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Does an Agency-Type of Audit Model Fit a Stewardship Context? Evidence from Performance Auditing in Dutch Municipalities

SANDRA TILLEMA AND HENK J. TER BOGT*

Abstract: The degree of auditor independence is an important issue in the performance auditing literature. However, little attention has been paid to the influence of the context in which an audit body operates. This paper investigates how an audit model with a high degree of auditor independence, which is consistent with agency theory's rather formal view of relationships in organizations, functions in a context with more informal relationships, as implied by stewardship theory. Based on two case studies and a survey, the paper concludes that Dutch councilors are more satisfied with audit reports if in their municipality there is a fit between context and audit model.

Keywords: performance auditing, local government, independence, agency theory, stewardship theory

INTRODUCTION

Since the 1990s, performance auditing has attracted considerable attention in the public sector as a form of auditing which may complement the traditional, financial form of auditing (Shand and Anand, 1996, pp. 57–59). In contrast to financial auditing, performance auditing focuses on performance issues, rather than the quality of financial reports. However, whereas the role of financial auditing institutions as 'independent watchdogs' seems to have been well established, the role of audit bodies which conduct performance audits is still

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a subject of discussion. The performance auditing literature argues that various models can be used to conduct performance audits in government organizations (Barzelay, 1997; and Pollit, 2003). One type of audit model emphasizes the independent position of the audit body. In practice, many audit bodies operate according to this type of model (Morin, 2003, p. 21; and Sloan, 1996, p. 140). However, several authors propose an alternative type of audit model, which puts less emphasis on auditor independence and more on auditor responsiveness (e.g., Christensen et al., 2002; and Tillema and ter Bogt, 2010). For instance, Power (2000, p. 118) observes that: 'Once society overcomes its concerns about *formal* auditor independence, it will become clear that expertise, *operational* independence and proximity to real time cultures of control are desirable.'

Although several authors discuss the two types of audit models, most of them do not relate these types to the context in which an audit body operates. This paper uses agency and stewardship theory to characterize such contexts. In this respect, it focusses on the relationships between the different layers and units in government organizations, and more particularly on the relationship between the elected body and the executive. The paper will argue that audit models with a high degree of auditor independence are consistent with the rather formal view of relationships in organizations which follows from agency theory, while models with a high degree of auditor responsiveness are consistent with the more informal view of such relationships which is implied by stewardship theory.

In practice, relationships in government organizations will often have both agency and stewardship characteristics, but the mix of characteristics may differ considerably among organizations. In the next section, we will develop the idea that, in organizations where relationships have many stewardship characteristics, an audit model with an emphasis on auditor responsiveness may be more successful than a model with an emphasis on auditor independence. An indication for success would be that stakeholders are more satisfied with the reports of the audit body. In this respect, particularly the opinions of elected politicians (e.g., members of parliament and councilors) are important, as elected bodies are considered as one of the main audiences of audit reports (Barzelay, 1996, p. 31; Morin, 2003, p. 21; and Sloan, 1996, p. 140). Therefore, this paper investigates the influence of audit model choice on elected politicians' satisfaction with audit reports. It concentrates on the practice of performance auditing in Dutch municipalities, where the relationship between the council and the executive often has at least some stewardship characteristics.

Since 2006, the local governments in The Netherlands have been required to have established a body which is charged with conducting performance audits. Such an audit body typically conducts only one or a few audits per year. It can investigate and evaluate a wide range of policy areas, policies, initiatives and projects. Often external researchers are hired to collect and analyze the data. Based on the findings from an investigation, an audit body draws up an audit report. This report is presented to the municipal council, which discusses it with the executive. The council can then formulate its own conclusions,

often requiring the executive, and indirectly the municipal organization, to take particular actions. Probably inspired by the audit model used by the Dutch National Court of Audit, many municipalities use an audit model which emphasizes auditor independence. However, there is also a considerable number of municipalities which have chosen an alternative model, with more emphasis on auditor responsiveness. This alternative model might better fit the stewardship characteristics of the relationship between the council and the executive in many Dutch municipalities. Moreover, the model's greater emphasis on auditor responsiveness does not threaten the objectivity with which a municipality's (annual) financial statements are audited, as all financial audits are conducted by an independent public accountant, rather than the local audit body.

In order to explore the effects of a 'fit' (or lack of 'fit') between the audit model used for performance audits and the context in which the audit body operates, we investigate the impact of the two audit models used in The Netherlands on Dutch councilors' satisfaction with audit reports. For this purpose, we adopt a multi-method approach: first we use case research to investigate how a particular audit model functioned in two municipalities, and then we use the outcomes from a survey among a large number of councilors to draw more general conclusions.

PERFORMANCE AUDITING AND AUDIT MODELS

Performance auditing is a formal assessment of the performance of an organization against specific performance criteria, conducted by a formally independent body (Pollitt, 2003; Lindeberg, 2007; and Lonsdale, 2008). The goals of many audit bodies are twofold: to reinforce the accountability relationship between, on the one hand, a government organization, and on the other hand, citizens and their elected representatives; and to stimulate government organizations to make performance improvements (Barzelay, 1996; see also Pollit, 2003). Audit bodies can use a variety of models to conduct performance audits. This paper uses two organizational theories to develop our thinking about the fit between these models and the context in which audit bodies operate: agency theory and stewardship theory.

Agency theory focuses on the agency relationship, which is 'a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent' (Jensen and Meckling, 1976, p. 308). According to agency theory, agency relationships are problematic, because the principal and the agent are likely to have diverging interests, while it is difficult or expensive for the principal to verify the actions of the agent (Eisenhardt, 1989; and Jensen and Meckling, 1976). As a consequence, the agent will not always act in the best interest of the principal. As such, agency theory is grounded in a rather pessimistic view of human motivation. In practice, such a view seems more likely in contexts where organizational layers and units operate at a distance from each other, while the frequency and intensity of the contacts among them

are limited. In such contexts, individuals have limited insight into each other's goodwill and competences, which may result in a lack of trust. To control the organization, the different layers and units interact through a series of contracts, which clearly specify their separate responsibilities (cf. Eisenhardt, 1989; and Jensen and Meckling, 1976).

Hence, agency theory is particularly relevant to (often larger) organizations where relationships are characterized by a lack of trust, formal agreements and a clear separation of roles. Such relationships match with an audit model which aims at providing a monitoring device which can help the higher layers (i.e., the elected body, and indirectly the citizens it represents) to curb opportunistic behavior by the lower layers (i.e., the executive, and indirectly the operating units). The audit body is supposed to verify the behavior of the lower layers and to assess whether the formal agreements have been met (cf. Davis et al., 1997, p. 23; and Jensen and Meckling, 1976, pp. 306, 323–26). Hence, the audit body's primary goal is to enhance the accountability relationship between the executive and the elected body (Barzelay, 1996, pp. 40, 44–45; see also Moe, 1984, pp. 765–66). The audit body is independent from both the elected body and the executive to enable it to conduct 'impartial' investigations (Lonsdale, 2008, p. 229; Morin, 2003, pp. 20–21, 24; and cf. Jensen and Meckling, 1976, p. 306). This independent position implies that the audit body is able to determine what, how and when audits are conducted (English and Guthrie, 2000, p. 110; and Lonsdale, 2008, p. 228).

An alternative audit model can be deduced from stewardship theory. Similar to agency theory, stewardship theory focuses on relationships in which one person engages another person to perform some service on his/her behalf. However, in contrast to agency theory, it assumes that individuals are motivated, not by personal welfare, but by 'a need to achieve, to gain intrinsic satisfaction through successfully performing inherently challenging work, to exercise responsibility and authority' (Donaldson and Davis, 1991, p. 51). Under this theory, 'agents' (now called 'stewards') are intrinsically motivated to act in the best interest of the organization's principals (Davis et al., 1997; Donaldson and Davis, 1991; and Hernandez, 2012). Hence, stewardship means that an individual attaches more importance to the long-term best interests of the group than to his/her personal goals.

The key question in stewardship theory is not how to curb opportunistic behavior, but how to structure the context in which the steward works so that (s)he can work the most effectively. Stewardship theory suggests that organizational goals can be attained, not through control mechanisms such as monitoring devices, but through collaboration and empowerment of the steward (Davis et al., 1997; and Hernandez, 2012). Hernandez (2012, p. 172) argues that this approach fosters pro-organizational and trustworthy behavior by the steward. According to Donaldson and Davis (1991, pp. 51–52), this line of reasoning may imply that the roles of the principal and the steward are not

always as clearly separated as agency theory suggests, as a 'fusion' of roles may facilitate the achievement of the organization's goals.

Stewardship theory's suggestions to focus on collaboration and empowerment rather than control, are more likely to be implemented in contexts where people are willing to trust each other (Davis et al., 1997, pp. 33–34, 40). This willingness is probably higher in (perhaps smaller) organizations where individuals from different layers and units maintain frequent and intensive contacts, and have an insight into each other's intentions. Under these circumstances, higher layers are more likely to give lower layers the opportunity to take all the actions they regard necessary to achieve the shared goals. As formal responsibilities are not emphasized, the roles of the different layers and units are not always clearly separated.

Hence, stewardship theory is relevant to organizations where relationships are characterized by mutual trust, informal arrangements and no clear separation of roles. Such relationships match with an audit model which is aimed at helping the principal and the steward to get involved in each other's work and stimulating open communication and trust rather than conflict between them (cf. Davis et al., 1997; and Morin, 2003). In this stewardship-type model, the audit body's primary goal is to support the *joint efforts* of the elected body and the executive to achieve the *shared goal* of satisfying citizens' needs by making performance improvements. To achieve this goal, but also to avoid conflicts between the two governing bodies, the audit body has a more intimate relationship with the audited organization than in the audit model inspired by agency theory (Barzelay, 1996, p. 45; and Morin, 2003, pp. 21–22, 24). It is more responsive, in the sense that it is willing to listen to the organization and more likely to incorporate its requirements and expectations into the design and implementation of audits (Lonsdale, 2008, p. 228). A consequence of responsiveness may be that the audit body adjusts its reports to some extent in the light of (anticipated) pressures from the elected body and the executive (Pollitt, 2003, p. 165). In this respect, Sloan (1996, p. 141) stresses that responsiveness can also be in the interest of other stakeholders, including citizens, as disagreements between the audit body and the audited organization are not likely to contribute to the democratic debate or to performance improvement. To some extent, this argument is confirmed in a survey conducted by Reichborn-Kjennerud (2013).

Possibly influenced by the emphasis on auditor independence in financial audits, in practice many audit bodies use an agency-type of audit model as the basis for their performance audits (Morin, 2003, p. 21; Pollitt, 2003, p. 165; and Sloan, 1996, p. 140). However, the relationship between the elected body and the executive in a particular government organization does not necessarily have (only) agency characteristics. In some organizations, the stewardship characteristics are actually quite dominant, as will be illustrated in one of our case studies. Davis et al. (1997) argue that in such organizations organizational practices should not be focused on monitoring and controlling persons, because

through a self-fulfilling prophecy this approach would produce behavior that is consistent with agency theory, and would be detrimental to the steward's motivation (see also Argyris, 1973, pp. 260–61; and Walton, 1985). Taking the opposite perspective, Hernandez (2012, pp. 182–84) argues that the governance approach (including empowerment) proposed by stewardship theory promotes a sense of psychological ownership; that is, individuals feel as though the organization is 'theirs'.

Following these arguments, this paper puts forward the idea that, in organizations where the relationship between the elected body and the executive has many stewardship characteristics, elected politicians may be more satisfied with audit reports if the audit body uses a model which is inspired by stewardship theory rather than agency theory. Some initial support for this idea is provided by a study of Christensen et al. (2002), who investigated how the national audit body in Norway contributes to the relationship between the parliament and the executive. The authors argue that this audit body has become more effective since its role has become more aligned with the stewardship nature of this relationship.

The remainder of this paper further investigates the consequences of a 'fit' (or lack of 'fit') between, on the one hand, the nature of the relationship between the elected body and the executive and, on the other hand, the audit model used. It presents the results from an empirical study into performance auditing in the Dutch local government sector. The main research question is as follows: how do the audit models used by Dutch municipalities impact on councilors' satisfaction with audit reports, given the nature of the relationship between the council and the executive in these municipalities?

RESEARCH CONTEXT

The Dutch local audit bodies operate in a context that is characterized by a transition in the system of governance used by Dutch municipalities (Tweede Kamer der Staten Generaal, 2001, pp. 2–6; see also Tillema and ter Bogt, 2010). For approximately 150 years, Dutch local government organizations had used a monistic system of governance. In this system, the roles of the municipal council and the executive were interwoven. This was partly because, except for the mayor, the members of the executive were also members of the council. Hence, for a long time the relationship between the council and the executive in Dutch local government organizations had distinct stewardship characteristics, in the sense that the members of the two governing bodies cooperated in the municipal council, while the roles of the two bodies were not clearly separated, but depended largely on informal arrangements.

Around the turn of the century, the Dutch central government was no longer satisfied with this system of governance, and it decided to change the Local Government Act. The new Act, which was implemented in 2002, requires that Dutch municipalities use a dualistic system of governance. In this system, the

roles of the council and the executive are clearly separated, at least formally. This is reflected in the rule that members of the executive are not allowed to be members of the council. The changes were considered necessary because 'a controlling role at a distance from the executive' is the first requirement to make the council accountable to citizens and to let it fulfill its 'pivotal role' in the larger chain of accountability relationships (Tweede Kamer der Staten Generaal, 2001, pp. 4–6). This means that, with the dualistic system, the relationship between the council and the executive in Dutch municipalities has more agency characteristics than in the past, including formal agreements between both governing bodies and a clearer separation of roles.

To support the council, the new Local Government Act includes some new monitoring and accountability mechanisms. One of them is performance auditing, which had already been introduced by some (mostly larger) municipalities on their own initiative. The Act requires that from 2006 onwards all local governments have a body which is charged with conducting performance audits. In a memorandum, the Minister argued that the audit bodies were needed 'to strengthen the position of the council' in the task of controlling the work of the executive, and to provide a 'good starting point' for the municipality to become accountable to citizens. These arguments, which emphasize control and accountability, clearly reflect an agency-type of thinking. Inspired by the practices developed by the Dutch National Court of Audit, the Minister argued that the local audit bodies should be independent, and able to conduct autonomous investigations. Nevertheless, central government allowed local governments to choose between a few audit models, partly because the municipalities that had already introduced an audit body on their own initiative were using a variety of models.

Today, most local governments use either the external or the mixed model, as the two models are called in The Netherlands. The external model largely resembles the model adopted by the Dutch National Court of Audit. One main characteristic of this model is that the audit body operates at a distance from the audited organization. This is reflected in the composition of the audit body, which includes only members who have no connection with the audited organization. The mixed model is different in the sense that the audit body includes not only external members, but also councilors. As these councilor-members play an intermediary role, there is a more intimate relationship between the audit body and the council, and more generally, the local government organization. Through its councilor-members the audit body receives information about the organization's requirements and expectations on a continuous basis. Moreover, once an audit report has been published, the councilor-members may stimulate the council and the executive to use it. Therefore, the mixed model, which emphasizes auditor responsiveness, can be regarded as an example of a stewardship-type of audit model, whereas the external model, which emphasizes auditor independence, can be regarded as an example of an agency-type of audit model.

RESEARCH METHODS

To investigate how the use of either the external or the mixed model impacts on councilors' satisfaction with audit reports, we used a multi-method approach which combined case research with a survey. We started with the case research. This research aimed at uncovering how the audit models used in two municipalities relate to councilors' satisfaction with audit reports, and how the nature of the relationship between the council and the executive in these municipalities affects this relationship between audit model and councilors' satisfaction. However, although the case studies improved our understanding of the relationship between audit model and satisfaction with audit reports in two municipalities, they did not reveal which audit model on average leads to a higher level of satisfaction in a particular context. Therefore, we continued with a survey among Dutch councilors. This survey built on insights derived from the case research, in the sense that these insights provided the inspiration for the statements included in the questionnaire, and that the findings from the case research were used to reflect on the survey results.

CASE STUDIES

Data and Method

For the case research, we selected one municipality with the external model (Leeuwarden) and one with the mixed model (Groningen). In 2012, Leeuwarden and Groningen had 95,000 and 193,000 inhabitants, respectively, which makes both municipalities part of the group of larger Dutch municipalities. The data for the case studies were collected between January and October 2008, and the most important data were 18 semi-structured interviews (eight in Leeuwarden and ten in Groningen) with councilors, members of the executive, department managers, and the research assistant and members of the audit body. Important issues during the interviews were: the nature of the relationship between the council and the executive,¹ the interviewees' views on the audit model used in their municipality, and councilors' satisfaction with the audit reports and, more generally, the work of the audit body. With the respondents' permission all interviews were recorded. On the basis of our written notes and audio recordings, we produced interview reports, which were typically between eight and ten pages in length. These reports were sent to the interviewees, and their comments were used to draw up the final interview reports. Together with additional data from documents (e.g., the municipal by-laws, recent audit reports and minutes of council meetings), these reports formed the basis for our analysis. Some of our initial conclusions from this analysis, and particularly those regarding councilors' satisfaction with audit reports, were cross-checked with the results from a questionnaire which was sent to all councilors in the two municipalities. The questions in this questionnaire were developed based on the interviews, and

were tested in a pilot study. The usable response rate for the questionnaire in Leeuwarden and Groningen was 49% (n = 18) and 51% (n = 20), respectively.

Relationship Between Council and Executive

Although the transition from the monistic to the dualistic system of governance was formalized in 2002, in practice the changes started earlier, and have been taking place quite gradually ever since. Based on our interviews in the two case organizations, it seems that at the time of our research, councilors in Leeuwarden and Groningen still found it quite difficult to fulfill their new, more independent role, mainly because their knowledge and understanding of particular policy areas were often limited. Various interviewees stressed that being a councilor is only a part-time job, and that most councilors have their main employment elsewhere and 'come to the city hall at five o'clock in the afternoon'. Some also indicated that the 'collective memory' of the council is limited, as each round of elections leads to substantial changes in the composition of the council. The councilors' lack of expertise meant that often the council had to rely on the ideas and opinions of the executive and officials.

However, the interviews also revealed that the council in Groningen, as compared to the council in Leeuwarden, more often assumed a role that was clearly separated from the role of the executive. This difference existed already long before the introduction of the dualistic system in the two municipalities (Tillema and ter Bogt, 2010, p. 760). The administrative climate used to be rather 'politicized' in Groningen, whereas the council in Leeuwarden was more acquiescent. In the words of the research assistant of the audit body in Groningen:

Nevertheless, the independent role of the council *vis-à-vis* the executive has gradually become more visible in the recent years. [...] Occasionally, the council's coalition parties too have opinions that differ from those of the executive, and they also express them.

The situation in Leeuwarden was quite different, in the sense that the council usually closely cooperated with the executive and followed the executive in its ideas and opinions. This indicates that the council trusted the executive. Furthermore, the formal difference in roles between the council and the executive that is implied by the dualistic system was not really put into practice. A member of the audit body in Leeuwarden pointed out:

[T]he council could manifest itself in a more prominent manner *vis-à-vis* the executive. What you see now is that both the executive and the council clearly belong to the same 'internal clan', where the relationships are very close.

So, at the time of the interviews the relationship between the council and the executive in Groningen showed a mix of agency and stewardship characteristics, whereas in Leeuwarden the stewardship characteristics were dominant. The

interviews revealed that this difference was also reflected in the way in which the two councils used audit reports in their discussions with the executive. Whereas in Leeuwarden the council normally followed the executive in its reaction to reports, in Groningen the council sometimes assumed a role separated from the executive and used reports to hold the executive accountable and to redirect its actions.

The Audit Model Used

The historical background of the audit bodies in the two municipalities was quite different. In 1997, Groningen was one of the first municipalities in The Netherlands which, on its own initiative, decided to introduce an audit body the sole purpose of which was to conduct performance audits. Its decision to establish an audit body was in part a response to complaints of councilors that they had not been adequately informed by the executive about major problems in their municipality at that time. So a low level of trust between the council and the executive played a role in the establishment of an audit body in Groningen. At the start the audit body in Groningen used the internal model (with only councilors on the audit body), but several years ago it was decided to switch to the mixed model. The external members who were added to the audit body were selected by the municipal council for their research and/or business experience. In Leeuwarden the audit body was established in 2005, shortly before the Dutch central government required all local governments to have an audit body. Some interviewees in Leeuwarden said that it was likely that without this requirement an audit body would not have been introduced, at least not in that time. The audit body in Leeuwarden used the external model.

All interviewees and a majority of the respondents to our questionnaire in Leeuwarden had a strong preference for an external (agency-type) model. This seems inconsistent with our earlier observation that the relationship between the council and the executive in this municipality had many stewardship characteristics. The councilors interviewed in Leeuwarden explained the organization's support for the external model by saying that audit bodies can only function independently if they use such a model. According to one of them, independence is important, because:

With an independent audit body, the council is kept at a distance from the work of the audit body, which helps you to avoid audits getting a political dimension.

Other interviewees in Leeuwarden confirmed this view and observed that, with councilor-members on the audit body, 'political considerations' might influence the selection of subjects for investigation. Perhaps more importantly, several interviewees in Leeuwarden suggested that they preferred the external model, not only because the council is kept at a distance from the work of the audit body, but also because the audit body is kept at a distance from the work of the council and indirectly the executive. They argued that being a councilor-member

can be problematic if the audit body produces a report that criticizes a particular policy that was supported by this member in his/her role as a councilor, or that is the responsibility of his/her 'own' member of the executive (i.e., a member of the same political party). So, in Leeuwarden 'protecting' the close cooperation between the council and the executive was an important reason for preferring the external model.

A majority of the interviewees and of the respondents to our questionnaire in Groningen preferred a mixed (stewardship-type) model. As the relationship between the council and the executive in Groningen had a mix of agency and stewardship characteristics, the use of either audit model would have been consistent with the context in this organization. According to interviewees in Groningen, the main advantage of using the mixed model was that the audit body is more responsive to the council, in terms of both the selection of subjects for investigation and the content of audit reports. With respect to the selection of subjects for investigation, various interviewees argued that the audit body can only play a role if it carries out investigations that are politically relevant. By contrast, one of the members of the audit body in Leeuwarden said that in his view the audit body must avoid selecting subjects that are politically 'hot issues', as these were likely to bring the audit body in a 'political minefield'.

With respect to the content of audit reports, the interviews revealed that the audit body in Groningen consciously tried to adjust the content of its reports to the level of expertise of councilors. In the words of one councilor-member of this audit body:

It is important that our activities match those of the council; that we do not diverge from the council in this respect. If we fail to achieve that, the council's interest in our work fades rapidly. In this context, it is also important that the content of the reports is rather practical. In addition, the content has to be concrete and the language use clear.

Similar remarks were not made by the interviewees in Leeuwarden. One of the external members of the audit body in Groningen explained that the use of the mixed model helped the audit body to adjust the content of its reports, not only to councilors' expertise, but also to their perspective:

As far as I'm concerned, the main advantage of having councilors on the audit body is that they can communicate the council's needs. [An investigation] has to be comprehensible for the councilors in our audit body [...] and it must fit their perception of their environment.

A councilor-member of the audit body in Groningen explained that, whereas external members usually adopt a technical and substantive perspective, councilor-members focus on political and administrative aspects and keep an eye on whether a report is useful for the council. Similarly, a councilor remarked that external members sometimes lack an awareness of political issues, and act

in a rather 'technocratic' manner, while they ignore the political arguments that played a role at that time.

Satisfaction with Audit Reports

In Leeuwarden and Groningen, all the councilors we interviewed valued the existence of an audit body in their municipality, in the sense that it gave them an opportunity to ask for investigations into particular subjects and that its reports could help them in their work as councilors. In both municipalities, the councilors mentioned some reports about which they were very positive, because these reports had provided them with useful information, but they were also quite critical of other reports. On average, the respondents to our questionnaire, both in Leeuwarden and in Groningen, were slightly positive about the audit reports. Nevertheless, compared to councilors in Groningen, councilors in Leeuwarden were somewhat less satisfied, particularly with the content and the usefulness of audit reports. They had more doubts about the quality of the reports (on a 7-point Likert scale, the mean scores in Leeuwarden and Groningen were 3.1 and 2.2, respectively), and found less often that the conclusions and recommendations of the audit body followed directly from the reports (mean scores of 5.2 and 5.9). Moreover, councilors in Leeuwarden, compared to their counterparts in Groningen, told less strongly that not having access to audit reports would make their work more difficult (mean scores of 3.3 and 4.0), and said that the reports enabled them to a lesser extent to discuss issues with the executive (mean scores of 4.9 and 5.6).

Discussion of the Case Study Findings

The case research showed that, although formally the two case organizations had implemented the dualistic system of governance (which can be linked to agency theory), in practice elements of the monistic system (which can be linked to stewardship theory) were still present in both organizations. The explanation provided by the case studies was that councilors often lacked the expertise that is needed to fulfill their new, more independent role. In this respect, our findings are consistent with the results from a study conducted by Hanemaayer et al. (2008). Based on a survey among, and group discussions with, persons involved in Dutch local governments, they conclude that, although in a technical sense the dualistic system is now functioning roughly as it was intended in the new Local Government Act (p. 83), in practice the executive often seems to have a powerful position relative to the council, partly because of its access to information (p. 85).

The stewardship characteristics of the relationship between the council and the executive can have implications for the practice of performance auditing. The case studies revealed a fit in Groningen and a misfit in Leeuwarden between the mix of agency and stewardship characteristics in these municipalities and the audit model used. The misfit between the stewardship context in Leeuwarden

and this municipality's use of an agency-type model might explain why councilors in this municipality, compared to councilors in Groningen, were less satisfied with the content of audit reports and regarded these reports as less useful. Due to its use of an agency-type model, the audit body in Leeuwarden operated at a distance from the council. As a result, it had limited incentives to adjust the content of its reports to councilors' expertise and political perspective. This made it easier for councilors to criticize the reports, rather than to use them to discuss issues with the executive or to hold the executive accountable. Hence, the agency-type of audit model helped the council in Leeuwarden to 'protect' the executive, with which it had an intimate relationship, against the conclusions from the audit body. Nevertheless, one of the consequences of choosing this audit model seemed to be that, although councilors in Leeuwarden were quite satisfied with the choice of the external model, they were less satisfied with the reports produced by their audit body.

However, it is unclear whether the impact of the fit in Groningen and the misfit in Leeuwarden are mainly the result of idiosyncratic factors or reflect a more general relationship. For this reason, we decided to investigate the relationship between satisfaction, audit model and context on a larger scale by using a survey of Dutch councilors.

SURVEY

Councilors' Satisfaction, Audit Model Choice and Organizational Size

Based on the case studies, we got the impression that the use of the mixed model, as compared to the external model, will have a positive impact on councilors' satisfaction with audit reports, because of this model's fit with the stewardship characteristics in many Dutch municipalities. However, this relationship may be stronger in some municipalities than in other municipalities, as municipalities differ in terms of the mix of agency and stewardship characteristics. To some extent, such differences can be captured by the size of municipalities. Compared to smaller municipalities, larger municipalities in The Netherlands, which are often located in urban areas, are confronted with more complex issues, and receive more financial resources from the central government to deal with these issues (cf. Herweijer, 1998). As a consequence, larger municipalities are more concerned with adjusting national policy programs to the local needs and preferences than smaller municipalities. This implies that the issues discussed in their councils are more likely to have a political dimension. This can be a reason for the councils in larger municipalities to assume a 'political' role which is clearly separated from the role of the executive, and to stress their formal responsibilities. Therefore, it seems plausible that in larger municipalities the relationship between the council and the executive has more agency characteristics than in smaller municipalities. This argument is supported by Hanemaayer et al. (2008, p. 83), who conclude that there are indications that

the dualistic system (which can be linked to agency theory) functions better in larger Dutch municipalities than in smaller ones. More generally, Perrow (1986, pp. 16–17) argues that the self-interested behavior that is assumed by agency theory is more likely when tasks are specialized and hierarchies are extended, which are both typical of larger organizations. The stronger agency context in larger municipalities reduces the fit of the mixed model, while it improves the fit of the external model. Therefore, we suggest that an increase in the size of municipalities mitigates the positive effect of using the mixed model.

Data and Method

To investigate the effects of audit model choice and organizational size, we conducted a survey. In March 2009, we sent the questionnaire which we used in Leeuwarden and Groningen to all councilors in 64 other Dutch municipalities. These municipalities were selected in such a way that they varied in terms of size, from around 10,000 to approximately 295,000 inhabitants. Of all 1,934 questionnaires that were sent, a total number of 510 questionnaires were returned. Twentytwo questionnaires were excluded from our analysis; either because the respondents had indicated that they were not able to complete the questionnaire, or because the municipality of the respondents used neither the external nor the mixed model. Hence, the usable response rate was 25.2% ($n = 488$). In addition to more general questions about the background of the respondent, the questionnaire comprised 47 statements on various topics, including the respondent's satisfaction with audit reports. These statements were developed on the basis of the replies given by the interviewees in our case studies. The respondents were asked to indicate on a 7-point Likert scale the extent to which they disagreed or agreed with each of the statements. In addition to the individual-level data collected through the questionnaire, some municipality-level data was gathered through the websites of the respondents' municipalities and Statistics Netherlands.

The bases of the dependent variables were all statements in the questionnaire which dealt with the topic of the respondent's satisfaction with audit reports. These statements referred to the respondent's opinions about the selection of subjects for investigation and the content of audit reports (which, according to the interviewees in the case studies, are both influenced by audit model choice), or more generally the usefulness of audit reports. A principal component analysis was conducted on the selected eleven items. Table 1 shows the factor loadings after rotation. The items that load on the same components suggest that the first component, which combines all items related to the selection of subjects and the usefulness of audit reports, represents the Relevance of audit reports. The second component, which combines all items related to the content of audit reports, represents the reports' Lack of Quality. The resulting factor scores of the respondents, which were obtained through the regression method, were used in the bivariate analysis described below. However, to facilitate interpretation,

Table 1
Factor Loadings Found in a Principal Component Analysis

<i>Item</i>	<i>Relevance Component</i>	<i>Lack of Quality Component</i>
<i>Selection of subjects</i>		
The audit body always investigates subjects which are important for the proper functioning of the local government organization.	0.571	-0.130
Through its reports, the audit body is always able to bring important topics to the council's attention, which have not been sufficiently dealt with so far.	0.758	-0.121
The audit reports are always a reflection of the issues which are receiving a great deal of political interest at that time.	0.735	0.080
<i>Content of reports</i>		
The audit reports, including their conclusions and recommendations, show that the audit body is well capable of carrying out its tasks.	0.143	-0.780
Sometimes I have doubts about the quality of the audit reports and the conclusions and recommendations of the audit body.	0.116	0.912
In my view, the audit body's reports and its conclusions and recommendations always form a well-balanced and subtle assessment of the issues at hand.	0.058	-0.810
In my view, the conclusions and recommendations formulated by the audit body are always in line with the content of the audit reports.	0.089	-0.801
<i>Usefulness of reports</i>		
For me the audit reports are an important source of information to do my work as a councilor.	0.762	-0.150
If I did not have access to the audit body's reports (including its conclusions and recommendations), my work as a councilor would be much more difficult.	0.806	0.092
Also after some time, I often use the audit reports to look up information.	0.740	0.023
The audit reports enable me as a councilor to discuss issues with the executive in a more effective manner.	0.812	-0.061
Cronbach's Alpha	0.881	0.866

Note:

Cases with missing values were excluded list-wise; an oblique (direct oblimin) rotation was used; factor loadings with absolute values greater than 0.4 are printed in bold; items with factor loadings greater than 0.4 were used to calculate Cronbach's Alpha's.

the Lack of Quality variable was transformed into a Quality variable by reversing the scores of all respondents.

The independent variables in our analysis were Mixed model, Size and the interaction between Mixed model and Size. Mixed model is a dummy variable at the municipal level, with the value 1 assigned to municipalities using the mixed model and the value 0 to municipalities using the external model. We expected that this variable would have a positive effect on both dependent variables. The Size variable was introduced to capture the influence of the nature of the relationship between the council and the executive. It was measured by the number of inhabitants of a municipality. A natural logarithm was taken to correct for a positive skew. We were particularly interested in the degree to which the relationships between both dependent variables and the use of the mixed model were influenced by the mix of agency and stewardship characteristics. Therefore, we added the interaction term Mixed model \times Size. We expected that this term would have a negative coefficient, as we proposed that an increase in the size of municipalities mitigates the positive effect of using the mixed model.

We controlled for a variety of alternative influences. At the municipal level, we controlled for the number of years that a municipality had experience with an audit body, according to the municipality's website. At the individual level, we added Coalition party as a dummy variable for whether a councilor was a member of one of the parties which cooperate in the executive (value 1) or not (value 0), and Experience councilor to reflect the number of years that the respondent had experience as a councilor. A summary of the descriptive statistics for each independent or control variable is provided in Table 2.

Table 2

Descriptive Statistics for the Independent and Control Variables

<i>Variables</i>	<i>Actual Score</i>		<i>Mean</i>	<i>Std. Dev.</i>
	<i>Minimum</i>	<i>Maximum</i>		
Mixed model	0.00	1.00	0.59	0.49
Size	9.26	12.59	11.03	0.71
Experience audit body	2.00	14.00	5.71	3.01
Coalition party	0.00	1.00	0.63	0.48
Experience councilor	0.25	30.00	6.72	5.21

Findings

We estimated two bivariate response models. Model 1 includes the two dependent variables (Relevance and Quality) and the three independent variables (Mixed model, Size and Mixed model \times Size). Model 2 overlaps with Model 1,

but includes the control variables (Experience audit body, Coalition party and Experience councilor) as well. Because of the multilevel structure of our dataset (respondents are nested within municipalities), both models were structured as random intercept models to control for unobserved municipal factors.

Table 3 provides the results. It offers evidence that the use of the mixed model is positively associated with councilors' opinions about the relevance and quality of audit reports. This result is consistent with our proposition that the use of the mixed model, as compared to the external model, will have a positive impact on councilors' satisfaction with audit reports, because of this model's fit with the stewardship characteristics in many municipalities. However, the relationship is stronger for the quality of audit reports (significant at the 1% level) than for the relevance of audit reports (significant at the 5% and 10%

Table 3**Municipal- and Individual-level Predictors of Relevance and Quality**

<i>Independent Variable</i>	<i>Model 1</i>		<i>Model 2</i>	
	<i>Relevance</i>	<i>Quality</i>	<i>Relevance</i>	<i>Quality</i>
Fixed effects				
Constant	-3.578** (1.571)	-5.160*** (1.407)	-4.264** (1.726)	-5.318*** (1.573)
Municipal level				
Mixed model	4.408** (2.139)	6.738*** (1.917)	4.209* (2.126)	6.793*** (1.936)
Size	0.313** (0.145)	0.449*** (0.130)	0.402** (0.164)	0.476*** (0.149)
Mixed model × Size	-0.373* (0.196)	-0.571*** (0.175)	-0.353* (0.194)	-0.575*** (0.177)
Experience audit body			-0.040 (0.031)	-0.011 (0.028)
Individual level				
Coalition party			-0.151 (0.092)	-0.134 (0.090)
Experience councilor			-0.002 (0.009)	0.001 (0.009)
Random effects				
Variance municipal level	0.180*** (0.054)	0.124*** (0.043)	0.170*** (0.053)	0.124*** (0.043)
Covariance municipal level		0.147*** (0.044)		0.145*** (0.043)
Variance individual level	0.770*** (.055)	0.768*** (0.055)	0.770*** (0.056)	0.758*** (0.055)
Covariance individual level		0.385*** (0.044)		.383*** (0.044)
-2 × log-likelihood		2,239.454		2,154.782
N		447		432

Note:

Estimates are maximum likelihood estimates; standard errors in parentheses; *, **, *** indicate statistical significance at the 10%, 5% and 1% levels, respectively.

level for models 1 and 2, respectively). This suggests that audit bodies with the external model have developed effective ways to produce audit reports which are relevant to councilors (e.g., by asking the council to propose subjects for investigation), but not to adjust the content of audit reports to the expertise and political perspective of councilors.

Table 3 also shows that organizational size has a positive impact on councilors' opinions about the relevance (significant at the 5% level) and quality (significant at the 1% level) of audit reports. The positive relationships might be explained by the more dominant agency characteristics in larger municipalities. Although municipalities have some freedom to adjust the practice of performance auditing to their local context (e.g., by adopting the mixed model), central government's arguments to make performance auditing compulsory at the local level were strongly influenced by agency-type of thinking. As a result, the practice of performance auditing might fit better in larger municipalities, as the relationship between the council and the executive has more agency characteristics in these municipalities.

As expected, the interaction between organizational size and the use of the mixed model has a negative impact (significant at the 10% and 1% level, respectively). Probably, this negative relationship can also be explained by the more dominant agency characteristics in larger municipalities. With respect to the relevance of audit reports, the case studies showed that one of the disadvantages of using the mixed model is that it can lead to political influences on the selection of subjects for investigation. Such influences imply that the audit body is not impartial when selecting subjects. It is likely that this has a negative impact on councilors' satisfaction with the relevance of audit reports, particularly in (often larger) organizations where the relationship between the council and the executive has more agency characteristics, as these organizations emphasize auditor independence. With respect to the quality of audit reports, the case study in Groningen revealed that using the mixed model can lead to adjustments of the content of audit reports to councilors' political perspective, by taking political arguments into account when assessing decisions made by the local government organization in the past. Interviewees in Groningen were quite positive about such adjustments. However, for reasons similar to those discussed above, it can be expected that particularly when the relationship between the council and the executive has more agency characteristics, which is more likely in larger municipalities, such adjustments have a negative impact on councilors' satisfaction with the quality of audit reports. None of the control variables included in Model 2 is statistically significant.

Discussion of the Survey Results

Overall, the survey results provide support for the idea developed in the second section that there should be a fit between the mix of agency and

stewardship characteristics of the relationship between the council and the executive in a particular government organization and the audit model used by this organization. However, this is not to say that the idea that there should be a fit is always reflected in the choice of audit model in practice. Of all (smaller and larger) municipalities that participated in our survey, 41% used the external model and 56% the mixed model, which is similar to the percentages of 42% and 55%, respectively, found by the Dutch consultancy firm Jacques Necker (2009, p. 4). However, when we split our sample evenly into a group of smaller and a group of larger municipalities, we find that, whereas 67% of the larger municipalities in our study used the mixed model, only 46% of the smaller municipalities used this model. These figures suggest that smaller municipalities have a somewhat lower tendency to select a stewardship-type of audit model, in spite of the fit found between this model and the size of (and indirectly, the stewardship context in) these municipalities.

One explanation for this counterintuitive finding can be inferred from the case study in Leeuwarden. In this municipality, there was little enthusiasm for establishing an audit body because councilors and members of the executive were afraid that audit reports would lead to political problems. However, when the Dutch central government required municipalities to establish an audit body, Leeuwarden could no longer postpone its decision to establish an audit body. It decided to choose the external model, mainly because this model would minimize the chance that audit reports would disturb the close relationships among councilors and members of the executive. In fact, by making this choice, the municipality positioned its audit body at a distance from the 'internal clan' of councilors and members of the executive, which made it easier to criticize and ignore audit reports. In this way, the case study in Leeuwarden explains why, in organizations where stewardship characteristics are dominant, there can be incentives to adopt an agency-type of audit model.

CONCLUSIONS AND DISCUSSION

The findings in this paper support the idea that elected politicians are more satisfied with performance audit reports if there is a fit between the context in which the audit body operates and the audit model used. More generally, these findings challenge the applicability of practices that are inspired by agency theory in a stewardship context. This also includes some NPM practices, as one of the theories underpinning the NPM movement is agency theory (Boston et al., 1996, pp. 18–21; and Hood, 1991, pp. 5–6). Our findings suggest that if such agency-type practices are applied in organizations where relationships do not meet the underpinning agency-theory assumptions, these practices may not be valued by the persons involved, while their contribution to the well-functioning of the organization may be limited. For example, in Leeuwarden, and probably many other Dutch municipalities, there appeared to be much

more an atmosphere of collaboration and trust, rather than conflict and mistrust, between the council and the executive. The findings from our research suggest that, in such a stewardship context, practices inspired by agency theory may function better if they are adjusted to this context. This would lead to the application of more consensus and consultation-oriented practices. Such practices are generally not propagated by NPM advocates, as they could give rise to situations where the roles of the organizational layers, units and bodies are not clearly separated.

In addition, our findings showed that the presence of stewardship characteristics can also be a reason for organizations *not* to adjust a practice inspired by agency theory to the specific context in which it will be implemented. The case study in Leeuwarden revealed that the decision to implement an audit body in its pure (agency-type) form can sometimes be seen as an attempt to keep this practice at a distance from the close relationships within the organization, and to minimize its interference with these relationships. This raises the question of whether in stewardship contexts agency-type practices, such as performance auditing, should be implemented at all. Enforcing such practices upon organizations where relationships have many stewardship characteristics could imply that the organizations implement those practices in such a way that their effects are minimal, as in Leeuwarden. Alternatively, such enforcement could imply that some of the informal arrangements which used to exist in these organizations are transformed into more formal arrangements, including a clear separation of roles (cf. Davis et al., 1997, pp. 32–34). This could be detrimental to the level of mutual trust and to the intrinsic motivation of the persons involved (cf. Argyris, 1973, pp. 260–61). To improve our understanding of how such, probably less desirable, outcomes can be avoided, further research is needed on the functioning of agency-type practices in a broad range of organizations, which vary in terms of their mix of agency and stewardship characteristics. On a more general level, future research could shed more light on the usefulness of agency and stewardship theory in explaining and understanding the functioning of governance and control practices in government and other public sector organizations.

Overall, our findings demonstrate that practices inspired by agency theory do not always fit the context in which they are implemented. This conclusion may not come as a surprise; for instance, if we consider that NPM has been the subject of an on-going debate, in which it is criticized for its reliance on unrealistic, inappropriate and conflicting assumptions (see, for example, Aucoin, 1990; Kickert, 1997; Lapsley, 2009; and Terry, 1998). However, the approach followed in our paper has added a new dimension to this debate, in the sense that this paper built its criticism on empirical evidence, distinguished between situations of fit and misfit, and considered an alternative theory. It is hoped that this approach will inspire others to further investigate the (mal)functioning of agency-type practices in the public sector.

NOTE

- 1 When analyzing the data, we regarded all references to mistrust, formal agreements and a clear separation of roles as indications of agency characteristics, and all references to mutual trust, informal arrangements and no clear separation of roles as indications of stewardship characteristics.

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