



# The quality change of the Big4 audit firms assessed

Outcomes of the assessment of the quality-oriented culture, the quality cycle and the quality safeguards

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## Dutch Authority for the Financial Markets

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As an independent market conduct supervisor, we contribute to a sustainable financial system and prosperity in the Netherlands.

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## Summary

Financial statements are of great value to society. Investors, banks and other stakeholders must be able to trust them. Auditors contribute to the reliability of financial statements by providing an audit opinion as a result of statutory audits.

The AFM grants licenses to PIE audit firms to carry out statutory audits of Public Interest Entities (PIE), such as listed companies, banks and insurers. In view of their impact on society, PIE audit firms are subject to strict requirements.

### Towards sustainable high quality for statutory audits

Since 2014, audit firms have been carrying forward a quality change process to safeguard the quality of their statutory audits sustainably. This process is needed to justify public trust in auditors and audit firms and their audit opinions.

As the supervisory body, the AFM is putting its shoulder to the wheel. We assess behaviours and cultures at audit firms, their quality safeguards and the quality of statutory audits.

### Progress at the Big4

In 2017, the AFM judged in its assessment that the improvement program was proceeding too slowly at the four large PIE audit firms, also called the **Big4**. These are Deloitte, EY, KPMG and PwC.

While the quality of statutory audits was insufficient, we were positive about the focus and commitment of Deloitte, KPMG and PwC in implementing the improvement program in their organisations. Our most recent assessment looked at the quality change at the Big4, which achieved comparable results in the areas of quality change that were assessed.

### Assessment of the Big4 quality change

This assessment looked at the extent to which the Big4 have a quality-oriented culture. An organisation with this kind of culture promotes a focus on quality on an ongoing basis. This is reflected, for instance, in the (exemplary) behaviour of policy makers, statutory auditors and staff. We also examined how boards of directors focus on achieving quality and which means and instruments (quality safeguards) they use to achieve sustainable quality change. The boards use what is known as a quality cycle, with which improvements can be implemented methodically and continuously. We did not inspect the quality of statutory audits.

## Main outcomes of the Big4 quality change

The Big4 have made headway in their quality change process. The main outcomes are:

1. The Big4 boards of directors have a quality cycle

The boards' quality cycle is a plan-do-check-act cycle aimed at continuous improvement. For example, they formulate quality change objectives (*plan*), design a learning environment (*do*), use dashboards to monitor quality (*check*) and make adjustments on the basis of outcomes (*act*).

2. The boards regularly display exemplary behaviour and make decisions that are consistent with a quality-oriented culture in the examples studied

A quality-oriented culture focuses on the quality of statutory audits. Boards of directors contribute to a quality-oriented culture, including by sharing experiences and errors, making decisions about statutory audits in accordance with this culture and ensuring that the appraisal and promotion process revolves around quality.

3. The interviewed statutory auditors and staff feel that they are supported in bringing about a quality-oriented culture

The interviewed statutory auditors and staff feel that they are supported in realising their organisation's push for quality change. This takes the shape of tools and training sessions as well as staff meetings and branch visits by the board of directors. Staff also say statutory auditors support them by adjusting deadlines and ensuring that desired behaviour as well as misconduct can be discussed.

The Big4 continue to work on bringing about a quality-oriented culture. They still see challenges ahead with respect to learning from mistakes, the example set by statutory auditors and pressure of work.

## Using quality safeguards

The AFM also assessed quality safeguards. We looked at policy, implementation and the boards of directors' monitoring processes and course-correcting methods. The AFM assessed the following quality safeguards at the Big4: Engagement Quality Control Reviews, consultations, file coaching and root cause analyses.

We observed that, in the experience of the Big4 audit teams, the quality safeguards contribute to the statutory audits. Also, boards of directors share the outcomes so the entire organisation can learn from them.

## Room for reinforcement

The Big4 could reinforce the quality safeguards assessed so as to enhance their contribution to the statutory audits. This could be done by, for example:

- evaluating the depth of audit evidence reviews in Engagement Quality Control Reviews and discussing this with the persons executing this quality safeguard;
- reinforcing the role of the persons being consulted in reviewing the underlying facts of a consultation and following up the processing of the consultation in the statutory audit; and
- reinforcing root cause analyses and file coaching.

Additionally, most of the Big4 could tighten their Engagement Quality Control Review policy in two areas, bringing these reviews fully in line with legislation and regulations.

## Insights relevant to the entire sector

With this assessment, we looked at the outcomes regarding aspects of the Big4 quality change. The insights derived from this are relevant to the entire audit sector, including both other PIE audit firms and non-PIE audit firms. Accordingly, we call on the entire sector to include the areas of concern in their next steps in the quality change.

The quality change assessed is relevant with regard to reliable Audit Quality Indicators (AQIs) as well. Developing these AQIs was one of the recommendations of the Committee on the Future of the Accountancy Sector (CTA). The sector can use the insights from our assessment for this.

# 1 The AFM carried out an assessment of the quality change at the Big4

Since 2014, audit firms have worked on a structured approach to changing their culture and behaviour in order to improve the quality of statutory audits<sup>1</sup> (improvement program).<sup>2</sup> Among other things, this program aims to reinforce a quality-oriented culture. In 2017,<sup>3</sup> the AFM concluded that the program was proceeding too slowly at the PIE audit firms.<sup>4</sup> The AFM reported favourably, however, on the focus and commitment shown by Deloitte, KPMG and PwC in executing and safeguarding the program. Each of the Big4 audit firms, Deloitte Accountants B.V. (Deloitte), Ernst & Young Accountants LLP (EY), KPMG Accountants N.V. (KPMG) and PricewaterhouseCoopers Accountants N.V. (PwC) went on to take steps towards quality change.

In the present assessment, the AFM examined the quality change, in the expectation that it would be able to determine the associated results. Among other things, the results relate to the behaviour of policy makers<sup>5</sup> and audit teams<sup>6</sup> and the extent to which this behaviour is in line with a quality-oriented culture and with the quality cycle used by the audit firm's board of directors to promote quality. The AFM did not inspect the quality of statutory audits.

In 2019, the AFM assessed the quality change at Deloitte, EY, KPMG and PwC. These four PIE audit firms all have their own company culture and quality control systems. However, they are of comparable size (both in terms of revenue and in terms of staff) and have comparable international networks. Known internationally as the Big4, they have a combined market share of 53% of total statutory audits in the Netherlands.<sup>7</sup>

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<sup>1</sup> A statutory audit is an audit of a company's financial accounts for the public benefit that has been specifically designated a statutory audit under the Audit Firms Supervision Act (Wta). This might involve auditing the financial statements of medium-sized and large companies and of municipalities, provinces and a range of financial firms.

<sup>2</sup> This improvement program was prompted among other things by a report by the Netherlands Institute of Chartered Accountants, '[In het publiek belang](#)' (In the public interest), published on 25 September 2014.

<sup>3</sup> See the AFM report of 28 June 2017, '[Kwaliteit OOB-accountantsorganisaties onderzocht](#)' (Quality of PIE audit firms).

<sup>4</sup> The AFM has licensed PIE audit firms to carry out statutory audits of Public Interest Entities (PIEs). PIEs are companies or institutions whose size or social function is such that an inadequate statutory audit of their financial accounts can seriously impact trust in the public function of the audit report ([Section 2 of the Wta](#)).

<sup>5</sup> This report will go on to use the term boards of directors.

<sup>6</sup> By audit teams, the AFM means statutory auditors and staff who carry out statutory audits in accordance with Section 1 of the Audit Firms Supervision Decree.

<sup>7</sup> AFM 2019 Monitor for audit firms.

The AFM employs a number of interventions to encourage the Big4 in their quality change.

The AFM employs a number of interventions to encourage the Big4 in their quality change. These include:

- progress reviews for improvement programs;
- assessments of the quality control system and the quality of statutory audits; and
- an assessment of the audit sector's structure.

In addition to the quality of statutory audits and the quality control system, the AFM's assessments since 2015 have also focused on behavioural and cultural aspects as part of improvement programs.<sup>8</sup> The AFM has previously inspected the quality of statutory audits and assessed the quality control system and the execution and safeguarding of the improvement program, making reports available to the public in 2015, 2017 and 2019.<sup>9</sup> Additionally, in 2018, the AFM examined 'the contribution of attitudes, behaviours and culture to the audit team's orientation on quality' in order to provide audit firms with practical guidelines for a quality-oriented culture.<sup>10</sup>

Starting in the second half of 2020, the AFM wants to assess the execution of quality change by the PIE audit firms. It will look at the aspects of this quality change as well as at the quality of statutory audits.<sup>11</sup>

### The AFM has assessed aspects of the quality change

The AFM has assessed the safeguarding of the following aspects of the quality change at each of the Big4 firms:

- 1) the improvement program, including the quality-oriented culture;
- 2) the quality cycle;<sup>12</sup>
- 3) four quality safeguards.

These aspects are important preconditions for sustainably safeguarding the quality of statutory audits. This is represented schematically in Figure 1.<sup>13</sup> This sustainable safeguarding is crucial to justify society's trust in the auditor, the audit firm and the audit report on an ongoing basis.

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<sup>8</sup> This was confirmed in the [Government's response to the report of the Committee on the Future of the Accountancy Sector](#): 'The AFM's approach to supervision has developed continuously over the past ten years. Since 2015, in addition to inspecting the quality of statutory audits, the AFM has focused increasingly on quality safeguards and on the behaviour and culture of audit firms.'

<sup>9</sup> See the AFM website, [Research reports on the supervision of audit firms](#).

<sup>10</sup> See the AFM report of 9 May 2019, '[The contribution of attitudes, behaviours and culture to the audit team's orientation on quality](#)'.

<sup>11</sup> See the AFM Agenda 2020: <https://www.afm.nl/nl-nl/verslaglegging/agenda-2020>.

<sup>12</sup> The quality cycle is represented visually in Figure 2 (see Chapter 2).

<sup>13</sup> The AFM discusses these aspects and their interrelatedness in Chapter 4.



However, on the basis of this assessment, the AFM cannot determine the extent to which these preconditions influence the quality of statutory audits.

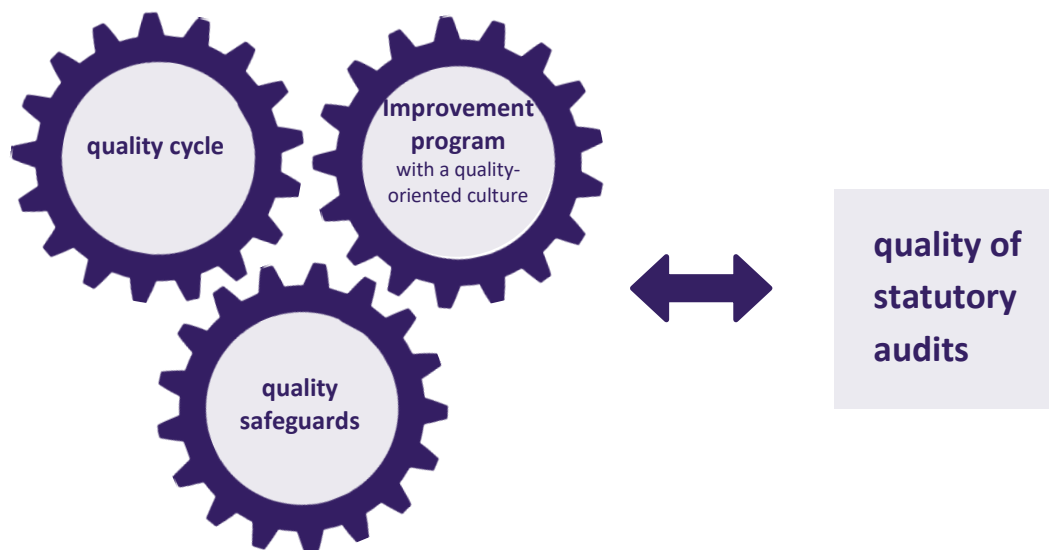


Figure 1: Overview of the three aspects of the quality change

The AFM looked at four quality safeguards: Engagement Quality Control Reviews (EQCRs), consultations, file coaching and root cause analyses. These assessed safeguards are important to the sustainable safeguarding of the quality of statutory audits. The aim of EQCRs is to prevent serious deficiencies in statutory audits before an audit opinion is issued. Consultations and file coaching provide support to audit teams during statutory audits of specialist and other subjects. Root cause analyses offer an insight into factors that influence quality by analysing completed statutory audits or specific themes.

#### The assessment consists of two parts

Firstly, the AFM assessed the results achieved on the various aspects of the quality change. This included an assessment of the policy of the audit firms with regard to the four quality safeguards. We verified whether this policy was being complied with. We also assessed whether the firms' policy on EQCRs and consultations complies with relevant legislation and regulations. This part of the assessment is evaluative, meaning that the information received was evaluated and analysed and, taken together, compared to a relevant expectation for 2019 or to legislation and regulations. The AFM has worked with expectations in its assessments since 2015. The expectations for 2019 are based on mid to long-term objectives, taking account of the steps required in the improvement program to meet these objectives to safeguard the quality of statutory audits. The expectations used for this assessment are included as an appendix.

Secondly, the AFM carried out an exploratory assessment of the contribution made to statutory audits by EQCR and consultation quality safeguards.<sup>14</sup> This assessment looks at the depth and

<sup>14</sup> EQCRs and consultations are enshrined in legislation and regulations, and audit firms have used them for some time to safeguard the quality of statutory audits.

diligence with which the EQCRs and consultations were carried out. The observations from the exploratory assessment point at areas for improvement that the Big4 audit firms can use to reinforce their quality safeguards.

### This report offers an insight into the quality change at the Big4

In this report, the AFM sets down its assessment, describing the results obtained by each of the Big4 on the aspects of their quality change. These results are thus made available to supervisory boards, audit committees and users of financial accounts, such as investors and creditors. These aspects are also relevant for obtaining reliable quality indicators (AQIs), as identified in the report by the Committee on the Future of the Accountancy Sector (CTA).<sup>15</sup> In addition, other audit firms can benefit from an insight into the results achieved by the Big4.

### The AFM completed its assessment in early 2020

The AFM conducted this assessment at the Big4 between June 2019 and February 2020. We collected information on the basis of documents and interviews relating to the period of September 2018 up to and including September 2019. At the end of 2019, we communicated the preliminary observations orally to each of the Big4. The AFM completed its assessment at the start of 2020 with an analysis of the supplementary information received in reply to these observations. In April 2020, the four audit firms received a preliminary report tailored to each firm, to which they responded. The definitive firm-specific reports were sent out on 30 June 2020.

### Reading guide

In Chapter 2, the AFM describes the results of its assessment for the aspects of the quality cycle and quality-oriented culture of the quality change at the Big4. Chapter 3 goes into the results for the aspect of quality safeguards and the opportunities identified for reinforcing these safeguards. Chapter 4 describes the assessment methodology. The expectations used for this assessment are included in the appendix to this report.

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<sup>15</sup> See the report by the Committee on the Future of the Accountancy Sector, [Vertrouwen op controle](#) (Trust in audits), of January 2020.

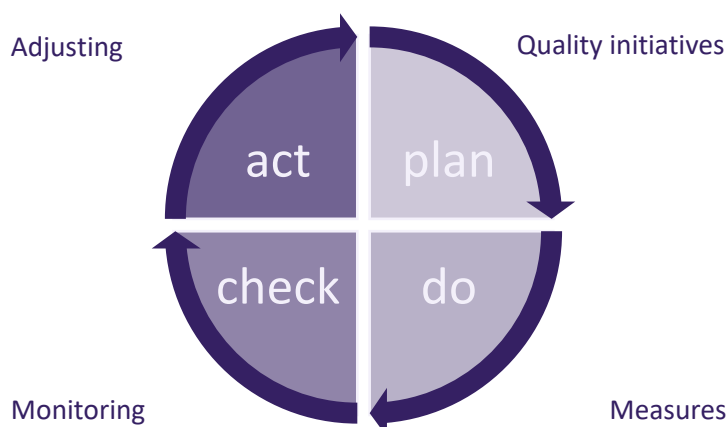
## 2 The Big4 have achieved results with regard to the quality cycle and the quality-oriented culture

The Big4 have all achieved similar results with regard to the quality cycle and the quality-oriented culture,<sup>16</sup> meeting most of the expectations for 2019. A number of areas for improvement were also identified for each of the Big4. Section 2.1 describes the results for the quality cycle; Section 2.2 describes the results for the quality-oriented culture.

### 2.1 The Big4 have a quality cycle

A quality cycle (Figure 2) requires an insight on the part of the boards of directors into the quality and the factors that affect it positively or negatively (quality-enhancing and quality-impeding factors). The quality cycle is based on the plan-do-check-act cycle, which aims for continuous improvement. The cycle is effective if it is followed all the way through. This is an ongoing cycle for planning actions (*plan*), carrying them out (*do*), verifying whether their results are as intended (*check*) and adjusting the execution on the basis of this check (*act*).

Figure 2: Quality cycle



The AFM has identified several examples of initiatives and measures where the boards of directors followed the complete quality cycle at the level of the audit firm.<sup>17 18</sup> In the examples that were assessed, the boards of directors formulated quality objectives for their organisation (*plan*) and developed these into quality change initiatives and measures (*do*). For instance, the Big4 carried out initiatives for the evaluation of partner portfolios, and daily stand-up meetings were introduced to stimulate the learning organisation, providing an opportunity to discuss task distribution and desired behaviour in statutory audits. The boards of directors monitor (*check*) the progress made on the quality change objectives, making use of such tools as dashboards. They make adjustments (*act*) when desired effects are not achieved, for instance by adjusting initiatives or taking new initiatives. In doing so, they reflect critically on themselves with regard to achieving

<sup>16</sup> The AFM made use of both interviews and documents. See Chapter 4 for details about the information sources used in the assessment.

<sup>17</sup> Situations may still arise in which the boards of directors have not gone through the full quality cycle.

<sup>18</sup> Observations about the quality cycle are based on the documents received and on interviews with the members of the boards of directors.

the objectives on quality. The boards of directors also evaluate periodically whether the initiatives and measures assessed have had the desired effects. These evaluations may lead to different priorities with regard to the formulated objectives on quality. In the quality cycle, the boards of directors also make use of insights from the outcomes of the quality safeguards, such as the root cause analyses. The AFM has also identified areas for improvement to enhance this insight from the quality safeguards.<sup>19</sup>

## 2.2 The Big4 have achieved results in their quality-oriented culture

A quality-oriented culture pursues the sustainable safeguarding of the quality of statutory audits. Important elements of such a culture are:<sup>20</sup>

- the experience of (exemplary) behaviour on the part of the members of the board of directors, statutory auditors and staff. This exemplary behaviour conveys to statutory auditors and staff what behaviour is accepted in the audit firm;
- decisions by the board of directors on such issues as promotions and portfolio management, which demonstrate that quality is decisive in the decision-making;
- the audit firm's support for behaviour appropriate within a quality-oriented culture. Initiatives such as training sessions, tools and organising objections are needed to enable statutory auditors and staff to exhibit behaviour appropriate to a quality-oriented culture.

The following subsections describe the results for these three elements of the quality-oriented culture.

### 2.2.1 The boards of directors regularly demonstrate exemplary behaviour and makes decisions that are in line with the quality-oriented culture

The AFM's assessment found that, in the experience of staff, the boards of directors<sup>21</sup> regularly show exemplary behaviour that is in line with their quality-oriented culture. In this way, the boards of directors project accepted behaviour in the audit firm to the staff. For example, personal mistakes are shared with the statutory auditors and staff. The boards of directors have formulated themes for quality improvement such as coaching, feedback, and sharing and learning from mistakes, and have developed initiatives that focus on the desired behaviour of statutory auditors and staff.<sup>22</sup> For example, in their communications, the boards of directors emphasise the quality change initiatives and praises behaviour appropriate to the quality-oriented culture, sharing good examples in meetings. Statutory auditors and staff state that the boards of directors discuss quality, behaviour and culture with them during branch visits, thus showing that signs are

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<sup>19</sup> See Chapter 3.

<sup>20</sup> See the appendix for the 2019 expectations regarding the quality-oriented culture.

<sup>21</sup> The observations about exemplary behaviour and decisions by boards of directors are based on the documentation received, examples from the interviews with the boards of directors and the experiences of statutory auditors and staff. Situations may still arise, however, in which behaviour presented as an example or decisions are not consistent with a quality-oriented culture.

<sup>22</sup> In accordance with Section 1 of the Audit Firms Supervision Decree, the audit teams consist of the statutory auditors and (other) staff. The AFM held interviews about the quality-oriented culture with statutory auditors and with staff from various audit teams. Accordingly, this chapter distinguishes between statutory auditors and staff.

taken seriously. The boards of directors use these meetings to discuss personal mistakes, for instance, and to gain insight into signs of high workload.

In its assessment, the AFM found examples of decisions made by the boards of directors that are in line with a quality-oriented culture. To give an example, in the situations assessed, the boards of directors tend to be critical when it comes to the acceptance and continuance of audit clients. They let go of audit clients if the audit firm could not deliver the desired quality. In the experience of staff, the review and promotion process across all job levels revolves around quality. The statutory auditors and staff state that the outcomes of internal and external quality assessments are included in the review process and that the boards of directors often put a premium on quality in the reviews. They also report that the boards of directors take action if quality requirements are not met, for instance by withholding promotions or letting go of statutory auditors.

### 2.2.2 Statutory auditors and staff feel that they are supported in bringing about a quality-oriented culture

Statutory auditors and staff<sup>23</sup> experience<sup>24</sup> support from the audit firm in exhibiting behaviour appropriate to a quality-oriented culture. Statutory auditors and staff indicate that they are being involved in the quality-oriented culture and that they are able to discuss the informal aspects of their work, for instance during branch visits by the board of directors. Statutory auditors and staff also take the initiative to organise branch meetings about themes such as the learning organisation. At the audit team level, involvement and open discussion are encouraged by planning consultations, daily stand-up meetings and engagement evaluations. The boards of directors also engage the Young Professional Boards to involve staff and to gather input from staff, which they then discuss with the board of directors. For example, they discuss the way staff experience the quality change initiatives, as well as specific cultural themes such as trust, acknowledgement and appreciation, and relay the input collected to the board of directors.

Staff also feel the audit firm supports them in the area of project management by making tools available, making clear working arrangements and setting behavioural and other rules in the audit team and vis-à-vis audit clients. They furthermore report increased attention for 'soft skills', coaching and feedback. These themes are dealt with by internal training programs and are supported by initiatives such as the daily stand-up meetings. Staff also experience that attention is paid to reducing workload: they discuss the work-life balance with each other as well as with the statutory auditors.

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<sup>23</sup> Observations about staff experiences are based on the interviews conducted with (senior) managers and audit leaders. Where the AFM discusses the experience of the statutory auditors, this is based on the interviews conducted with them. With regard to the actions of the boards of directors, the AFM bases itself on the interviews held with them.

<sup>24</sup> Where an observation is based primarily on interviews, the AFM will write 'in the experience of' staff, statutory auditors or the board of directors; or staff, statutory auditors or the board of directors 'feel/feels', 'state/states' or 'report/reports'.

Staff additionally experience support from the statutory auditors with regard to delivering quality. For example, they note that statutory auditors are more approachable, more involved with carrying out statutory audits and more often present on-site at the audit client than before. Staff indicate that the statutory auditors adapt schedules and postpone the deadlines of statutory audits when this is required for the sake of quality. In the experience of staff, statutory auditors are willing to display their vulnerable side, for example by discussing personal mistakes during staff meetings and carrying out evaluations of how engagements were performed. Staff report that they discuss desirable behaviour with each other and make each other aware of undesirable behaviour. They give examples of discussing instances of undesirable behaviour on the part of the statutory auditors with the latter; this could concern failing to meet review agreements or agreements about visiting the audit client on-site. Staff also experience support when notifying audit clients of issues such as not complying with agreements.

The AFM also noted that the Big4 face challenges with regard to a quality-oriented culture. This finding is in line with the outcomes of the internal (culture) reviews carried out by the Big4. These cover (1) learning from mistakes, (2) exemplary behaviour by the statutory auditors in feedback and coaching and (3) workload. Although the Big4 took initiatives regarding these themes, they acknowledge that more work is required.

- Learning from mistakes can be further developed. For example, boards of directors request root cause analyses or (culture) reviews to gain more insight in this area. The boards of directors of most firms could provide further support to the statutory auditors and staff in learning from mistakes and creating a safe learning environment, for instance by distinguishing between acceptable and unacceptable mistakes. Some statutory auditors and staff members experience an imbalance between the assessment of mistakes on the one hand and their consequences and the lessons learned from them on the other. This leads to a reluctance to share mistakes.
- The exemplary behaviour of statutory auditors in terms of dealing with coaching and feedback can be further improved. Staff note that the statutory auditors respond differently to feedback they receive. The statutory auditors could provide more feedback on each other's behaviour and be more open to discussing the scheduling and distribution of their statutory audits.
- Still greater attention could be paid to the workload. Staff find attention is paid to reducing their workload, for instance in the discussions about the work life balance they have with each other, with statutory auditors and with the boards of directors. They also find the work-life balance could be improved, for instance by reducing overtime. Due to the initiatives and measures, staff sometimes feel work is piling up or there is pressure on them to fill in forms.

### 3 The Big4 could reinforce the quality safeguards assessed

The AFM assessed four quality safeguards (EQCRs, consultations, file coaching and root cause analyses). The AFM carried out both an assessment of quality safeguards (as part of the quality change) and an exploration of the contribution made to statutory audits by the quality safeguards of EQCRs and consultations.

Based on its assessment, the AFM concludes that results have been achieved in reinforcing the quality safeguards. Areas for improvement were also found, and the exploration led to observations for reinforcing the quality safeguards assessed.

The Big4 could further tighten the EQCR policy (Section 3.1)<sup>25</sup> and improve the execution of the quality safeguards assessed (Section 3.2).<sup>26</sup> Lastly, the boards of directors could reinforce monitoring and adjusting for the quality safeguards assessed (Section 3.3).<sup>27</sup> For these aspects, the AFM also describes the results achieved by the Big4.

#### There are several aspects to a quality safeguard

There are several aspects to a quality safeguard. Figure 3 represents these aspects as they relate to each other. Below, the AFM will expand on these various aspects of a quality safeguard as considered in the assessment.

The *policy* of quality safeguards deals with their objectives and intended effects and the way these are reflected in procedures, descriptions and standards. Once a year, the audit firm evaluates the policy and the quality control system, including the quality safeguards. The audit firm has decided on its **objective** in designing a quality safeguard. This is based on part on legislation and regulations and the audit firm's quality improvement objectives. The audit firm has also decided what **effect** it wishes the quality safeguard to have. One goal of file coaching might be to identify deficiencies and risks of deficiencies during statutory audits so the audit team can made timely adjustments. The intended effect could be to raise the quality of statutory audits for which file coaching took place.

The *execution* of quality safeguards involves, among other things, the depth and diligence with which they are executed. The audit firm sets up a **process** and provides the means to support it, including allocation of experts, time, templates and tools, for example. The **person executing the quality safeguard** gives practical expression to the quality safeguard through their attitude and behaviour. This is visible in the interaction with the audit team and the depth and diligence with which the activities are carried out.

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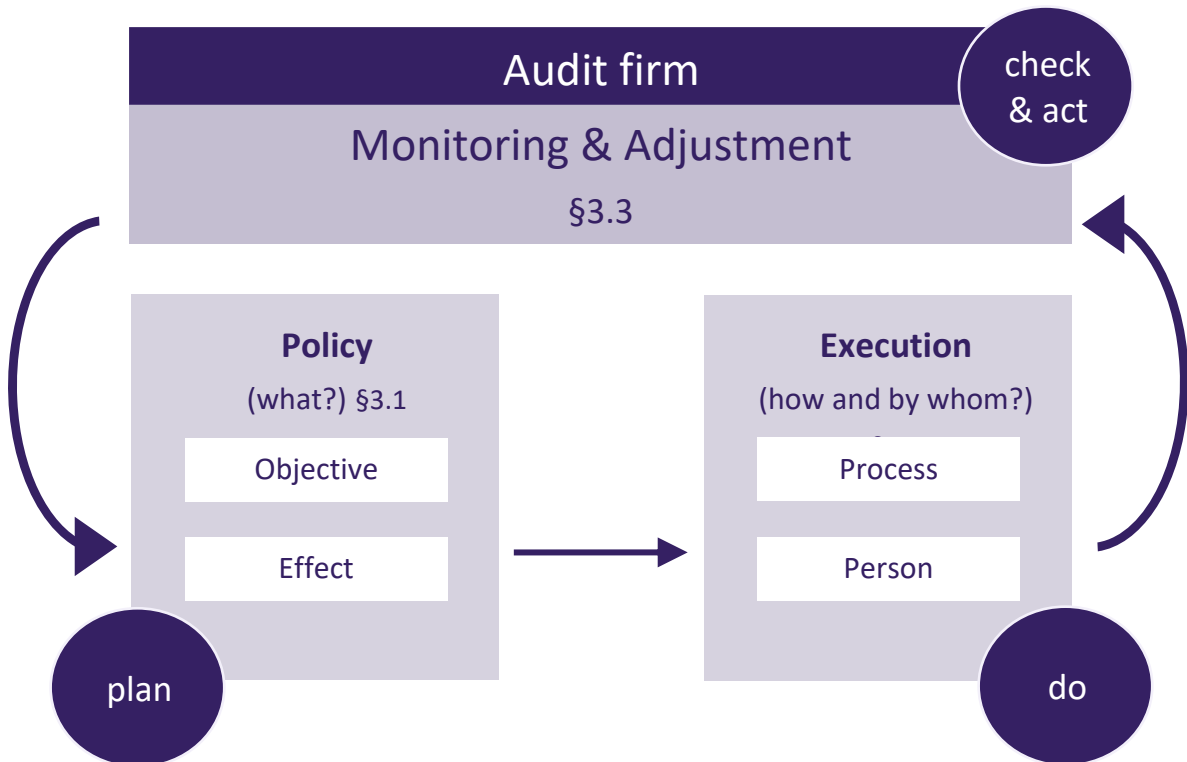
<sup>25</sup> Section 3.1 describes the areas for improvement from the assessment with regard to statutory requirements.

<sup>26</sup> Section 3.2 describes the observations from the exploration for EQCRs and consultations, as well as the results and areas for improvement from the assessment on the basis of the expectations for the quality safeguards assessed.

<sup>27</sup> Section 3.3 describes the results and areas for improvement from the assessment on the basis of the expectations for the quality cycle at the level of the quality safeguards assessed.

The *monitoring* and *adjustment* of quality safeguards refers to the **insight** of the audit firm’s boards of directors into the design and execution of the quality safeguard. Quality safeguards provide the audit firm with relevant (management) information about the quality of statutory audits. The boards of directors **make adjustments** if the execution diverges from the objective of the quality safeguard and does not lead to the intended effect. The boards of directors can make adjustments if the execution of the EQCR does not meet legal and regulatory norms. Observations from internal quality reviews (IQRs) may prompt the boards of directors to include these themes in file coaching programs or to designate them mandatory consultation themes.<sup>28</sup>

Figure 3: Quality safeguards<sup>29</sup>



### 3.1 The Big4 could further improve their EQCR policy

Two legal and regulatory aspects (Article 8 of the EU regulation)<sup>30</sup> do not find sufficient expression in the EQCR policies of most of the Big4. Firstly, the policies of most of the Big4 insufficiently reflect that EQCRs of statutory audits for a PIE audit firm must always be carried out by a statutory auditor. Secondly, the professional confidentiality of engagement quality control reviewers not employed by the audit firm (Article 8(3) of the EU regulation) is not reflected clearly

<sup>28</sup> IQRs are an important yardstick for audit firms to gain an insight into the quality achieved. With this measure, the audit firm also evaluates compliance with the quality control system, allowing the firm to determine whether legal and regulatory norms have been met. With this information, the firm can identify factors that enhance or impede quality, detect and rectify organisation-wide deficiencies and prevent their recurrence.

<sup>29</sup> The arrows in Figure 3 represent information flows.

<sup>30</sup> See EU Regulation 537/2014.



enough in the EQCR policy. In these two respects, most of the Big4 fall short of the legal and regulatory norms.

## 3.2 The Big4 could reinforce the execution of the quality safeguards assessed

The boards of directors share the outcomes of the quality safeguards with the organisation and learn from them. They also have an insight into the process of execution of the safeguards. In the experience of the audit teams,<sup>31</sup> the assessed quality safeguards of EQCRs and consultations contribute to the statutory audits. The teams also find that file coaching provides specialist support for the statutory audits and that root cause analyses help them understand factors that influence quality.

The Big4 could improve the execution of EQCRs, consultations, root cause analyses and file coaching. The depth of the inspection of audit evidence in EQCRs (Section 3.2.1) and the role of the persons being consulted (Section 3.2.2) could be improved, as could the structured identification and sharing of observations from file coaching (Section 3.2.3) and the consistent execution of root cause analyses (Section 3.2.3).

### 3.2.1 The depth of the inspection of audit evidence in EQCRs could be improved

The audit teams report that EQCRs help them in carrying out statutory audits. In their experience, critical questions are asked in the EQCRs, audit evidence is reviewed objectively and the result is an improved approach to audits and associated audit evidence.

The Big4 could improve EQCRs by evaluating the depth of the inspection of audit evidence and by discussing inconsistencies in the execution of EQCRs. These inconsistencies cannot always be attributed to the specific nature and circumstances of the statutory audit. For example, one engagement quality control reviewer may inspect the 'top memo' of an item in the financial statement without using the underlying audit evidence, while another reviewer does inspect this information in a comparable case.

### 3.2.2 The role of the persons being consulted could be improved

The audit firm should ensure that, where needed, statutory auditors request advice (a consultation) from persons with relevant expertise in order to carry out a statutory audit. Consultations are often about new or complex situations. The audit teams find they receive support with statutory audits from persons being consulted who contribute knowledge and experience during consultations. The teams find this leads to, for example, the improvement and better substantiation of the technical point of view.

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<sup>31</sup> By audit teams, the AFM means the statutory auditors and (other) staff who carry out statutory audits as intended by Section 1 of the Audit Firms Supervision Decree.

Most of the Big4 could improve the role of persons being consulted with regard to (1) reviewing the accuracy and completeness of the principles and facts of the consultations and (2) follow-ups of consultations.

- The role of the person being consulted in reviewing the submitted consultation and the principles and facts, and their substantiation using audit evidence, could be improved. The audit team is responsible for the accuracy and completeness of these principles and facts and the audit evidence. The persons being consulted use their own discretion to verify these principles and facts in the consultation requests, as well as the audit evidence provided as evidence for them. The boards of directors of the Big4 have not provided sufficient clarity about the role of the persons being consulted in assessing the principles and facts in the consultation requests.
- The consultation process could be improved by monitoring the follow-up of the consultation. The statutory auditor is responsible for following up on the consultation in the statutory audit. The persons being consulted normally do not receive feedback on how the audit team followed up on the expert opinion in the statutory audit. As a result, there is a lack of insight into how these opinions were followed up on.

### 3.2.3 The structured identification and sharing of observations from file coaching could be improved

The file coaches aim to support the audit teams during statutory audits by coaching them in specialist subjects. The boards of directors have assigned themes to this end; alternatively, the file coach together with the audit team selects areas for improvement in the statutory audits. During the statutory audits, the file coaches review such areas as risk assessment, planned and completed audit activities and the recording of audit evidence. The Big4 share the observations and areas for improvement received from the file coaching with the organisation as learning points.

The Big4 could improve the practice of file coaching by structurally identifying signs and sharing these in the organisation, for instance about project management, insufficient delivery from the audit client or challenging interactions between the statutory auditor and other members of the audit team or the audit client. Having a structured process facilitates the sharing of signs with the organisation and makes it possible to support audit teams in this regard.

### 3.2.4 The consistent execution of root cause analyses could be improved

Root cause analyses provide insight into the factors that influence quality. Having an insight into the causes of insufficient quality of statutory audits, as well as the causes of satisfactory quality, is essential to be able to take the right quality improvement measures in order to meet quality change and other objectives. The boards of directors acquire this insight on various levels through root cause analyses of both individual statutory audits and organisation-wide themes. This involves insight into technical, process-related and behavioural aspects. Process-related aspects might include delivery or pressure on the audit client's schedule. Behavioural aspects might

include team dynamics or communication within the audit team. This information enables the audit firm to identify quality-enhancing and quality-impeding aspects and to take initiatives and measures in the area of statutory audits or across the organisation.

The Big4 could improve the execution of root cause analyses. Each of the Big4 uses its own methodology, but this is not applied consistently. This concerns, for example, consistently involving a behavioural expert in both individual and organisation-wide root cause analyses. Such analyses in which the quality is sufficient could also be carried out with greater regularity. In this way, the Big4 could increase their insight into factors that influence quality.

Elaborating the relationship between observations, causes and measures provides insight into which observations resulted in causes that affected quality and how the suggested measures prevent such causes. Most of the Big4 could better elaborate the relationship between observations, causes and measures in their root cause analyses. As an example, take a root cause analysis in which the cause 'professional critical reading' cannot be derived from the observations that the audit team insufficiently understood a standard loan agreement and should have sought consultation. Drawing attention to professional critical reading of loan agreements (a measure) may not anticipate that the statutory auditor could make a different risk assessment on whether to consult next time. Better elaboration gives the boards of directors greater insight with which to monitor the effect of measures and make adjustments.

### 3.3 The Big4 could improve the monitoring and adjustment of the quality safeguards assessed

The boards of directors have an insight into the process and outcomes of the quality safeguards, for instance regarding the progress and hours spent on an EQCR and, in the area of consultations, regarding the nature of specialist themes and numbers of consultations. The boards of directors also discuss the reports of the outcomes of root cause analyses and file coaching programs. The boards of directors furthermore have an insight into the process of assigning engagement quality control reviewers to statutory audits and of selecting specialist and other themes for file coaching.

The boards of directors could improve the monitoring and adjustment of the quality safeguards assessed by increasing their insight into the execution of the safeguards. This could concern the insight into the depth of questions posed by engagement quality control reviewers about significant risks, the depth of inspection of audit evidence by engagement quality control reviewers or the questions posed by the person being consulted about the consultation request and the principles and facts included therein. The insights gained improve the boards of directors' ability to monitor and make adjustments with regard to the goal and the intended effect of the quality safeguards.

The boards of directors of most of the Big4 could also increase their insight into the behaviour of the person executing the quality safeguard. This will allow them to take more initiatives to assess whether the behaviour is in line with the quality-oriented culture and to encourage exemplary

behaviour on the part of the persons executing the quality safeguards in relation to statutory audits, such as targeted learning from mistakes.

This insight into the execution of the quality safeguards and the behaviour of the persons executing them is lacking for a number of reasons, including:

- The interaction between the engagement quality control reviewer and the audit team is not very visible at any of the Big4. The depth and diligence of activities executed, made apparent among other ways through the questions asked and the feedback methods, shows up only to a limited extent in the EQCR report or audit file.
- The Big4 do not record the interaction between the persons being consulted and the audit teams in the consultation memorandums, which include the definitive specialist views.
- The boards of directors of most of the Big4 insufficiently assess the depth and diligence with which root cause analysts perform their analyses. As a result, there may be a lack of awareness as to whether the root cause analyst obtained a sufficiently thorough understanding of the causes of the quality-enhancing and quality-impeding factors.

## 4 Description of the assessment methodology

In this part of its report, the AFM describes the methodology used for this assessment. The assessment consists of two parts. The AFM first carried out an assessment of the results of safeguarding<sup>32</sup> the quality change outcomes achieved<sup>33</sup> in the areas of 1) the quality-oriented culture, 2) the quality cycle and 3) four quality safeguards. As part of this assessment, the AFM assessed whether the audit firm's policy meets legal and regulatory requirements for the quality safeguards of EQCRs and consultations and whether the policy of the four quality safeguards assessed was adhered to. Secondly, the AFM carried out an exploration of the contribution made to the statutory audits by the quality safeguards of EQCRs and consultations. The assessment was carried out between June 2019 and February 2020 and used information from the period of September 2018 up to and including September 2019.

Section 4.1 describes the assessment. Section 4.2 describes the exploration of the contribution of EQCRs and consultations to statutory audits. Section 4.3 describes the written reports of the assessment sent out by the AFM. Section 4.4 describes the implementation of both parts of the assessment. Section 4.5 sets out the limitations of both parts of the assessment.

### 4.1 Assessment of the quality change based on the expectations for 2019

#### 4.1.1 Themes that were assessed

The AFM carried out an assessment at the Big4 of 1) the quality-oriented culture, 2) the quality cycle and 3) four quality safeguards. These are important prerequisites for sustainably safeguarding the quality of statutory audits.

It follows that a coherent set of measures in these three areas that were assessed is an important part of the quality change. Below, the AFM goes into the elements of this process.

- A *quality-oriented culture* aspires to a continuous focus on high-quality statutory audits in the public interest.
- The *quality cycle* is based on the plan-do-check-act cycle aimed at continuous improvement. This is a continuous cycle for planning actions, carrying them out, verifying whether the results are as intended and adjusting the execution based on the outcomes of this check.
- The *quality safeguards* are methods, procedures and measures included in an audit firm's quality control system. They are meant to ensure that the statutory auditor who issues the audit opinion can do so in an expert, independent, principled and recognisable way.

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<sup>32</sup> Safeguarding means ascertaining something is in order and will remain in order.

<sup>33</sup> This is an ongoing process aimed at the sustainable safeguarding of the quality of statutory audits. This involves, among other things, elements of the quality control system such as rewards with performance incentives and the factors that influence quality, such as cultural elements.

The measures may be those prescribed by law, such as EQCRs, or they may be measures considered necessary by the audit firm itself, such as root cause analyses.

The elements of the quality change were assessed in relation to one another. After all, the improvement program has a positive impact on the quality safeguards, and it urges ongoing attention on the part of the audit firm for sustainably safeguarding the quality of statutory audits. The execution of quality safeguards provides the audit firm with relevant management and other information about the quality of statutory audits. This information provides important input for the quality cycle and may lead to adjustments, for instance at the organisational level or at the level of the statutory audits. The quality safeguards go on to have a positive effect on audit procedures, and so on the quality of statutory audits.

### The selection of quality safeguards

In its assessment, the AFM considered four quality safeguards. Below (Table 1), the AFM lists its reasons for this selection.

Quality safeguard	Explanation
<b>Engagement Quality Control Review (EQCR)</b>	<p>The EQCR is intended to prevent serious deficiencies in the quality of statutory audits for which audit opinions are issued. Audit firms can use the information from EQCRs to gain insight into the achieved level of quality of statutory audits and to detect deficiencies, for instance in order to introduce organisation-wide quality change measures for the sustainable improvement of the quality of statutory audits.</p> <p>The EQCR was one of six relevant quality safeguards for which the AFM requested special attention in its report of 28 June 2017.</p>
<b>Consultation</b>	<p>Consultations contribute to improving expert knowledge and its application, as well as helping to safeguard consistency in the execution of statutory audits. Consultations provide the boards of directors with relevant management and other information about the need, for instance, to take (additional) quality change measures.</p> <p>Consultations were one of six relevant quality safeguards for which the AFM requested special attention in its report of 28 June 2017.</p>
<b>File coaching</b>	<p>File coaching helps the statutory auditor and the audit team during statutory audits. It assists the audit firm in learning from good practices, dilemmas and mistakes. With the insights gained, the boards of directors can increase the quality of statutory audits.</p> <p>The Big4 use file coaching and see this as an important quality safeguard.</p>

Quality safeguard	Explanation
<p><b>Root cause analyses</b></p>	<p>An insight into the causes of either sufficient or insufficient quality of statutory audits is essential to be able to take the right quality change measures in order to meet quality change and other objectives. This information enables the audit firm to identify quality-enhancing and quality-impeding factors and to detect, remedy and prevent deficiencies across the organisation.</p> <p>The root cause analysis was one of six relevant quality safeguards to which the AFM drew particular attention in its report of 28 June 2017.</p>

Table 1: Considerations for the selection of quality safeguards

#### 4.1.2 Expectations used for the assessment

The AFM formulated expectations that describe the results for each aspect of the quality change. To this end, the AFM uses expectations for 2019 that describe results, keeping in mind that further steps will be needed in the improvement program to meet mid to long-term objectives in order to safeguard the quality of statutory audits.<sup>34</sup> The expectations for 2019 are included in the appendix.

In 2015, the AFM formulated mid to long-term objectives for the PIE audit firms that contribute to the improvement and sustainable safeguarding of statutory audits. These objectives are based among other things on the (problem) analyses and suggestions for improvement described in the Netherlands Institute of Chartered Accountants report '*In het publiek belang*' (In the public interest),<sup>35</sup> as well as on the AFM's recommendations in the past years on the occasion of assessments. The mid to long-term objectives were shared with the sector in the AFM report of October 2015.<sup>36</sup>

<sup>34</sup> The mid to long-term objectives were shared with the sector in the public report of October 2015. See the AFM report of 15 October 2015, '[Dashboard 2015: Verandering en verbetermaatregelen](#)' (Dashboard 2015: Change and measures for improvement).

<sup>35</sup> See the Netherlands Institute of Chartered Accountants report of 25 September 2014, '[In het publiek belang](#)'.

<sup>36</sup> See the AFM report of 15 October 2015, '[Dashboard 2015: Verandering en verbetermaatregelen](#)'.

Expectations filled in on the basis of legislation, regulations and principles for good management

The mid to long-term objectives formed the basis for the 2019 expectations for a quality-oriented culture (as part of the improvement program), the quality cycle and the quality safeguard of root cause analyses. The expectations for the quality safeguard of file coaching are based on the expectations for root cause analyses. The Audit Firms Supervision Act, the EU Regulation and the legislation and regulations derived from these served as the basis for the 2019 expectations for the quality safeguards of EQCRs and consultations.

The 2019 expectations for the quality safeguards are based in part, then, on the Audit Firms Supervision Act, the EU Regulation<sup>37</sup> and resulting legislation and regulations regarding the quality control system and principles for good management and supervision, such as the Dutch corporate governance code. This concerns legislation and regulations<sup>38</sup> about:

- the quality control system, including: Sections 18 and 22 of the Audit Firms Supervision Act, Sections 8 and 22 of the Audit Firms Supervision Decree, Chapter 2 of the Accounting Bodies Regulation;
- ethical and controlled business operations: Section 21 of the Audit Firms Supervision Act.

### The results per theme of the quality change

The expectations for 2019 describe the results of the assessment with regard to the quality-oriented culture, the quality cycle and the four assessed quality safeguards.

### Results for the quality-oriented culture

The results for the quality-oriented culture consist of the behaviour and decisions on the part of the boards of directors, the behaviour of statutory auditors and staff and support from the audit firm for this behaviour. Exemplary behaviour on the part of the boards of directors and statutory auditors gives the staff an impression of the behaviour accepted in the audit firm. The decisions of the boards of directors on such issues as promotions and portfolio management show whether quality is decisive in decision-making. Initiatives such as training sessions and tools are needed to support statutory auditors and staff in displaying behaviour appropriate to a quality-oriented culture.

### Results for the quality cycle

A quality cycle is needed for the sustainable safeguarding of statutory audits (see Figure 2 in Chapter 2). This means that an audit firm should have an insight into the quality and the factors that have a positive or negative influence on the quality delivered (quality-enhancing and quality-impeding factors). The audit firm develops quality change initiatives accordingly, takes measures

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<sup>37</sup> Regulation (EU) No 537/2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC.

<sup>38</sup> The references mentioned here are based on the regulations as per 1 January 2018.



as required by these initiatives, monitors whether the measures have the desired effect and makes adjustments in case of insufficient quality.

In its assessment, the AFM distinguishes between the quality cycle on the level of the audit firm and the board of directors and the quality cycle on the level of the quality safeguard:

- On the level of the audit firm, an example of a relevant question is whether the board of directors has decided what it wants to achieve with the quality change initiatives, which signs derives from the initiatives and whether knows how and to what extent the initiatives contribute to the firm's quality objectives. The principles for the quality cycle consist of the relevant information sources about quality safeguards and quality change initiatives and measures. This can involve the evaluation of IQRs, a culture survey and communicating the outcomes of EQCRs to staff.
- At the level of the quality safeguard, important questions are whether process safeguards are in place, whether policy compliance is evaluated and whether the board of directors has an insight into the execution of the quality safeguards. In this assessment, the AFM looks at four quality safeguards: EQCRs, consultations, root cause analyses and file coaching.

### Results for the quality safeguards

The AFM expects the four quality safeguards assessed to have had results. These comprise the following elements:

- The AFM expects that activities around the quality safeguards are carried out by expert members of staff with independent positions and support within the organisation who are able to carry out their activities objectively and expertly. With regard to the independent position of staff executing the quality safeguards, the AFM has evaluated their independence with regard to the audit client as well as the audit team. The independence of a person executing quality safeguards from the audit client is only one aspect of independence from the audit client. The overarching independence from the audit client did not fall within the scope of this assessment.
- The AFM expects that the audit teams experience a contribution to the statutory audit from the EQCRs and consultations. In its contribution, the AFM primarily deals with two themes: audit activities related to fraud risk factors and estimates related to a significant risk. Users of the audit opinions, among others, name both themes as areas in need of work.<sup>39</sup> In the past, the AFM also reported the auditing of estimates as one of the most frequent shortcomings.<sup>40</sup>

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<sup>39</sup> See, for example, the attention for the valuation of intangible assets as a key audit matter in the [2018 auditors letter](#) from the Association of Stockholders (VEB).

<sup>40</sup> See the AFM report of 28 June 2017, '[Kwaliteit OOB-accountantsorganisaties onderzocht](#)'.

- The AFM expects that audit firms use file coaching to support audit teams in carrying out quality statutory audits.
- The AFM expects that root cause analyses provide the audit firms with an insight into factors influencing the quality of statutory audits. The AFM also expects that root cause analyses are carried out on the basis of a variety of signs from the organisation, that statutory audits of both sufficient and insufficient quality are considered and that the analyses deal with both individual statutory auditors and their team and with organisation-wide aspects.

### Compliance with the policy and with legislation and regulations

The AFM further assessed whether the policy complies with relevant legislation and regulations for the quality safeguards in the areas of EQCRs and consultations.<sup>41</sup> Compliance with the policy<sup>42</sup> of the Big4 audit firms was assessed for four quality safeguards: EQCRs, consultations, file coaching and root cause analyses.

### The expectations for 2019 correspond to earlier expectations

- In its report '*Kwaliteit overige OOB-accountantsorganisaties onderzocht*' (Quality assessment of other PIE audit firms) from 2019 (the 2019 report),<sup>43</sup> the AFM arranged the 2018 expectations for the improvement program into a model consisting of six elements (2018 model). The expectations for 2019 regarding the quality-oriented culture relate to the elements 'Intended effect', 'Applying the vision', 'Willingness' and 'Execution' from the 2018 model.
- The expectations for the quality cycle relate to the element of 'Reflection' from the 2018 model.
- The quality safeguards expectations for 2019 build on the expectations for 2018 (see the 2019 report).

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<sup>41</sup> Article 8 of the EU Regulation, Section 18 of the Audit Firms Supervision Decree (EQCR) and Section 17 of the Audit Firms Supervision Decree (consultations).

<sup>42</sup> Section 22 of the Audit Firms Supervision Decree.

<sup>43</sup> See the AFM report of 14 November 2019, '[Kwaliteit overige OOB-accountantsorganisaties onderzocht](#)'.

### 4.1.3 Qualitative interpretation for the assessment in the institution-specific reports

This section describes the AFM’s qualitative interpretation of the assessment outcomes in the institution-specific reports (see also Section 4.3), as well as the clusters of expectations used in the assessment.

#### Qualitative interpretation of the assessment’s results

The institution-specific reports include the AFM’s qualitative interpretation of the results against the expectations for 2019. This interpretation identified a number of areas for improvement based on relevant observations related to the expectations for 2019. On the basis of the assessment outcomes, the qualifications used in the institution-specific reports are positive and somewhat positive. The AFM used the following classification:

In line with expectations	The audit firm meets the expectations for 2019 with regard to part of the assessment.	Positive  In this assessment, this means that the audit firm achieved results and that the AFM has not identified any areas for improvement.
Almost in line with expectations	The audit firm meets most of the expectations for 2019 with regard to part of the assessment.	Somewhat positive  In this assessment, this means that the audit firm achieved results and that the AFM has identified a limited number of areas for improvement.
Falls short of expectations	The audit firm does not meet some of the expectations for 2019 with regard to part of the assessment.	
Falls well short of expectations	The audit firm does not meet several or any of the expectations for 2019 with regard to part of the assessment.	

Table 2 Overview of the qualifications used, their significance and their application in this assessment

In the institution-specific reports, the AFM used a qualitative qualification – the policy was adhered to or the policy was not adhered to – in assessing compliance with the policy, legislation and regulations. The AFM used the qualification ‘the policy was not adhered to’ irrespective of the nature and size of the elements that were not carried out in accordance with the policy, and irrespective of whether the policy conforms to legislation and regulations (expectations C1.2, C2.2, C3.2 and C4.2). If no policy is in place, compliance was not assessed.

### The AFM created clusters of expectations for the themes of the assessment

The information obtained from interviews and documents was assessed and analysed as a whole and was related to the relevant expectations. A number of clusters of expectations were created with regard to the quality-oriented culture, the quality cycle and the quality safeguards.

1. Four clusters of expectations were selected for the aspect of the quality-oriented culture. The first cluster comprises the behaviour expected from staff (A1<sup>44</sup>), the exemplary behaviour of the statutory auditors (A8) and the behaviour displayed by staff (A9). The second cluster comprises the exemplary behaviour of the board of directors (A7), the board of directors’ decisions in line with the quality-oriented culture (A4) and the way staff experience these decisions (A5). The third cluster comprises the expectations about the involvement of staff as experienced (A2) and the experienced opportunities for discussing the company’s informal aspects (A3). The fourth cluster comprises the expectations about enabling staff to change successfully (A6) and about whether lessons are being learned from the quality safeguards (A10).
2. The aspect of the quality cycle comprises two clusters. The first cluster concerns the quality cycle at the level of the audit firm and the board of directors (B1, B2, B3 and B4). The second cluster comprises the quality cycle for each of the quality safeguards assessed (C1.1, C2.1, C3.1 and C4.1).
3. The aspect of quality safeguards is divided into four clusters. The first cluster comprises the contribution of the EQCRs and consultations as experienced by staff (C1.4 and C2.4). The second cluster comprises the expectations about support through file coaching (C4.4 and C4.5). The third cluster comprises the insight derived from root cause analyses of factors influencing the quality of statutory audits (C3.4, C3.5 and C3.6). The fourth cluster comprises the expectations for the four quality safeguards assessed regarding independence, expertise, position and support (C1.3, C2.3, C3.3 and C4.3).

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<sup>44</sup> This numbering refers to the expectations per aspect of the assessment: the quality-oriented culture (A), the quality cycle (B) and quality safeguards (C). See the appendix for this.

## 4.2 Exploration of the contribution of EQCRs and consultations to statutory audits

The AFM carried out an exploration of the contribution made to statutory audits by the quality safeguards of EQCRs and consultations. The exploration focuses on their execution and particularly on the depth and diligence of their execution.

This has led to observations that provide an insight into the way EQCRs and consultations contribute to statutory audits. The AFM did not explore whether statutory auditors obtained sufficient and suitable audit evidence for statutory audits related to the EQCRs and consultations that were assessed.

## 4.3 Written reports

This paragraph describes the written reports the AFM sent out about the assessment.

### Firm-specific reports

In April 2020, the AFM sent each of the Big4 a draft assessment report describing the preliminary conclusions, areas requiring attention and observations from the exploration of the contribution of EQCRs and consultations.

The Big4 had the opportunity to respond orally and in writing to these institution-specific reports. The AFM asked them to point out any inaccuracies or incomplete information and to provide arguments for this and, where needed, documentation. The responses from the Big4 were evaluated, which may have led to the amendment of conclusions, areas for improvement, observations or reported facts. With the outcomes of this assessment, the AFM created a definitive assessment report, which was sent to each of the Big4 at the end of June 2020.

### Public report

The AFM notified the Big4 in April 2020 that the assessment outcomes would be included in a public report. They were given the opportunity to point out any factual errors in this public report; where needed, the AFM made adjustments.

## 4.4 Description of the implementation of the two parts of the assessment

The AFM used various information sources for both the assessment and the exploration (hereinafter: the assessment). The AFM performed a desktop analysis based on the documentation requested from the Big4 for each aspect of the assessment. The AFM requested documents that deal with the themes mentioned in the expectations and that show how the audit firms worked with these expectations. The firms were also asked to do a self-assessment. This is each firm's own opinion, which was used exclusively by the AFM to prepare for the interviews for this assessment.

The AFM also held in-depth interviews with each of the Big4. On the quality-oriented culture, seven interviews were held at each firm – with the board of directors, the statutory auditors, the (senior) managers and the audit leaders. The group discussion model was used for the interviews with external auditors and staff. For the quality cycle, the AFM held two interviews per firm with the board of directors and five interviews per firm with the process owners of the quality safeguards assessed. These (in-depth) interviews provided an insight into such questions as how the staff experienced quality initiatives, how they experienced the actions of the board of directors and how the quality cycle is safeguarded. For the quality safeguards, about 20 (in-depth) interviews were held at each of the Big4 with engagement quality control reviewers, the persons being consulted and the audit teams for the EQCRs and consultations that were assessed, and with the process owners of the four quality safeguards assessed for, among other things, the experienced contribution of EQCRs and consultations and the exploration of the depth and diligence of their execution.

At each of the Big4, the AFM also assessed five EQCRs, five consultations, three file coaching programs and five individual root cause analyses to evaluate compliance with the policy and the exploration of the contribution of the EQCRs and consultations. The EQCRs and consultations relate to the statutory audits of PIE audit firms for the 2018 financial year. In preparation for the interviews and to support the examples given in the interviews, the AFM consulted the audit files for the statutory audits to which the EQCRs and consultations referred.

#### 4.5 Limitations of the assessment

The assessment method imposes limitations on the conclusions that can be drawn from the outcomes. These limitations are explained below.

The AFM has not assessed whether the quality-oriented culture, the quality cycle and the quality safeguards are sufficient to provide sustainable safeguards for the quality of statutory audits

The assessment uses the expectations for 2019 as a benchmark. It gives an indication of whether the assessed elements from the quality-oriented culture, the quality cycle and the quality safeguards contribute to the (sustainable) safeguarding of the quality of statutory audits. However, the AFM cannot determine the extent to which these elements impact the quality of statutory audits, as the assessment does not establish whether there is a causal link between them and the quality of statutory audits. Thus, the AFM does not pronounce on whether the quality-oriented culture, the quality cycle and/or the quality safeguards are sufficient to ensure the sustainable safeguarding of the quality of statutory audits.

The AFM has not carried out an integral assessment of all aspects of the quality-oriented culture, the quality cycle and the quality safeguards

The AFM has not carried out an integral assessment of all aspects of the quality change and the quality control system. Neither has it assessed whether the statutory auditor obtained sufficient

and suitable audit evidence for the statutory audit related to the EQCRs and consultations that were assessed. It is possible, therefore, that there are deficiencies in aspects not included in the AFM's assessment. The outcomes included in this report should be seen in this light, and the absence of observations and comments does not mean there might not be other omissions. The assessment is based on a sampling of observations.

The AFM has not taken a statistical sample. The assessment findings can therefore not be projected onto the quality-oriented culture, the quality cycle and the quality safeguards as a whole. The AFM bases its observations on the interviews and the supplied documents for each part of the assessment. The observations and examples about 'staff experiences' are based on what interviewed members of staff have said.

The assessment of quality safeguards is based exclusively on PIE audit clients

For its assessment of the quality safeguards of EQCRs and consultations, the AFM selected EQCRs and consultations that relate to the statutory audits of PIE audit clients. The AFM's observations about these quality safeguards only refer to PIE audit clients. Consequently, they are not representative of these quality safeguards in the case of other statutory audits.

## Appendix: Expectations for 2019

### A. Quality-oriented culture

1. Members of staff know what the change means for their work and what behaviour is expected of them.
2. They experience an involvement in the 'who, what and when' of changes to achieve a quality-oriented culture.
3. They find that the ability to discuss their experience of the change (the informal aspects of the company) is taken seriously and that action is taken accordingly.
4. The board of directors makes decisions (such as on promotions, portfolio management, the assignment of statutory auditors and budget allocations) that are in line with a quality-oriented culture.
5. In the experience of staff, the decisions taken (such as on promotions, portfolio management, the assignment of statutory auditors and budget allocations) are in line with a quality-oriented culture.
6. Staff experience that the audit firm enables them to change successfully.
7. Staff experience that the board of directors bears out the (exemplary) behaviour proper to a quality-oriented culture.
8. Staff experience that the statutory auditors bear out the (exemplary) behaviour proper to a quality-oriented culture.
9. Staff are able to identify behaviours they themselves bear out that are proper to a quality-oriented culture.
10. Staff experience that the audit team learns from quality change measures and quality safeguards during statutory audits.

### B. Quality cycle

1. The board of directors periodically evaluates the safeguarding of the change initiatives, quality change measures and quality safeguards, for instance by staying informed about the outcomes of the annual evaluation of the quality control system, culture measurements, internal quality assessments and root cause analyses. In its evaluation, the audit firm will consider the following:
  - a. whether the change initiatives, quality change measures and quality safeguards provide the desired insight into the quality objectives;
  - b. the desired effects of the change initiatives, quality change measures and quality safeguards;
  - c. the cohesion between the various change initiatives, quality change measures and quality safeguards;
  - d. compliance with its policy on the selected quality safeguards.



2. Based on the outcomes, the board of directors takes change initiatives and quality change measures and adjusts the quality safeguards.
3. The board of directors monitors the desired effect of the change initiatives, quality change measures and adjustments to the quality safeguards.
4. The board of directors makes adjustments when the desired effect is not achieved.

## C. Quality safeguards

### *C1 Consultations*

1. The audit firm is aware of the level of compliance with the consultation policy.
2. The consultations are carried out in accordance with the set policy.
3. The consultation is carried out by one or more independent experts with sufficient standing and support in the organisation.
4. In the experience of the statutory auditor and staff, the consultation policy contributes to the quality of statutory audits.

### *C2 EQCR*

1. The audit firm is aware of the level of compliance with the EQCR policy.
2. The EQCRs are carried out in accordance with the set policy with regard to statutory requirements.
3. The EQCRs are carried out by one or more independent experts with sufficient standing and support in the organisation.
4. In the experience of the statutory auditor and staff, the EQCR policy contributes to the quality of statutory audits.

### *C3 Root cause analysis*

1. The audit firm is aware of the level of compliance with the root cause analysis policy.
2. The root cause analyses are carried out in accordance with the set policy.
3. The root cause analyses are carried out by one or more independent experts with sufficient standing and support in the organisation.
4. The audit firm carries out root cause analyses on the basis of various signs, analysing statutory audits of insufficient quality as well as statutory audits of sufficient quality.
5. The root cause analyses are aimed both at the individual statutory auditor and their team and at cross-organisational aspects.
6. The root cause analyses provide the audit firm with an insight into factors that influence the quality of statutory audits:
  - The audit firm follows a system involving the assessment of quality-enhancing, quality-impeding, specialist, process-related and behavioural aspects. This makes it clear why those involved do or do not display (want to display, feel confident to display) certain behaviour and why they are able or unable to do so.

- The audit firm gathers observations from various information sources and clarifies the relationship between observations, causes and proposed measures.
- The audit firm clarifies the considerations for the selection of relevant causes and their consequences for the quality of statutory audits.

#### *C4 File coaching*

1. The audit firm is aware of the level of compliance with the file coaching policy.
2. File coaching takes place in accordance with the set policy.
3. File coaching is done by one or more independent and competent experts.
4. On the basis of various signs, the audit firm provides file coaching, with the target, theme and scope set in advance.
5. The file coaching includes aspects relating to technical expertise, to processes and to behaviour.

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