2003) uses a positivist perspective; whereas, Patton (2002) used a subjectivist perspective. Both are acceptable approaches.

Audit fees (including extra billing)

Out of the 20 interviews, six financial executives cited high audit fees (including extra billing) as the main reason for changing audit firms and here are two comments:

The main motivation to change for years has been a question of finance. We were with a big 4 and it was very expensive. There is no value added to pay 100,000\$ versus 60,000\$ for an audit. It's almost 500,000\$ over 12 years that we waste (case 1).

The main factor would be audit fees. Today there is pressure to reduce audit fees, especially when the company is working in a difficult industry when profitability is questionable. Our first cost line is employees and our second is audit fees, so we get pressure within the company and then we get a second pressure from the audit committee (case 5).

Interestingly, when the CFOs of these two companies continued talking about audit fees, they added that issues with their auditor relationships accelerated the decision to seek better pricing. In case 1, the client would still have switched auditors, but a relationship issue regarding trust incited them to change about a year early:

Our Big 4 firm changed our audit partner and sent us a replacement auditor that we didn't trust. The partner demonstrated to us major confidentiality issues so we lost trust in him. This issue accelerated the process, would we have waited a year, maybe before changing (case 1).

In case 5, the CFO, after citing audit fees as the main reason for switching auditors (see above), expressed problems with trust as the instigator to look for better pricing:

Obviously the relationships that we build are with the audit partner and the manager who are our two main collaborators. So a breach of trust with either of these two would force us to look elsewhere (case 5).

Similarly, other clients who mentioned price as a main reason for switching went on to say that relationship issues would cause them to verify other pricing:

What triggered the process here was the way situations were handled which led to some uneasiness with the relationship. There was a restatement that had to be done because there was an issue with currency. The auditors dissociated themselves so it kind of created an "us and them" scenario. The approach became adversarial. Then people said by the way we've been with the same people with for twenty years, we should go to market. Then of course what the shocker is the new guys are bidding 30-40% less. How could the incumbent then reduce his price by 40% to match? Needless to say that auditor was in turn history (case 2).

Therefore, even though clients did cite audit fees as main reasons to switch, further explanations from clients show some preliminary evidence that enhanced relationships would have at the very least weakened the high audit price issue and delayed the switching behavior; or, the client would have invited the auditor to discuss pricing issues instead of proceeding to a request for a price quotation:

If you are happy with the auditor and you think you might have an issue with costs, I think you should really be sitting down with the firm and say, look, you know that I don't really want to go to bid. To me, the costs look like they're over the top and here are the reasons. Can we find a way to work to be more efficient? What can you do? (case 2)

Other than audit fees, clients cited Extra Billing as another economic reason for switching auditors. Clients did not seem bothered by the extra charges, but more so by the surprise factor. In fact, the clients

would have preferred paying more fees upfront or a lump sum fee at year-end instead of paying each time they picked up the phone:

When ever I call my auditor, I get a bill for 1000\$. For example, I just purchased homes for an investment and I want to structure the transaction for tax purposes, and for 15 minutes I got a bill for 1200\$. In the other businesses that I had, I would say in the audit package when I call, cumulate everything and we will look at it at year end, not every time I call (case 12).

It is important to deliver what is promised. It will cost this and the cost and time is respected. Once a relationship is established and we might call someone from the audit firm during the year for some advice and then I get a bill for the ,5 hour that we talked...I have a problem with that.....you know, I would rather pay more audit fees...but getting a bill for a 5-10 minute question...that's irritating (case 4).

Relationship issues, primarily related to Trust and Communication were cited directly as reasons for auditor switching.

Relationship Issues (Communication and Trust)

Nine of the 20 participants directly mentioned relationship issues with their auditors as the main reason for potential auditor switching change. The definition of a business relationship is complex and contains many factors; therefore, when participants mentioned the general concept Relationship we asked clarification to know what specific components of the relationship were important.

The participants highlighted Communication and Trust. They wanted frequent and open, two-way communication. Trust issues were related to the confidentiality of the audit partner:

The Big 4 firm changed our partner and we had a big problem, a big problem with trust....he talked to us about other clients in the transport industry they had....they told us things that happened to

other companies, what they lost and what they gained and what they changed You say to yourself, well it is totally, unacceptable from a partner....a lack of confidentiality therefore, a lack of trust (case 1)

A trusting relationship could make up for high audit fees:

Even if the fees are a little higher, I'm getting all of the other services, and I know can trust them. I'm willing to pay more for the audit...because anytime I need to make a phone call, they're not going to charge me for a phone call and I know I'm going to have the answer that I want (case 16).

Clients also have a high expectation for open and frequent two-way communication with the auditor, without the fear of insulting one another.

It is important that the relationship that I have as CFO with the audit partner is when we consult each other often...he could tell me if I did something that he was not comfortable with right away....the surprise effect is not desirable (case 5).

Moreover, there is some evidence that open communication in a good relationship could help mitigate poor service.

With a good relationship we can simply explain why we are not satisfied with the service and we expect that the firm will take action to fix the service (case 17).

Clients cited the lack of business knowledge as the third reason for auditor switching.

Business Knowledge

Five participants cited the lack of business knowledge by juniors, managers, and partners as a reason to switch auditors. Included in business knowledge are both, knowledge about the company, as well as knowledge about the industry in which the company operates. The result of a lack of business knowledge is the extra time required by the client to explain the business issues to the auditor. In addition,

this extra time is not only perceived as a waste of time for the client but also a potential reason for cost overruns, resulting in higher than planned audit fees.

We changed from a medium size firm to a Big-4 because the medium size firm did not have very much experience in the insurance business...so we had to have many discussions with them to explain our processes and to explain to them the different insurance programs and how they worked. We had to spend a lot of time explaining. For example, there were often audits of our past insurance claims, so we had to explain exactly what happened when there was an insurance claim. We had to really explain the total process (case 14).

.....from the juniors to the manager up to the partner, it is important that they know about our company and our industry (case 13).

In the second part of our interview, we asked questions about what the client could value in the audit and this evidence provides additional support for the client's reasons to switch audit firms.

Customer Perceived Value (see Table 1)

We asked participants what value they would like from the audit service and how could a firm differentiate themselves from other firms. The important findings in this section are that clients primarily value their relationship with their auditor including additional advice. Some clients also value the knowledge of the auditors given the current complexities of accounting, which provides the client reassurance and validation that the client's financial work is well done.

Relationships

It was confirmed by some participants that the actual audit service is a commodity and the differentiating factor is the people delivering the service:

It always comes down to individuals...it's the same thing as a bank differentiating itself from another bank...we are 6 that are similar.....it's individuals...it is the chemistry that is created between clients and their auditor. This becomes the value-added (case 17).

...everybody gets news letters and updates on accounting norms, but to have access to people at the firm to call and brainstorm ideas or technical problems...for example I take the phone and I say we just did this transaction and I think we can account for it this way are there other ways to do it, do it understand it correctly? (case 15)

Additional Services

The client wants to go beyond the actual audit and receive a little more business advice from the auditor. The clients recognize that the audit firm is part of a large network of partners and other clients from different and similar industries, located in different geographical areas. Clients said that they would like to increase their communication with the auditor and benefit from this audit firm network.

....some extra business advice would be extremely important to us. And this is honestly something that is lacking....yes we have a conversation once a year but as a customer, you need those conversations more often than once a year and really like specific. Like there's this research in the software business, did you know about that? They could provide us more regarding the business (case 16).

.....at the end of the year in my year end meeting will come with some ideas but in my opinion does not go very far.....we would really appreciate more....(case 12)

The client wants the additional service to the actual audit without additional fees.

...an audit is an audit....I don't see any difference....the difference would be after the audit...it's the phone calls and they don't charge us for phone calls (case 16).

The validation of the complex accounting issues is also highly valued:

....you are responsible for the financial statements and they're coming in to validate what you did...that's the theory....you know we moved to IFRS...and like it or not this is not what our guys do all day....like for example companies are going through valuation of intangibles and goodwill because the economy's been tough....so people are doing the work but the auditors are challenging you...it kind of puts you on guard (case 2).

....accounting standards are more and more complex and we can with our teams try to interpret the standards but there are always about interpretations of standards so we want to know what is the right vision...to have advice from an audit firm that have seen the application in many areas, it is very useful for us (case 17).

Even though we did not plan on asking about independence in our interview, some participants willingly expressed the importance of auditor independence as a valuable part of the audit service.

Independence (part of CPV)

Clients desiring enhanced relationships with their auditors and additional business advice could be concerning for audit standard setters, since both relationships and additional advice could be blamed for causing threats to auditor independence. However, the client stressed the importance of maintaining a strong relationship while also remaining distant (close but not too close). Independence was in itself an important value for the client, and is also a reason for potential switching.

.....the relationship that the auditor has should be with all parties at all levels in the company, but there should be a special effort for the three parties: the CFO, the owner and the president of the audit committee....and I don't mean invitations to restaurants or to play golf....but rather to stay close...because we are solicited by others so staying close keeps the door closed (case 5).

....a good relationship doesn't mean we have to go for dinner every month or for lunch. No that's it's not that. It's just a phone call, hi is everything going well ?, how's business ? Do you guys need anything? It means we are on their agenda, that they care....it's not just I'm coming for the audit, pay me and see you next year (case 16)

....and I think in the audit, this is challenging for people to understand that the auditors got to kind of draw a line. They are not your friends and they got a job...and I think that companies need to shoulder part of the responsibility (case 2)

Insert Table 1 here

Participant Description (see Table 2)

In the third part of our interview we asked participants some descriptive questions. All of our participants were financial executives and were involved in the relationships with their companies' financial audit firm. The industries and size of the companies where the participants worked varied in size and industry type. Approximately half of the companies were private and the other half were public (two companies were not for profit). This sample provided us a wide variety of companies, which was our objective.

We learned that the decision making for auditor switching was a shared activity. It might be assumed that in the case of a public company the audit committee is responsible for decisions regarding auditor selection and auditor switching. This might be the case in theory; however we obtained direct evidence that the decision making involved the financial executive. In the case of a public company, the financial executive, with or without the approval of the president or owner, forms a team and makes a recommendation to the audit committee, which then takes this recommendation to the board. In none of our cases did the audit committee or the board not choose the firm recommended by the financial executives and their team. In private companies where there is no audit committee, financial executives

shared the decision making with others such as owners and presidents. We did not notice any notable differences in our results (reasons for switching and perceived value) with respect to the different participant descriptions.

Insert Table 2 here

DISCUSSION

The objective of our research was to use an in-depth qualitative interview approach to determine the reasons clients would switch audit firms. We also wanted to determine the client's desired value from the audit. We added this second part to help better understand the client's reasons for switching, because customer perceived value has been shown to lead to client loyalty (Grønroos, 2000).

The main results indicate that a client would most likely switch audit firms when a trusting and open communicative relationship with either the audit manager or the audit partner was lacking. Additional results regarding the added value audit further emphasizes the importance of the client's relationship with the auditor. Clients also want additional business advice and they value the specific knowledge of the auditor. Finally, clients claim that independence is important for them as it provides validation and reassurance. Our results provide various contributions. Firstly we contribute to the empirical audit literature.

Empirical results in the audit switching literature provide mostly indirect evidence from archival data as to why clients would change audit firms (Stefaniak et al.2009). The studies that did use a direct approach did so mostly with survey studies, and the results were mixed. Some evidence suggests that clients change primarily due to audit fees (Beattie and Fearnley, 1998), while others indicate change for more behavioral reasons (Magari and Baldacchino, 2004). Other survey studies also show mixed results.

Our study contributes to this literature by providing an in-depth perspective directly from the client. The results of our study suggest that when participants cited economic reasons for switching, such as audit

fees and hidden costs, there were some behavioral reasons, such as relationship issues, for why audit fees were cited. If auditors would have enhanced their relationships with the clients, either through trust or more open communication, audit fees might not have been cited by some as the main switching reason. Therefore, our interview approach provides evidence that reasons for switching are complex and difficult to determine in mail surveys. Secondly, we contribute to audit theory.

It is theorized that clients would not perceive the audit, in itself, as important, because it does not provide value (Goldman and Barleve, 1974). It is further theorized that any perceived value would need to come from additional services such as business advice resulting from the audit (however not paid consulting service) (Beattie et al. 2000). Activities besides verifying financial statements are considered a by-product of the audit (Eilifsen et al. 2001). Our results support these audit theories. Clients do not see value in the core audit solution but they perceive value in additional services such as advice from auditors. Clients also perceive trustful and open communication with the auditor as a value added. Thirdly, we theoretically contribute to the marketing literature.

Our results support the marketing theory of Customer Perceived Value (CPV) (Groønroos 1997; 2000). The client also appreciates industry knowledge and wants to benefit from some additional advice beyond the core audit service, at no extra cost.. In addition to additional advice, the client values the relationship not only with the audit partner but also with the audit manager and with the juniors as well.. Crosby et al. (2002) stress the importance of relationships as component of the customer's perceived value.

In addition to our empirical and theoretical contribution, our study has practical applications. Audit firms need to continue investing in client relationships. Economic factors such as audit fees and extra billing seem to be more important for the client when the relationship attributes trust and communication are absent. Staying close to clients and providing information could help the client become less price-sensitive. Additional advice for the client does not only need to be in accounting but should also include advice regarding the clients business and industry.

Clients did not mention the value of any activities offered by audit firms such as information

sessions offered to existing and new clients. Instead clients want one on one information and advice. Maybe this is evidence that audit firms should reallocate resources from large information sessions to more one on one attention with the client.

In addition to communication, trust is very important. This is the issue with extra billing, not the economic factor. The client does not like the surprise factor which infringes on trust.

Audit partners were criticized for being present at the signing of the engagement letter and then disappearing, leaving only the manager on site. The audit partner needs to be at the client location more than just at the beginning of the audit and at the closing. A simple phone call now and again to the CFO would be important.

The relationships established with different individuals in the organization are important. It was mentioned that the audit firms needs to do a better job in maintaining a relationship with not only the CFO but also the president and the audit committee (in the case of public companies),

Clients were careful to mention that close relationships do not mean friendships. Clients are not interested in playing golf or being entertained by the auditor firm. Close relationships mean helpful relationships. Clients want an independent validation that the accounting in their department is accurate and they want some extra business advice if possible. The firms have networks and clients expect to gain from the firm's industry expertise.

Clients want the auditor to have industry knowledge and knowledge about the clients company. The client claims that they spend a great deal of time explaining industry-specific information to junior staff and managers which wastes time for the client and creates possible cost overruns. The client understands the problem with junior staff turnover in firms due to the structure of audit firm. Therefore, the client relies on the knowledge of the on-site manager. The concern, however, is that when the on site manger rotates, there is not a good enough transfer of knowledge to the new manager and the client is stuck educating the new manager.

And lastly, it is important that the audit firms and standard setters know that clients in this study valued the fact that the auditor was independent. The client also feels responsible to help the auditor

remain independent. Therefore, in the case of a disagreement regarding an accounting issue, the auditor should stick to their position without fear that they will offend this client.

LIMITATIONS AND FUTURE RESEARCH

This research has certain limitations. Firstly, it is a qualitative study with a small sample size; therefore, it is important not to generalize the results. Secondly, we did not require participants to have been involved in a past switching behavior; instead we asked about intentions, based on certain research in decision making. It could be argued that past switching behavior is a better predictor of future behavior.

This research provides an opportunity for future research. A mail survey with a wider population could be conducted with a questionnaire designed to determine if the auditor could use relationship attributes in order for the client to put less emphasize on audit fees. In the same study, participants could be asked to identify what value they are getting from the audit and what audit value would like prefer receiving. We could then ask if any desired audit value would reduce the impact of price.

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TABLE 1

Clients' reasons for audit firm switching and their perceived value

<u>Case</u>	<u>Reason for change</u>	<u>CPV</u>
1	<p><u>Price</u></p> <p>...it's been a while since we have been saying, it's very expensive...there is no added value paying 100 000\$ instead of 60 000\$</p>	<p><u>Additional Advice and Trust</u></p> <p>...it would be important to give us some advice...and we need someone we can trust.</p>
2	<p><u>Price and Service</u></p> <p>...for sure cost is one...but it would have to be material it...but a lot of times the trigger point is the servicing side.</p>	<p><u>Validation</u></p> <p>...in theory they are there to validate...in reality ...as it pertains to things like IFRS asking you to discount cash flows to support goodwill....these guys are challenging you...it kind of puts you on guard</p>
3	<p><u>Business Knowledge</u></p> <p>I want someone that will tell me more than what is in the accounting manuals....I want to know how to apply the standard in my industry....</p>	<p><u>Additional Advice</u></p> <p>...and I need business advice beyond the audit of the Financial statements ...for example someone who can tell if my sales expenses are high or low in respect to my revenues...</p>

<u>Case</u>	<u>Reason for change</u>	<u>CPV</u>
4	<p><u>Relationship with partner</u></p> <p>...price is important but is it the number one issue....not sure....the relationship with the partner and the manager involved in the file is important....we changed due to price and the confidence in the partner to modify our structure to help reduce taxes.....</p>	<p><u>Additional Advice and Validation</u></p> <p>...the audit side....its a necessary evil....but it validates our work...so we know our costs and margins are properly accounted for....I would like it if they could tell us...you are in one sector and another company is in the same sector... you should speak....a form of strategic alliance....</p>
5	<p><u>Price and the relationship (trust with the partner and the manager</u></p> <p>...there is an important pressure on audit fees....our relationship is built with the partner and the manager, and if there was a breach of trust with one of them, we would look elsewhere (go out for tender).....</p>	<p><u>Validation</u></p> <p>....our auditors do not verify our financial statements each quarter so during the year I validate important transactions and at year end I rely on them to verify my work, and I hope for no changes or surprises....</p>
6	<p><u>Relationship with audit partner</u></p> <p>...the ease to work with the partner and the communication....the audit is a necessary evil....so the good communication that the auditor has with our owner is the point number one.....</p>	<p><u>Independence and Validation</u></p> <p>...there is no value in the audit...only the fact of independence...so that my president is reassured with by numbers...</p>

<u>Case</u>	<u>Reason for change</u>	<u>CPV</u>
<u>7</u>	<p><u>Relationship with audit partner</u></p> <p>...if we need help, I know I can call our auditor and know that he will take care of things for us...this is more important than price.....</p>	<p><u>Additional Advice</u></p> <p>...I sure would love this....you charge 225\$ to come say everything is fine....I would like after our analysis... here are some things you could work on....</p>
<u>8</u>	<p><u>Business Knowledge</u></p> <p>...when they come to do the audit and the juniors don't read the file of the company and have not learned the industry (mining) and they come in every 5 minutes to ask questions....this is bad quality.</p>	<p><u>Additional Advice and Communication</u></p> <p>....we want to be made aware of the industry and we want industry updates....lots of communication</p>
<u>9</u>	<p><u>Relationship with the partner</u></p> <p>...I would leave firms if there was a lack of support on any issues....</p>	<p><u>Additional Advice</u></p> <p>....we want to know more about things like transfer pricing, and lean accounting, for example....</p>
<u>10</u>	<p><u>Relationship with the partner</u></p> <p>...we have a manager that is very disorganized.....but we stay because of the excellent relationship with the audit partner....</p>	<p><u>Additional Advice</u></p> <p>..since the auditor spends a number of weeks and they see man elements they should give us some advice such as how to better manage our inventory, without going to a point of a consulting mandate.... sometimes will find errors...</p>

<u>Case</u>	<u>Reason for change</u>	<u>CPV</u>
11	<u>Business Knowledge</u> ...they have a very good knowledge on the industry and our activities here....and we get the same staff...juniors that came here and that are promoted to manager will come back...so the knowledge is continued.....	<u>Validation and Communication</u>a confirmation of internal controls....open, timely, and transparent communication
12	<u>Price (Extra Billing)</u> ...as. soon as I call, I get a bill for 1000 dollars....I call because i purchased an investment and i am looking for an appropriate tax structure and bang....1200\$ bill....	<u>Additional Advice and Communication,</u>it is important that the auditor is easy to reach and that he understands my business....I would like additional advice (if the firm could coach our CFO)
13	<u>Business Knowledge</u> ...from the juniors to the partner, they need to know the business...our systems are particular here...	<u>Additional Advice :</u> ... if they notice something it would very interesting if they could tell us....even though we know it is not their mandate to tell us how to run our business and how to make our business decisions.....

<u>Case</u>	<u>Reason for change</u>	<u>CPV</u>
14	<u>Business Knowledge</u> ...in the insurance business the audit firm did not have a lot of experience so we had to spend a great deal of time explaining insurance programs and how they worked....	<u>Communication</u>it is nice for the partner to be there at the engagement letter but what about communication during the audit...where are we at....be present...
15	<u>Price and Relationship with the managers and staff..</u> price is a factor but ultimately they need to audit in an organized manner and not bother us too much....	<u>Relationship</u> I am not looking for a recommendation just someone to discuss with... that is value added for me.
16	<u>Relationship (Trust)</u> ...I know that when I make a call I won't get a bill right away...for this I am willing to pay a little more...but obviously if its double I will consider switching...	<u>Additional Advice</u> ...the value I get from the audit is specific questions regarding international laws....business advice is lacking....they could tell us you know there is research in the software industry did you know about it?

<u>Case</u>	<u>Reason for change</u>	<u>CPV</u>
17	<u>Relationship</u> ...if we are not happy with the service, such as difficulties with personnel from the firm or a problem with somebody competence we would discuss with the partner before going to look elsewhere.....	<u>Relationship</u> ...the relationship with the auditors becomes the value added.....
18	<u>Relationship</u> ...if you have an auditor that you have a good relationship with....you can manage things so you don't get last minute surprises...	<u>Validation</u> As the CFO it does bring a sanity check and a cross check on how things are, on what's happening in different parts of the organization.
19	<u>Relationship</u> ..if i have to argue with the firm, i would change...we want their advise, but we have an opinion and we want to be listened to....	<u>Validation</u> They come to confirm that the numbers are correct...they validate my work....would like to get notifications and accounting changes....
<u>20</u>	<u>Extra billing</u>I hate getting billed every time I ask a question...	<u>Additional Services</u> ...dedicate a few hours a year to let me know what's new...offer me something to save money...present me to other clients

TABLE 2**Participant Description**

Case	Position	Private or Public or Not for profit	Size # emp.	Big 4 – Non Big 4	Industry	Decision making involvement
1	CFO	Private	400	Non Big-4	Transport	With the owner
2	CFO	Public	10000	Big-4	Printing	With the president and the audit committee
3	CFO	Private	11	Non Big-4	Multimedia	With the president
4	CFO	Private	120	Big-4	Telecom	With the president
5	CFO	Public	5000	Big 4	Transport	With CFO and audit committee
6	CFO	Private	50	Non Big-4	Auto Parts	Sole decision- maker

Case	Position	Private or Public or Not for profit	Size # emp.	Big 4 – Non Big 4	Industry	Decision making involvement
7	Director of finance	Private	70	Non Big-4	Food Service (Franchising)	With the president
8	Director of finance	Public	30	Big-4	Mining	With the president and audit committee
9	Director Finance	Public	350	Big-4	Flooring Manufacturing	With CFO
10	Corporate controller	Private	50	Non-Big 4	Auto Parts	With CFO
11	Director Internal Audit	Public	12000	Big 4	Aeronautical Manufacturing	With CFO and Audit Committee
12	President	Public	100	Non Big 4	Construction	With audit committee
13	Director Finance	Private	8500	Big-4	Food Processing	With President

Case	Position	Private or Public or Not for profit	Size # emp.	Big 4 – Non Big 4	Industry	Decision making involvement
14	Director Finance	Not for profit	90	Non-Big 4	Professional Association	With CFO and audit committee
15	Corporate Controller	Public	5000	Big-4	Transport	With CFO, President and audit committee
16	CFO	Private	100	Big-4	Software	Sole decision maker
17	VP Finance	Public	20000	Big-4	Finance	With audit committee
18	CFO	Private	2500	Big-4	Mining	With audit committee
19	Director Finance	Not for profit	148	Non Big-4	Professional Order	With audit committee
20	CFO	Private	25	Non Big-4	Information Technology	With president and the board.

FIGURE 1
Relationships Among Auditor, Client, and External Users (Arens et al 2011)

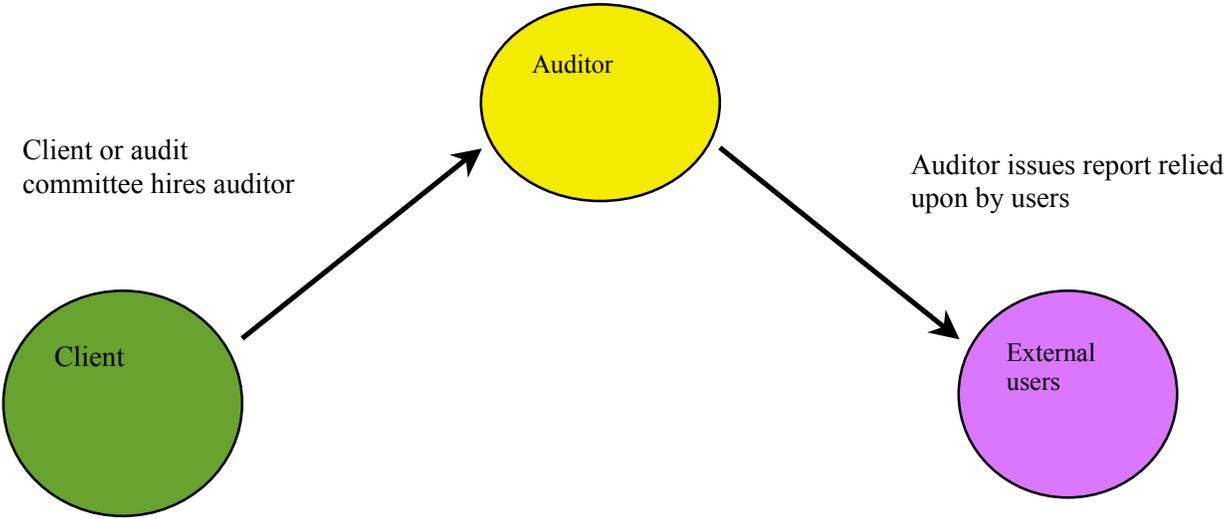
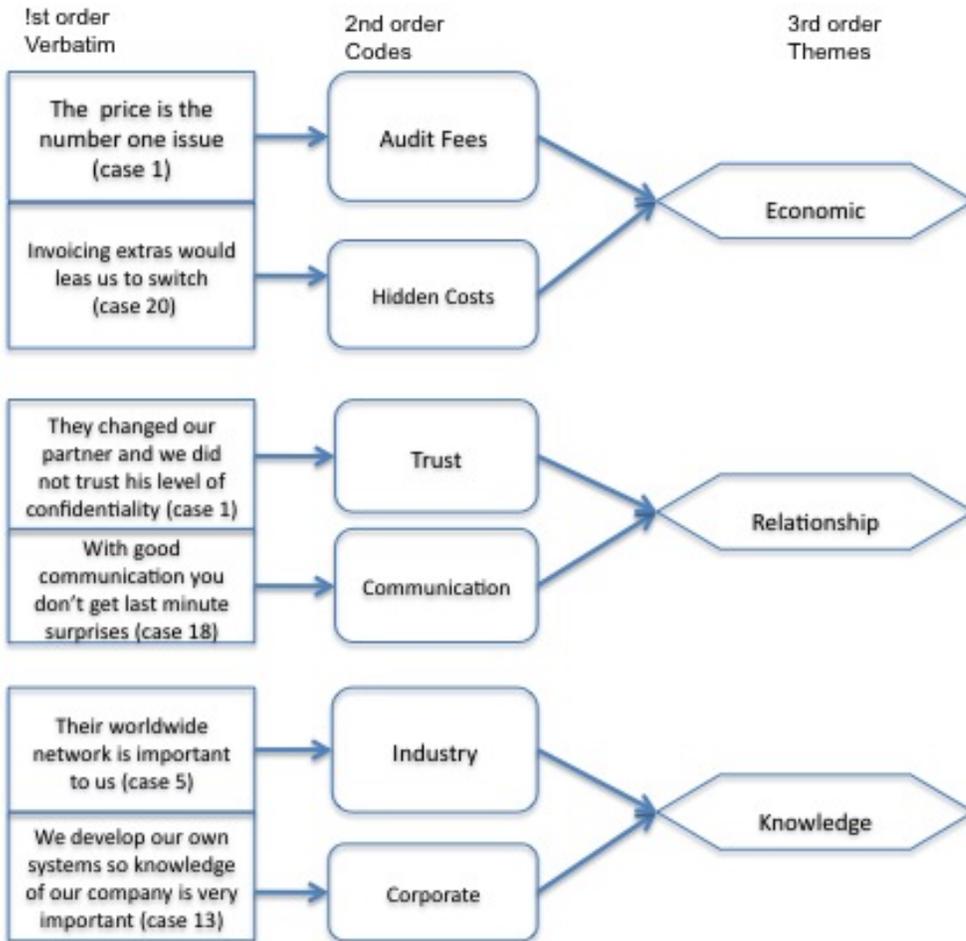
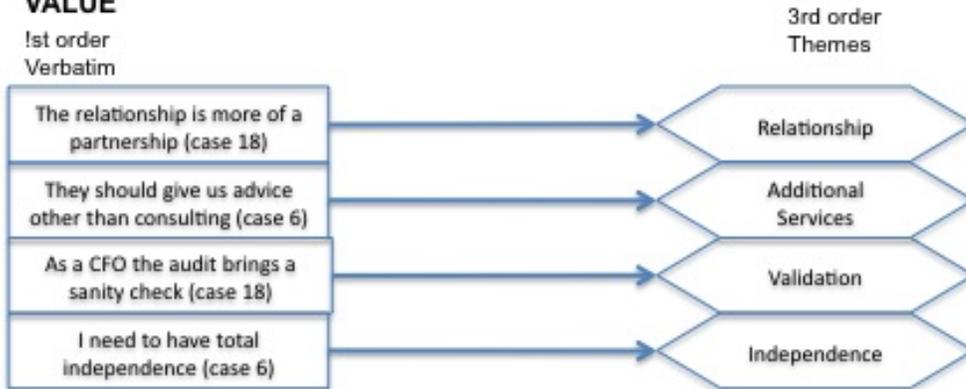


FIGURE 2
Data structure

REASON FOR CHANGE



CUSTOMER PERCEIVED VALUE



ANNEX 1

Interview Guide

Objective

The objective of this interview is to determine the factors that could influence the client's decision to switch auditors (from the client perspective).

Introduction for the participant

We appreciate your participation. This interview is being conducted to help us understand what is important for you when selecting (or switching) audit firms We are only interested in your perspective regarding the **core audit service and additional audit related services, but not including any other billable services** from your audit firm (and or auditor) that you are presently using or have used. Examples of additional audit related services include any advice regarding accounting regulations, internal controls, and business advice resulting from the audit. The questions are to measure your intentions and are hypothetical.

We will be very happy to provide you a summary of our research results.. This interview will be recorded and it should not exceed 30 minutes (**probably will exceed 30 minutes**). Once the recording is transcribed on paper, it will be erased. Your name and the name of your company and the name of any audit firm or auditor you mention will not appear anywhere in our research documentation. For each question, other than the demographic questions in Part 3, **we would appreciate receiving examples and**

anecdotes to substantiate your opinions.

Part 1 Loyalty (Open-ended questions) (15 minutes)

1. What sorts of situations (Why) would lead you to switch to another auditor firm ? **Main Question**
2. Have you ever switched or considered switching ? If so, why?
- 3 How important is price (versus service and relationship) in your decision to potentially switch audit firms?
- 4 Other than price and\ (or) quality are there any factors that could enter into your decision to switch firms ?

Part 2: Value (Open-ended questions) (10 minutes)

- 5 Does your audit firm (for the core audit service) provide value to you personally (or corporation) ? If so, how?
- 6 How could the audit firm (for the core audit service) add more value to you personally (or corporation) ?
- 7 What could a firm do to differentiate from other firms (positively)? (given comparable price and service)
- 8 What does it mean to have a good relationship (communication ? cooperation ? information? Trust ? etc)
- 9 How would you define **excellent** audit service (audit firm and auditor) ?

PART 3: Demographics (Closed-ended questions) (5 minutes)

- 10 Are you required to use an Audit or could you change to a Review?
- 11 If you were not required to use an Audit would you change to a Review ? Why?
- 12 Are you required to rotate auditors ?
- 13 Who uses your audit report ?
- 14 What type of business are you in?
- 15 Are you private or public ?
- 16 What is the size of your business (sales \$ and employees)?

17 Do you deal with a big 4 or non big 4 firm? What is the name of the firm?

18 How long have you been dealing with the firm?

19 Who is involved in the hiring decision and switching decision (of the audit firm)? **(You, other, Board, Audit committee. Who proposes, who influences who decides , what other influences are there?)** If it is not you, what influence do you have ?

THANK YOU VERY MUCH FOR YOUR HELP!