



## Quality of the other PIE audit firms

Findings of the assessment at the other PIE audit firms

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## The Dutch Authority for the Financial Markets

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<sup>1</sup> There is no English translation available for part 2 and part 3 of this report.

## 1. Summary

The AFM has assessed (elements of) the quality change and the quality of statutory audits at the other PIE audit firms. The AFM defines the quality change as the embedding of 1) the improvement programme, 2) the quality circle and 3) the quality safeguards. This is a continuous process with the aim to ensure the quality of statutory audits on a sustainable basis.

This assessment follows the previous AFM assessment, which in 2017 concluded amongst others that there had been limited results and progress at the other PIE audit firms in the implementation and embedding of the improvement programme.

The assessment was carried out at the other PIE audit firms, namely Accon, Baker Tilly, BDO, Grant Thornton and Mazars. The assessment period for the improvement programme is 2018 and the assessment period for the quality circle and the quality safeguards is 2017-2018. At Grant Thornton, the AFM limited the scope of its assessment to the quality safeguards and inspected fewer statutory audits, as the assessment had not yet been fully initiated. The other PIE audit firms held PIE licences in the assessment period and are a relevant segment. In 2018, they had a market share of 16% (3,231) of the whole market for statutory audits in the Netherlands, and had a market share of 14% (122) of the whole market for statutory audits of PIE audit clients in the Netherlands.

The assessment of (elements of) the quality change was carried out in conjunction with the inspection of the quality of the statutory audits. After all, the improvement programme is having a positive effect on the quality safeguards and encourages continuous attention to quality at a strategic level. The implementation of quality safeguards gives the audit firm relevant management and other information, which in turn provides important input for the quality circle and can lead, among other things, to (additional) quality measures being introduced at organisational level or at statutory audit level. The quality safeguards then have a positive effect on the performance of audit procedures, and thus also on the quality of statutory audits.

It is important that audit firms implement a cohesive package of measures to safeguard the quality of statutory audits. It is therefore needed to maintain and increase the focus and commitment (of resources) on the quality change in order to achieve the necessary change. At the same time, it is important to ensure that additional measures are taken to safeguard the quality of the statutory audits to be performed, both now and in the near future.

**Based on its assessment, the AFM concludes that the other PIE audit firms made progress in their quality change. At the same time, the quality safeguards ‘engagement quality control review’ and ‘internal quality review’ failed to prevent or detect the deficiencies found in the 12 statutory audits qualified as ‘inadequate’. The quality change is therefore still to be achieved in the quality of the statutory audits.**

Based on its assessment, the AFM concludes that the other PIE audit firms made progress in their quality change since the AFM’s former assessment in 2017. The results achieved varied however

between the other PIE audit firms. BDO has made great progress in its quality change, and Mazars has also achieved results. The results achieved by Accon are limited, while BT has made little progress. GT has made progress on its quality safeguards. The AFM did not review the other elements of quality change at GT.

The approach taken to quality change and the experiences of employees are similar. After the AFM's previous assessment, the other PIE audit firms have made progress on designing an improvement programme and strengthening their quality control systems. The employees state that they have experienced a sense of urgency regarding changing behaviour in the public interest. They also say that they understand what a quality-oriented culture entails, that there is a commitment within the audit firms to work towards a quality-oriented culture, and that they are willing to contribute to this.

BDO and Mazars have made the most progress in their improvement programme. This is visible in the urgency to deliver quality in the public interest, the content of the improvement programmes, the extent to which the exemplary conduct of the statutory auditors contributes to a quality-oriented culture, the extent to which the statutory auditors and the employees are involved in the improvement programme and the decisions of the board of directors that are in line with the target on the horizon.

BDO has made the most progress in embedding the quality circle. This concerns both the monitoring and the reflection of the progress of the improvement programme and the effect of the change initiatives taken, and the quality circle on the six quality safeguards.

The extent to which the quality safeguards meet the requirements of legislation and regulation and the extent to which the policy of these quality safeguards is complied with, is comparable. This is visible in the strengthening of the policy for root cause analyses and in the elements of the policy that do not meet the requirements of legislation and regulation. The majority of the other PIE audit firms have also complied with their policies for several quality safeguards.

In its assessment, the AFM inspected the quality of 14 statutory audits performed in 2017 and 2018, and gained an impression of these statutory audits. The quality safeguards 'engagement quality control review' and 'internal quality review' failed to prevent or detect the deficiencies found in the 12 statutory audits qualified as 'inadequate'. Most of the deficiencies were similar in nature to those found in previous inspections by the AFM.

## 2. The AFM has assessed the quality change (the improvement programme, the quality circle and the quality safeguards) and the quality of statutory audits at the other PIE audit firms

Since 2014, audit firms have adopted a structured approach to changing their culture and behaviour in order to improve the quality of statutory audits<sup>2</sup> (improvement programme).<sup>3</sup> Among other things, the aim of this improvement programme is to strengthen a quality-oriented culture. In 2017,<sup>4</sup> the AFM concluded that there had been limited results and progress in the implementation and embedding of the improvement programme, also at the other PIE audit firms.<sup>5</sup> They have made progress on the quality change since that time. The AFM defines the quality change as the embedding<sup>6</sup> of 1) the improvement programme, 2) the quality circle<sup>7</sup> and 3) the quality safeguards.<sup>8</sup> This is a continuous process with the aim to ensure the quality of statutory audits on a sustainable basis.<sup>9</sup> In this assessment, the AFM assessed the quality change and inspected the quality of a number of statutory audits.

The AFM carries out various interventions to encourage the other PIE audit firms to make progress on the quality change

The AFM has previously assessed the quality of statutory audits, the system of quality control and the implementation and embedding of the improvement programme at the other PIE audit firms. Public reports on these assessments were issued in 2013, 2015 and 2017.<sup>10</sup>

The AFM carries out various interventions to encourage the other PIE audit firms to make progress on the quality change. The AFM wants to encourage them to maintain and increase their focus and commitment (of resources) on the quality change in order to achieve the necessary change. At the same time, it is important to ensure that additional measures are taken to safeguard the quality of the statutory audits to be performed, both now and in the near future.

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<sup>2</sup> A statutory audit is an audit of the financial reporting of a company on behalf of the public that is specifically designated as a statutory audit in the Audit Firms Supervision Act (Wet toezicht accountantsorganisaties, the Wta). It concerns the audits of financial statements of medium-sized and large companies, municipalities, provinces and various financial enterprises.

<sup>3</sup> This was initiated partly due to the NBA report of 25 September 2014 '[In the public interest](#)'.

<sup>4</sup> See the AFM report of 28 June 2017 '[Quality of PIE audit firms reviewed](#)'.

<sup>5</sup> The other PIE audit firms are: accon avm controlepraktijk B.V. (Accon), BDO Audit & Assurance B.V. (BDO), Baker Tilly (Netherlands) N.V. (BT), Grant Thornton Accountants & Adviseurs B.V. (GT) and Mazars Accountants N.V. (Mazars).

<sup>6</sup> Embedding means that something is up to standard and remains up to standard.

<sup>7</sup> The quality circle is based on the plan-do-check-act cycle aimed at continuous improvement. This continuous cycle concerns planning an action, implementing the planned action, monitoring whether these actions are having the desired effect, and making adjustments or adaptations based on this monitoring.

<sup>8</sup> Quality safeguards are the methodologies, procedures and measures that form part of the quality control system of an audit firm. These should lead to a situation in which the statutory auditor who issues the audit opinion can do this in a professional, independent, ethical and recognisable manner. This may be due to measures prescribed by legislation and regulation, such as an internal quality review (IQR), but also due to measures deemed necessary by the audit firm itself, such as a root cause analysis.

<sup>9</sup> This includes elements of the quality control system such as performance-related remuneration and other factors that affect quality such as cultural aspects.

<sup>10</sup> See the AFM website [Review reports on supervision of audit firms](#).

After its assessment in 2017, the AFM has discussed the acceleration of the improvement programme with the executive and supervisory boards of the other PIE audit firms.<sup>11</sup> In addition to the conduct of assessments, the suitability test is another example of intervention by the AFM. The statutory requirements<sup>12</sup> implemented on 1 July 2018 relating to governance (establishment of a supervisory board) and the suitability test are expected to contribute to ensuring the quality of statutory audits.

In 2018, the AFM also explored the vulnerabilities in the structure of the audit sector and made an analysis of alternative models for this structure.<sup>13</sup> Partly on the basis of this report, the Minister of Finance has appointed a Committee on the Future of the Audit Sector (Commissie Toekomst Accountancysector, or 'CTA').<sup>14</sup> The CTA researches and advises on the issue of how the quality of statutory audits can be permanently improved and the changes to policy or legislation that would be desirable.<sup>15</sup>

### The other PIE audit firms are a relevant segment<sup>16</sup>

The other PIE audit firms have a market share of 16% (3,231) of the whole market for statutory audits in the Netherlands (figure 1), and a market share of 14% (122) of the whole market for statutory audits of PIE audit clients<sup>17</sup> in the Netherlands.<sup>18</sup> As a result, this is a relevant segment.

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<sup>11</sup> The AFM has communicated their key attention points to the other PIE audit firms in writing.

<sup>12</sup> [Wet aanvullende maatregelen accountantsorganisaties](#).

<sup>13</sup> See the AFM report '[Vulnerabilities in the structure of the audit sector](#)' of 21 November 2018.

<sup>14</sup> [Letter](#) to the House of Representatives of 21 November 2018 "Announcement of the Committee on the Future of the Audit Sector."

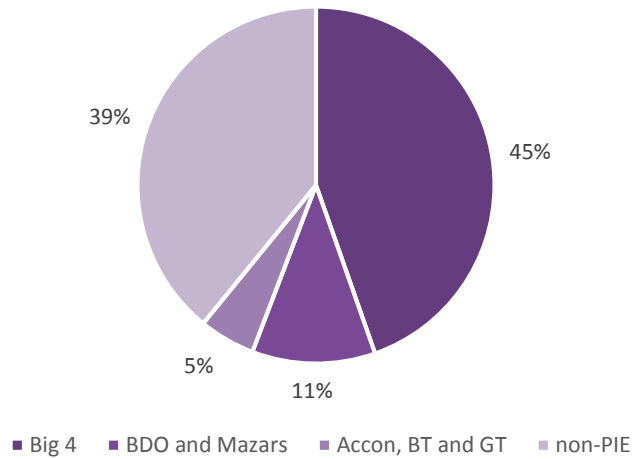
<sup>15</sup> The CTA published its [interim report](#) with draft findings on 1 October 2019.

<sup>16</sup> The number of Big 4 audit firms and other PIE audit firms is small (4 and 5 respectively) compared to the number of non-PIE audit firms (281). No independent conclusions may therefore be attached to the ratios in figures 2 and 3.

<sup>17</sup> PIE audit clients are listed legal entities, banks, insurers and reinsurers.

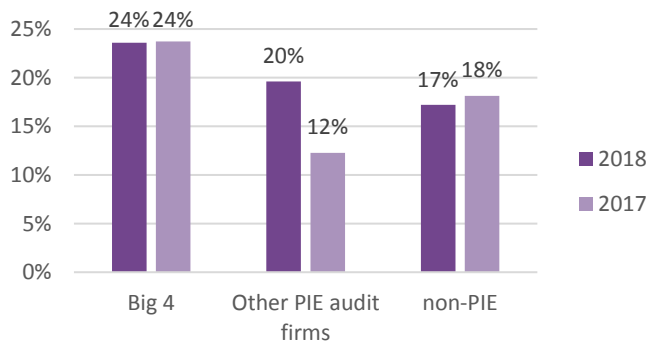
<sup>18</sup> Based on the number of statutory audits as stated in the 2018 Audit Firms Monitor. The Monitor is a digital questionnaire in which audit firms provide information on their most recently concluded financial year and the statutory audits they performed in that year.

Figure 1 Number of statutory audits<sup>1920</sup>



The number of engagement quality control reviews (EQCRs) compared to the number of statutory audits by the other PIE audit firms is in similar proportion to that at both the non-PIE audit firms and the Big 4 audit firms (figure 2).

Figure 2 Number of EQCRs compared to number of statutory audits<sup>21</sup>



<sup>19</sup> Derived from the AFM Audit Firms Monitor in 2018.

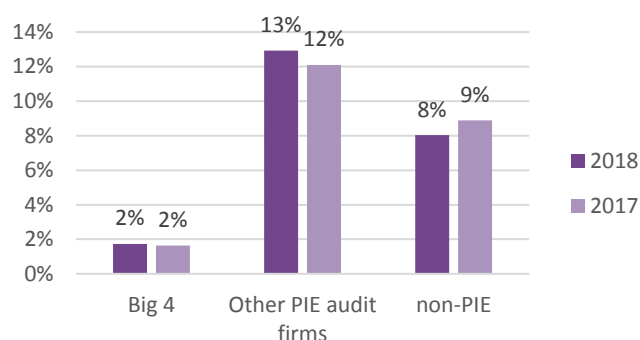
<sup>20</sup> PIE audit firms are audit firms licensed to perform statutory audits of Public Interest Entities (PIE). In addition to the other PIE audit firms, PIE audit firms include the following Big 4 audit firms ('the Big 4'): Deloitte Accountants B.V., Ernst & Young Accountants LLP, KPMG Accountants N.V. and PricewaterhouseCoopers Accountants N.V. Non-PIE audit firms are audit firms that are licensed to perform statutory audits of non-PIE audit clients.

<sup>21</sup> Derived from the AFM Audit Firms Monitor in 2018 and 2017.



The number of internal quality reviews (IQRs) compared to the number of statutory audits is slightly higher at the other PIE audit firms than at the non-PIE audit firms (figure 3).

Figure 3 Number of IQRs compared to number of statutory audits<sup>22</sup>



### Differences between audit firms

Each audit firm has differences in strategy and situational factors as well as different organisational features. In other words, each audit firm has its own organisational structure, also in relation to the structure of its quality change.

PIE audit firms are subject to additional statutory and regulatory requirements that affect their organisational structure. Compared to firms with a regular Wta licence, they have to meet additional requirements in relation to governance (the establishment of a supervisory board), the suitability test of executive and supervisory board members and independence. For the system of quality control, a limited number of stricter quality safeguards apply for PIE audit firms, such as the mandatory EQCR for audit engagements at PIE audit clients and the appointment of a compliance officer.

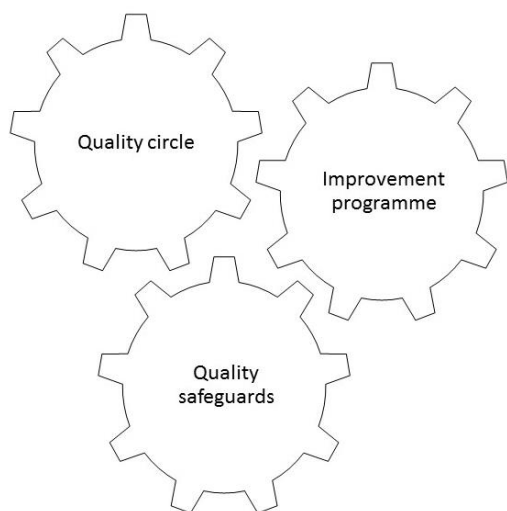
The assessment of the quality change was carried out in conjunction with the inspection of the quality of statutory audits at the other PIE audit firms

The assessment of (the elements of) the quality change was carried out in conjunction with the inspection of the quality of the statutory audits. After all, the improvement programme is having a positive effect on the quality safeguards and encourages continuous attention to quality at a strategic level. The implementation of quality safeguards gives the audit firm relevant management and other information, which in turn provides important input for the quality circle and can lead, among other things, to (additional) quality measures being introduced at organisational level or at statutory audit level. The quality safeguards then have a positive effect on the performance of audit procedures, and thus also on the quality of statutory audits.

<sup>22</sup> Derived from the AFM Audit Firms Monitor in 2018 and 2017.

The AFM classified the findings of its assessment according to the three elements of the quality change. These three elements are shown in diagram form in figure 4.

Figure 4 Overview of the three elements of the quality change<sup>23</sup>



The AFM has assessed the improvement programme in the period from 1 January 2018 to 31 December 2018.<sup>24</sup> This involved an assessment by the AFM of the extent to which the expectations for 2018 were met. These expectations were grouped into six elements.<sup>25</sup> The AFM also assessed the quality circle in the period from 1 January 2017 to 31 December 2018 by assessing the extent to which the expectations were met. Finally, the AFM assessed six quality safeguards in the period from 1 January 2017 to 31 December 2018. This involved an assessment by the AFM of the extent to which these quality safeguards met the requirements of legislation and regulation, and the expectations. In its assessment, the AFM focused on six quality safeguards<sup>26</sup> that it requested in its report of 28 June 2017<sup>27</sup> to give special attention:

- Client- and engagement acceptance and -continuation (portfolio management);
- Consultation;
- Engagement quality control review (EQCR);
- Internal quality review (IQR);
- Root cause analysis;
- Remuneration of statutory auditors.

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<sup>23</sup> The quality circle is shown in visual form in figure 5. The model used for the improvement programme is shown in visual form in figure 12.

<sup>24</sup> The expectations for 2018 were based on the medium- to long-term objectives, taking account of the fact that further steps in the improvement programme would be necessary to meet these objectives and therefore make it possible to safeguard the quality of statutory audits. See [part 3](#) of this report for the medium- to long-term objectives and the expectations for 2018.

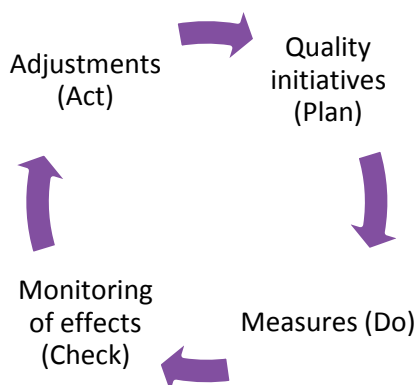
<sup>25</sup> The six elements are: sense of urgency, intended effect, translation of vision, willingness, execution and reflection. See section 4.1.2 for further explanation of the six elements.

<sup>26</sup> See section 4.1.3 for further explanation of the six quality safeguards assessed.

<sup>27</sup> See the AFM report '[Quality at PIE audit firms reviewed](#)' of 28 June 2017.

A quality circle (figure 5) is needed first of all for the embedding of the improvement programme, and secondly for the embedding of the quality of statutory audits. This means that an audit firm has designed a process for obtaining management and other information on change initiatives and quality measures (for instance from IQRs, EQCRs, culture surveys and root cause analyses) in a timely and structured manner in order to reflect and evaluate on a regular basis. This management and other information provides insight firstly into the progress of the improvement programme and secondly into the quality of statutory audits and the factors that contribute to or hamper quality. On the basis of this information, the audit firm can take new quality initiatives and take measures on this basis<sup>28</sup>, at both organisational and statutory audit level. The audit firm can then make adjustments if these quality initiatives do not have the desired effect.

Figure 5 The quality circle



In addition to its assessment of (the elements of) the quality change, the AFM inspected in accordance with professional standards the quality of a number of statutory audits performed in 2017 and 2018 which were subject to quality safeguards. This part of the assessment was not intended to form a general impression of the quality of statutory audits, but to gain an impression of the quality safeguards.

For its assessment of the quality change, the AFM used various information sources such as interviews and documents. The information obtained from this was assessed and analysed in the context of the relevant expectation or legislation and regulation. The AFM assigned a qualitative qualification for each expectation. The AFM also conducted a survey to obtain insight into the experience of employees.<sup>29</sup>

For the inspection of the quality of the statutory audit, the AFM requests the statutory auditor to explain the material parts of the audit selected by the AFM on the basis of the documentation in the audit file. The AFM assigned a qualitative qualification for each statutory audit. See section 4 for a description of the methodology.

<sup>28</sup> Both change initiatives and quality measures.

<sup>29</sup> The findings of the survey are described in section 3.2.

The assessment was conducted at Accon<sup>30</sup>, BDO, BT<sup>31</sup> and Mazars. GT was only partly included in the assessment. In December 2018, GT decided to convert its PIE licence into a regular Wta licence by 30 June 2019.<sup>32</sup> Since the AFM had in December 2018 not yet started its assessment at GT of the improvement programme, the six quality safeguards and the quality of one statutory audit, the AFM limited the scope of its assessment at GT.<sup>33</sup> The audit firms assessed held a PIE licence in the assessment period.

### A cohesive package of measures is needed to safeguard the quality of statutory audits

It is important that audit firms implement a cohesive package of measures to safeguard the quality of statutory audits. This means for example that audit firms need to take measures designed to encourage a quality-oriented culture and strengthening their quality safeguards. A cultural change is not an isolated process; it is complex and it takes time. At the same time, safeguarding the quality of statutory audits is necessary to continuously justify the public confidence placed in auditors, audit firms and audit opinions issued.

The public needs to be able to rely on the audit opinions issued by auditors and audit firms in their audit reports. The audit opinion adds assurance to the financial statements and contributes to confidence in those financial statements by a large group of users, including investors, banks, creditors, financial analysts and consumers. Confidence does not only relate to the question of whether the information in the financial reports presents a true and fair view, but also whether the information has been prepared in a reliable and proper manner and is represented in the reporting. If the public subsequently learns that the information is not reliable, this undermines public confidence in auditors, audit firms and audit opinions issued. This affects the entire sector.

Maintaining and increasing focus and commitment (of resources) on the quality change is therefore needed in order to achieve the necessary change. At the same time, it is important to ensure that additional measures are taken to safeguard the quality of the statutory audits to be performed, both now and in the near future.

The AFM will continue to draw attention internationally to the expected change focused on the quality of statutory audits, since the challenges in the sector are not restricted to the Netherlands.

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<sup>30</sup> Accon converted its PIE licence to a regular Wta licence on 2 July 2019.

<sup>31</sup> On [21 May 2019](#), BT stated that it would convert its PIE licence to a regular Wta licence by 1 January 2020.

<sup>32</sup> GT converted its PIE licence into a regular Wta licence on 28 June 2019.

<sup>33</sup> With respect to the six quality safeguards, the AFM assessed whether the policy of GT meets expectations and whether this policy was being complied with. Secondly, the AFM inspected the quality of two statutory audits performed by GT.

## This report contains the findings of the assessment

This report presents the AFM's findings from its assessment. The AFM thus presents insight in the results achieved by the other PIE audit firms with respect to the quality change. The AFM reports its primary conclusions and findings publicly and transparently.<sup>34</sup> These conclusions and findings will enable the users of financial reporting, such as investors and creditors, to understand how the audit firms concerned compare to each other. This information can also be used by supervisory boards, and especially audit committees, for the selection and evaluation of their statutory auditors.<sup>35</sup>

The AFM completed its assessment<sup>36</sup> with the collection of information on the assessment period in early 2019. The other PIE audit firms then received a draft report, to which they responded. The final reports were sent out at the beginning of July 2019. In mid-July 2019, the AFM informed them in writing that it intended to publish the primary conclusions and findings of its assessment in a public report with the application of Section 48a (6) Wta. The other PIE audit firms were given the opportunity to state their position, either orally or in writing, with respect to the intention to publish. The AFM assessed the position statements received. The AFM included the result of this assessment in a decision to publish and notified this decision in mid-October 2019. The primary conclusions and findings for each audit firm are stated in [part 2](#) of this report. The content of part 1 of this report is based on this information. The other PIE audit firms were given the opportunity to give a written response to the decision to publish. These written responses can be found on the AFM website.<sup>37</sup>

## Structure

The AFM describes the findings of its assessment in section 3. Section 4 describes the methodology. The primary conclusions and findings at each PIE audit firm are presented in [part 2](#) of the report. The AFM has published the related responses of the other PIE audit firms on its website.<sup>38</sup>

A list of abbreviations used in this report is provided in [part 3](#) of this report.

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<sup>34</sup> The primary conclusions and findings at each other PIE audit firm are presented in [part 2](#) of this report.

<sup>35</sup> Under the Wta, audit firms must share the primary conclusions and findings with the audit committee of a PIE audit client if the AFM publishes conclusions and findings that are partly based on statutory audits of the PIE audit client concerned.

<sup>36</sup> See sections 4.1.6 and 4.2.2 for an account of the progress of the assessment.

<sup>37</sup> See the [AFM website](#).

<sup>38</sup> There is no English translation available for these responses.

### 3. Differences in the extent of the quality change at the other PIE audit firms

The extent of the quality change at the other PIE audit firms show differences. But while the results achieved differ (section 3.1), the approaches to the quality change and the experiences of employees are similar (section 3.2). BDO and Mazars have made the most progress in the improvement programme (section 3.3). BDO has made the most progress in embedding the quality circle (section 3.4). The extent to which the quality safeguards meet the requirements of legislation and regulation and this policy is complied with, is comparable (section 3.5). The quality safeguards failed to prevent or detect the deficiencies in statutory audits (section 3.6).

In sections 3.1 to 3.6, the AFM lists the differences and correspondences between the other PIE audit firms that it identified, and cites a number of good practices<sup>39</sup> from its review. The primary conclusions and findings at each other PIE audit firm are presented in [part 2](#) of this report.

#### 3.1 Difference in results on the quality change

Based on its assessment, the AFM concludes that the other PIE audit firms have made progress in the quality change, as they have made progress on improving their quality since the AFM's former assessment.<sup>40</sup> The results achieved varied, however. BDO has made great progress in its quality change, and Mazars has also achieved results. The results achieved by Accon are limited, while BT has made little progress. GT has made progress on its quality safeguards. The AFM did not review the other elements of the quality change at GT. The status of quality change is shown in summary form in figures 6 to 10.

##### BDO has made great progress on its quality change<sup>41</sup>

BDO has made great progress on its quality change (figure 6). BDO has met the expectations for 2018 on five of the six elements of the improvement programme.<sup>42</sup> BDO is actively implementing the improvement programme. The board of directors of BDO has a clear idea of what it wants to achieve, and is shaping the change together with its statutory auditors and employees. BDO is also in a position to devote continuous attention to the change in its organisation. BDO also has an effective quality circle for both the improvement programme and for four of the six quality safeguards. In addition, BDO's policy meets the expectations for four of the six assessed quality safeguards and BDO has complied with its policy for the six assessed quality safeguards.

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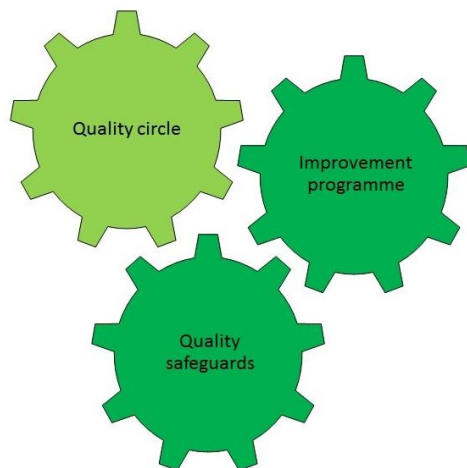
<sup>39</sup> Good practices are practical examples that show how audit firms can implement the improvement programme and the quality safeguards. These good practices can inspire other audit firms to achieve further improvement. Alternative interpretations that are appropriate to the specific features of the audit firms concerned are also possible.

<sup>40</sup> See the AFM report '[Quality at PIE audit firms reviewed](#)' of 28 June 2017.

<sup>41</sup> The primary conclusions and findings in relation to BDO are stated in [part 2](#) of this report.

<sup>42</sup> The expectations for 2018 were based on the medium- to long-term objectives, taking account of the fact that further steps in the improvement programme would be necessary to meet these objectives and therefore make it possible to safeguard the quality of statutory audits. See [part 3](#) of this report for the medium- to long-term objectives and the expectations for 2018.

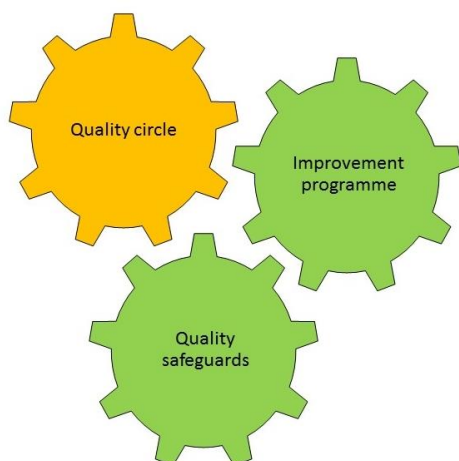
Figure 6 Quality change at BDO<sup>43</sup>



Mazars has made progress on its quality change<sup>44</sup>

Mazars has made progress on its quality change (figure 7). Mazars has nearly met the expectations for 2018 on four of the six elements of the improvement programme. Mazars feels the urgency to change and is working with its organisation on the development of its improvement programme. Consistent monitoring and direction by the board of directors is important for Mazars to embed the improvement programme at Mazars. Mazars has also made progress on the quality circle. In addition, Mazars' policy (nearly) meets the expectations for three of the six assessed quality safeguards and Mazars has complied with its policy for five of the six assessed quality safeguards.

Figure 7 Quality change at Mazars



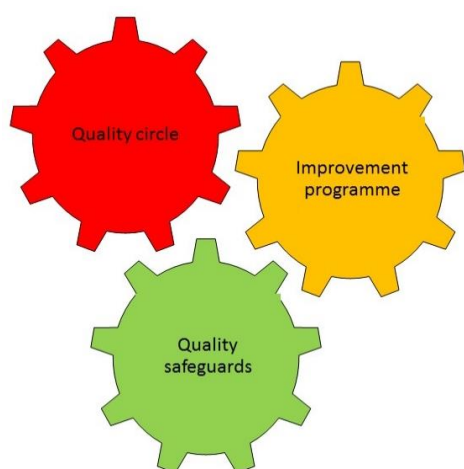
<sup>43</sup> Based on its primary conclusions and findings for each other PIE audit firm (see [part 2](#) of this report), the AFM has calculated an average qualitative qualification for each element of the quality change. See figures 6 to 10. The colours used for these average qualitative qualifications are: **in line with expectation**, **nearly in line with expectation**, **short with expectations**, **well short with expectation** or untested. See section 4.1.5 for further explanation.

<sup>44</sup> The primary conclusions and findings in relation to Mazars are stated in [part 2](#) of this report.

### Accon has made limited progress on its quality change<sup>45</sup>

Accon has achieved limited results in its quality change (figure 8). Accon has failed to meet the expectations for 2018 on four of the six elements of the improvement programme. The Accon board of directors does not have a shared view of its target on the horizon and its strategy for achieving it. The Accon board of directors has implemented various change initiatives and makes it discussable, but it does not adequately understand the various needs of its employees. Accon does not have an effective quality circle. Accons' policy (nearly) meets the expectations for four of the six assessed quality safeguards. In addition, Accon has complied with its policy for four of the six assessed quality safeguards.

Figure 8 Quality change at Accon



### BT has made little progress on its quality change<sup>46</sup>

BT has made little progress on its quality change (figure 9). BT has failed to meet the expectations for 2018 on all the six elements of the improvement programme. BT insufficiently acknowledge the urgency to safeguard the quality of statutory audits in the public interest. The employees interviewed<sup>47</sup> did not have an adequate understanding of the meaning of the improvement programme. The BT board of directors made the change discussable, but has not implemented adequate initiatives for change and is not sufficiently aware of what its employees need in order to change. BT does not have an effective quality circle. In addition, BTs' policy does not meet the expectations on five of the six assessed quality safeguards. BT has complied with its policy on three of the four assessed quality safeguards. BT does not have a policy for root cause analyses, and also has no policy for the remuneration of statutory auditors who are also shareholders.

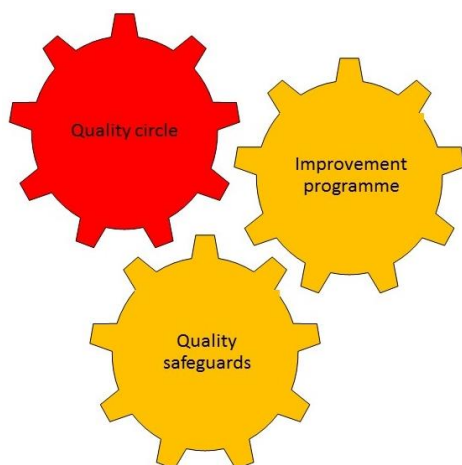
<sup>45</sup> The primary conclusions and findings in relation to Accon are stated in [part 2](#) of this report.

<sup>46</sup> The primary conclusions and findings in relation to BT are stated in [part 2](#) of this report.

<sup>47</sup> The AFM has used both interviews and documentation. For further details of the information sources used for the assessment, see section 4.1.6.



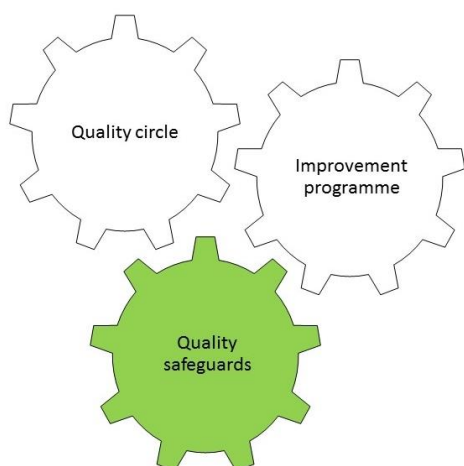
Figure 9 Quality change at BT



GT has made progress on its quality safeguards<sup>48</sup>

The AFM's assessment at GT was limited to the quality safeguards. GT has made progress on the quality safeguards (figure 10). GT has complied with its policy on five of the six assessed quality safeguards and its policy on four of the six assessed quality safeguards meets the expectations. The AFM did not assess the improvement programme and the quality circle at GT.

Figure 10 Quality change at GT



### 3.2 The approach taken to the quality change and the experiences of the employees are similar

Based on its assessment, the AFM concludes that there are similarities in the approach to the quality change.<sup>49</sup> After the AFM's former assessment<sup>50</sup>, the other PIE audit firms have made progress on designing an improvement programme and strengthening their quality control systems. They have also implemented initiatives for change and quality measures in the

<sup>48</sup> The primary conclusions and findings in relation to GT are stated in [part 2](#) of this report.

<sup>49</sup> All references to 'the other PIE audit firms' in sections 3.2 to 3.4 refer to Accon, BDO, BT and Mazars.

<sup>50</sup> See the AFM report '[Quality at PIE audit firms reviewed](#)' of 28 June 2017.

assessment period. Examples of this are the introduction of a change team, the hiring of external experts and the evaluation of the client portfolio in relation to the time, people and resources available. In addition, the board of directors of these audit firms have involved their statutory auditors and employees in the improvement programme, for example by organising meetings to discuss change and implementing change initiatives designed to produce feedback.

There are also similarities in the experiences of employees with respect to the improvement programme, including working on a quality-oriented culture. In order to obtain insight into the experiences of employees with respect to a quality-oriented culture and therefore also regarding the improvement programme, the AFM conducted a survey.<sup>51</sup> In this survey, the employees (or respondents) stated that they have experienced a sense of urgency regarding changing behaviour in the public interest. The respondents also say that they understand what a quality-oriented culture entails, that there is a commitment to work towards a quality-oriented culture at the audit firms, and that they are willing to contribute to this. In their experience, the respondents have been sufficiently enabled to change and are aware of the change initiatives implemented by the audit firm. To a lesser extent, the respondents recognised that decisions by the board of directors were in line with a quality-oriented culture. The respondents also stated to a lesser extent that in their experience they were being given sufficient time to deliver quality.

### 3.3 BDO and Mazars have made the most progress in the improvement programme

Based on its assessment, the AFM concludes that there are differences and similarities in the extent to which the improvement programme is embedded at the other PIE audit firms. The AFM notes that BDO and Mazars have made the most progress in the improvement programme.<sup>52</sup>

On the one hand, there are observable differences among the other PIE audit firms with respect to the urgency of delivering quality in the public interest, the implementation of an improvement programme, the extent to which the exemplary conduct the statutory auditors contributes to a quality-oriented culture, and the extent to which the statutory auditors and employees are engaged in the improvement programme. On the other hand, there are similarities in the decisions of the boards of directors in line with their objectives.<sup>53</sup>

The AFM has assessed whether the expectations for 2018 have been met with regard to six elements grouped in a model. A qualification in words is given for each element. See section 4 for further details of the AFM's methodology with respect to the improvement programme.

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<sup>51</sup> In order to obtain insight into the experiences of employees with respect to a quality-oriented culture and therefore also regarding the improvement programme, the AFM conducted a survey. See section 4.1.6 for further details.

<sup>52</sup> The primary conclusions and findings at each PIE audit firm are presented separately in [part 2](#) of this report.

<sup>53</sup> The 'target on the horizon' here concerns the mission, vision, strategy and core values of the audit firm.

## Differences in the urgency to deliver quality in the public interest

There are differences at the other PIE audit firms in the urgency to deliver quality in the public interest. They have formulated a target on the horizon that includes quality. The target on the horizon at BDO and Mazars is clearly focused on the quality of statutory audits and connects this quality to working in the public interest. The target on the horizon at BDO and Mazars forms the basis for the improvement programme and thus determines the actions of the board of directors and the change initiatives it implements. The statutory auditors and employees interviewed at BDO and Mazars are also conscious of the need to deliver quality and work in the public interest. This is not the case at Accon and BT.

Accon has formulated a target on the horizon in which the public interest has a central priority and an improvement programme that contributes to this. The board of directors does, however, not have a shared view of its target on the horizon. Moreover, the board of directors' actions are focused on growth and insufficiently on working in the public interest. BT has formulated a target on the horizon whereby the quality of statutory audits and the public interest is not on the first place. The target on the horizon, the improvement programme and the actions of the board of directors are actually focused on the centralisation of the management of the organisation and the provision of "high-quality" services to clients, where the relationship is primarily established with the aim of being a top-3 player in the segments in which BT wishes to operate.

## Differences in the content of the improvement programmes

The improvement programmes at the other PIE audit firms vary in terms of the interpretation of the objective and the specification of who and what has to change, and when the changes need to occur.

BDO and Mazars have formulated a practical improvement programme that states who and what has to change, and when the changes need to occur. BDO has defined targets, change initiatives and results to be achieved in its improvement programme. Mazars works together with the organisation on achieving its target on the horizon of 'trust through quality'. Mazars has specified the reasons underlying the need to change, explaining the roles and responsibilities of its employees in the change.

Accon has not provided a description of its target on the horizon and therefore has not adequately defined who and what has to change and when the changes need to occur in order to give central priority to quality in the public interest. BT has only defined who and what has to change and when the changes should occur for the purpose of a more centrally managed organisation, and has not defined who and what has to change and when the changes are needed to give central priority to quality in the public interest.

#### Good practice Mazars: Implementation

Mazars has taken various initiatives designed to encourage a learning attitude among its employees and get them to reflect on their behaviour. Desirable behaviour is explained and opened up for discussion using examples from practical situations. The desirable behaviour expected of partners is also described in practical terms in the 'partner conduct'.

#### Variation in the extent to which the exemplary conduct statutory auditors contributes to a quality-oriented culture

The extent to which the exemplary conduct of the statutory auditors contributes to a quality-oriented culture varies. The BDO employees interviewed stated that they had experienced exemplary conduct of the statutory auditors. They cited examples in which the statutory auditors were present during the execution of the audit more frequently than in previous years, they had more time for the employees, they were more actively managing the planning of the audit and they were prepared to terminate audit clients if necessary. The employees of Accon, BT and Mazars who were interviewed experienced less of this exemplary conduct.

In the experience of the BDO employees interviewed, the decisions taken contributed to a quality-oriented culture. The employees of Accon, BT and Mazars who were interviewed were able to cite only a few decisions that contributed to a quality-oriented culture.

#### Good practice BDO: Client- and engagement acceptance and -continuation

BDO has changed its client- and engagement acceptance and -continuation policy in order to realise its ambition. BDO's stated ambition is 'to deliver top quality always and everywhere'. For instance, BDO has further clarified and tightened its acceptance policy through the mandatory involvement of its board of directors with respect to certain new audit engagements. Items of attention with respect to the assessment of client- and engagement acceptance have also been communicated, such as the evaluation of the feasibility of engagements and the signalling of 'red flags'.

## Variation in the extent to which statutory auditors and employees are involved in the improvement programme

The extent to which the board of directors of the other PIE audit firms involve their statutory auditors and employees in their improvement programme varies. There is also variation in the extent to which the board of director of these audit firms have an impression of what their employees are thinking.

The other PIE audit firms organise meetings on their improvement programmes in order to understand what their employees are thinking. In addition, BDO and Mazars collect input on the level of support for the change in other ways, such as from their line managements. BDO and Mazars also use their leadership programmes and the Young Professional Board to involve employees in the improvement programme. These change initiatives provide the boards of BDO and Mazars with information as to what their employees need in order to be able to change.

## The decisions of the board of directors in line with their target on the horizon are consistent

There are similarities in the extent to which the employees of the other PIE audit firms interviewed experienced exemplary conduct and the extent to which the board of directors and the statutory auditors act and take decisions in line with the target on the horizon.

In the experience of the employees of Accon, BDO, BT and Mazars interviewed, their board of directors show conduct that is consistent with the target on the horizon. The Accon employees interviewed for instance recognise that the board of directors shows exemplary conduct in relation to mutual consultation and on how to create an open culture. In the experience of the BDO employees interviewed, the board of directors show exemplary conduct with respect to a quality-oriented culture. The BT employees recognise that their board of directors show conduct that is consistent with the target on the horizon. The Mazars employees interviewed recognise that their board of directors has a presence at meetings for example, and that it communicates the message of 'trust through quality' in various ways.

The board of directors of Accon, BDO, BT and Mazars take decisions that are consistent with their target on the horizon. The Accon board of directors has taken various decisions such as the changes to its organisational structure and the expansion of its professional department. BDO is taking decisions that are consistent with a quality-oriented culture, such as expanding its Quality Risk Management department. BT has implemented several structural changes that are line with its target on the horizon, such as a supervisory board with external independent members.

It was not clear to the employees interviewed how the change would affect their daily work in practical terms. None of the other PIE audit firms had specified what they expect of their employees in terms of conduct in practice.

### 3.4 BDO has made the most progress in embedding the quality circle

Based on its assessment, the AFM concludes that there are differences in the extent to which the quality circle is embedded at the other PIE audit firms. The AFM notes that BDO has made the most progress with regard to embedding the quality circle, for both the improvement programme and the quality safeguards.<sup>54</sup> There are visible differences in the monitoring of and reflection on the progress of the improvement programme and the effect of the change initiatives implemented. There are also differences in the quality circle on the six assessed quality safeguards.

The qualification for the element 'reflection' and the quality circle on the quality safeguards is analogous to the methodology applied to the improvement programme. See section 4 for further details of the AFM's methodology with respect to the element 'reflection' in the improvement programme and the quality circle.

#### There are differences in the monitoring of and reflection on the progress of the improvement programme and the effect of the change initiatives implemented

The monitoring of and reflection on the progress of improvement programme and the effect of implemented change initiatives varies between the other PIE audit firms. BDO and Mazars regularly use information from various stakeholders to reflect on the progress of their improvement programmes in line with their targets on the horizon. BDO also monitors the effect of the change initiatives it has implemented, and makes changes on the basis of this monitoring and reflection. Mazars does not adequately use this information to monitor the desired effect of the change initiatives implemented. Accon and BT do not sufficiently monitor and reflect on the progress of their improvement programmes and the effect of the change initiatives they have implemented, nor do they reflect on whether the aims of the improvement programme are being achieved.

#### Good practice BDO: Reflection

The BDO board of directors has initiated a process for regularly reflecting on the improvement programme. For this, the board of directors receives input from the organisation and has information on whether the aims of the improvement programme are being achieved and where adjustments are needed. Monitoring thus occurs at the level of the improvement programme, and is not limited to the progress of the change initiatives.

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<sup>54</sup> The primary conclusions and findings at each other PIE audit firm are presented in [part 2](#) of this report.

## Variation in the quality circle on the six quality safeguards

The quality circle on the six quality safeguards varies between the other PIE audit firms. Only BDO has embedded the quality circle for four of the six assessed quality safeguards. Mazars has made a start on embedding the quality circle for five of the six assessed quality safeguards in the assessment period.

BDO and Mazars have, for example, initiated processes to regularly and on a timely basis obtain management and other information on the quality of statutory audits and the factors that have a positive or negative effect on quality, based on the quality safeguards (such as root cause analyses, IQRs and EQCRs). BDO and Mazars use this information to analyse the results of the quality safeguards in order to assess policy and implement quality measures. This is not the case at Accon and BT. Accon and BT receive ad-hoc information that is primarily focused on the assignment of accountability regarding the implementation of the quality safeguards. This information does not provide the board of directors with adequate insight into the quality of statutory audits and the factors that have a positive or negative effect on quality.

For four of the six assessed quality safeguards, BDO monitors the effect of the quality measures initiated and makes changes if the desired effect is not achieved. Accon, BT and Mazars do not have insight into the effect of their quality measures. As a result of the lack of this insight, Accon, BT and Mazars did not make any adjustments in the assessment period.

The other PIE audit firms do not obtain any information from consultations that provides them with insight into the quality of statutory audits and the factors that have a positive or negative effect on quality. Consultations are, however, a quality safeguard that an audit firm can use to obtain information with respect to the need to take (additional) quality measures or to monitor and measure the effect of the quality measures that have been implemented.

### 3.5 The embedding of quality safeguards is similar

Based on its assessment, the AFM concludes that there are similarities with respect to the extent to which the six assessed quality safeguards have been embedded by the other PIE audit firms.<sup>55</sup> There are similarities in the strengthening of policy regarding root cause analyses, the elements of policies that do not comply with legislation and regulation, and the extent to which policy is complied with.

For each quality safeguard, the AFM has assessed whether (1) the policy complies with legislation and regulation and (2) whether this policy is complied with. With regard to the assessment of compliance with legislation and regulation and compliance with policy, we have chosen the qualifications of green for compliance and red for non-compliance, regardless of the nature and scale of the elements of legislation and regulation or policy respectively. The findings of the assessment cannot be projected onto the entire system of quality control and the policy on

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<sup>55</sup> All references to the 'other PIE audit firms' in sections 3.5 and 3.6 concern Accon, BDO, BT, GT and Mazars.

quality. See section 4 for further details of the AFM's methodology with respect to the quality safeguards. Accon, BDO, GT and Mazars have strengthened their policies with respect to root cause analyses.<sup>56</sup>

### Most firms have strengthened their policies on root cause analyses

The policies on root cause analyses at BDO and GT meet the expectations. The policies at Accon and Mazars nearly meet expectations. Based on its assessment, the AFM concludes that these audit firms strengthened their policies on root cause analyses since its previous review.<sup>57</sup> This is demonstrated through the use of behavioural expertise, the inclusion of statutory audits of both inadequate and adequate quality and the inclusion of organisation-wide aspects. This does not apply to BT, as BT did not have a policy with respect to root cause analyses in the assessment period.

### Policy with respect to several quality safeguards does not meet the requirements of legislation and regulation in certain elements

Policies with respect to EQCRs and IQRs at the other PIE audit firms do not meet the requirements of legislation and regulation in one or more elements. At BT and Mazars, the policies for the remuneration of statutory auditors who are also shareholders do not meet the requirements of legislation and regulation.

The policies with respect to EQCRs at the other PIE audit firms do not meet the requirements of the EU regulation<sup>58</sup> that has been in force since 17 June 2016. The AFM notes that not all the requirements of the EU regulation were included in these policies during the assessment period. One example of this is the requirement that an EQCR of a statutory audit of a PIE audit client must always be performed by a statutory auditor.

The AFM also notes that the policies with respect to IQRs at the other PIE audit firms do not meet the requirements of the Accounting Firms Regulation (Verordening accountantsorganisaties, or VAO). At Accon, BDO, Mazars and GT for example, the policy does not state that at least one statutory audit by each statutory auditor must be included in the IQR cycle. The policies also do not include any factors (such as the nature and complexity of audit clients and the results of previous IQRs and external reviews) for the selection of these statutory audits.

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<sup>56</sup> The primary conclusions and findings at each other PIE audit firm are presented in [part 2](#) of this report.

<sup>57</sup> See the AFM report '[Quality at PIE audit firms reviewed](#)' of 28 June 2017.

<sup>58</sup> EU regulation (no. 537/2014); requirements for statutory audits of financial statements of PIEs.



#### Good practice BDO: Root cause analyses

In its approach to root cause analyses, BDO has chosen to hold group interviews as well as questionnaires and relate the findings to 12 identified factors that affect quality. These factors are established by means of an organisation-wide root cause analysis. BDO has analysed the common causes of findings with respect to individual statutory audits and put forward quality measures at organisation level.

The AFM also noted that Mazars and BT have an equal remuneration policy for their statutory auditors<sup>59</sup> that has no incentives for individual quality.

#### Most firms have complied with their policies with respect to several quality safeguards

The majority of the other PIE audit firms have complied their policies for several quality safeguards. For BDO, this applies to all six quality safeguards. GT and Mazars have complied for five quality safeguards and Accon for four. BT has complied with its policy for three of the four<sup>60</sup> quality safeguards.

#### Good practice BDO: EQCR

For one of the statutory audits inspected that the AFM qualified as 'adequate', the EQCR was performed by two persons. The records of the quality assessors clearly show that the quality assessors were involved in the audit and the audit programme at an early stage, and that they included audit programmes and underlying documentation in relation to material risks relevant to the statutory audit in their assessment. The quality assessors asked critical questions to obtain sufficient appropriate audit evidence<sup>61</sup> and assessed the follow-up to these questions.

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<sup>59</sup> The AFM focused on statutory auditors who are also shareholders.

<sup>60</sup> Since BT does not have a policy for root cause analyses and the remuneration of its statutory auditors, the AFM did not test compliance with these policies.

<sup>61</sup> Audit evidence is, for example, information from the financial accounts on which the financial statements are based, or other information from the audit client or from third parties.

#### Good practice BDO: IQR

At BDO, an IQR is designed to establish whether a statutory auditor has obtained sufficient appropriate audit evidence to substantiate their opinion. Ideally, an IQR is performed by a team of two persons. In their assessment, the assessors consider both the audit programme and the underlying documentation in the audit file. An IQR focuses on areas that are material for the audit. In addition, the weight assigned to identified deficiencies is motivated and the identified strong points and recommendations are included in the records of the internal quality review.

### 3.6 The quality safeguards failed to prevent or detect deficiencies in the statutory audits inspected

Based on its assessment, the AFM concludes that the quality safeguards EQCR and IQR failed to prevent or detect the identified deficiencies in statutory audits qualified as 'inadequate'<sup>62</sup>. The quality change is therefore still to be achieved in the quality of the statutory audits. The identified deficiencies<sup>63</sup> were similar in nature to those identified in previous inspections by the AFM.<sup>64</sup> In its assessment, the AFM inspected the quality of 14 statutory audits and gained an impression of these statutory audits that it inspected. Of these 14 audits, the AFM qualified 2 as 'adequate' and 12 as 'inadequate'. The AFM qualified two of the three statutory audits it inspected at BDO as 'adequate'.

Most of the identified deficiencies are similar in nature to those identified in previous inspections by the AFM

The AFM notes that the most of the identified deficiencies in the statutory audits inspections are similar to those found in previous inspections.

- **Inadequate testing whether internal controls are operating effectively.** For instance, the statutory auditor did not adequately test whether the internal controls were implemented correctly by the audit client. The statutory auditor for example failed to obtain sufficient understanding of the design of the internal controls and whether these internal controls were sufficiently accurate to prevent or to identify and correct a material error in the financial statements. The statutory auditor also failed to follow up on differences revealed in his tests of the operating effectiveness of internal controls.

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<sup>62</sup> How the AFM arrived at its qualification of 'inadequate' is explained in section 4.2.3.

<sup>63</sup> In its reference to the nature of deficiencies, the AFM is referring to the type of deficiencies that led to the conclusion that sufficient appropriate audit evidence had not been obtained with respect to the material element of the statutory audit reviewed.

<sup>64</sup> See the AFM report '[Findings of the review of quality of statutory audits at the Big 4 audit firms](#)' of 25 September 2014 and the AFM report '[Quality of PIE audit firms reviewed](#)' of 28 June 2017.

- **Failure to adequately establish whether the information used in the audit is reliable.** The statutory auditor failed to adequately establish the reliability of the information which they used in their procedures, while they either did not establish that the general IT controls were operating effectively or concluded that these controls were not operating effectively.
- **Estimates not adequately tested.** The statutory auditor failed to adequately test whether the underlying assumptions were reasonable. For example, the statutory auditor solely performed inquiries to assess whether the underlying assumptions were reasonable, but failed to verify the statements provided on the basis of source documentation.
- **Insufficient assessment of whether the tests of details were appropriate to the level of risk as estimated by the statutory auditor.** The statutory auditor for instance failed to carry out procedures with respect to the primary records of sales transactions during the year, such as records of sales prices and volumes. The procedures of the statutory auditor regarding revenue were limited to the period around year-end.
- **The procedures carried out to draw conclusions regarding the whole population were inadequate.** The statutory auditor for example carried out a selective review of part of the population. After carrying out these procedures, the statutory auditor drew a conclusion with respect to the whole population. The results of these procedures could, however, not be projected onto the whole population because the statutory auditor did not take a sample.<sup>65</sup>
- **Inadequate performance of substantive analytical.** The statutory auditor for instance failed to adequately determine a threshold that is acceptable without further investigation and failed to adequately investigate the differences between the expected figures and the figures reported.

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<sup>65</sup> The requirements of ISA 530 'Audit Sampling' apply to the use of samples in order to draw conclusions regarding the sampled population.

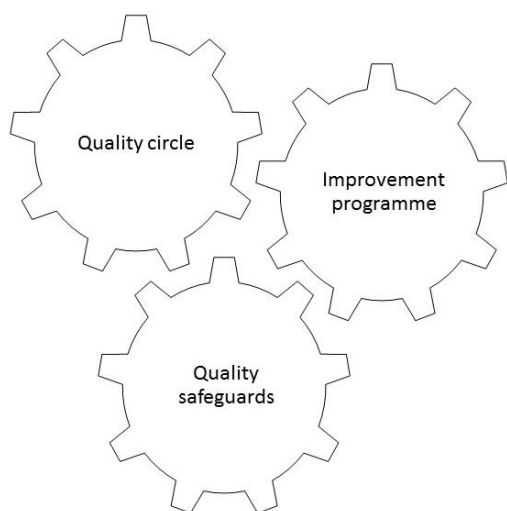
## 4. Description of the methodology

Section 4 describes the methodology used. Section 4.1 describes the methodology for the assessment of (the elements of) the quality change. Section 4.2 describes the methodology for the inspection of the quality of the statutory audits. In section 4.3, the AFM describes how its primary conclusions and findings were reported to the other PIE audit firms. Lastly, section 4.4 describes the limitations of the assessment.

### 4.1 Assessment of (the elements of) the quality change

This paragraph describes how the AFM designed and carried out its assessment of (the elements of) the quality change at the other PIE audit firms. The AFM classified the findings of its assessment according to the three elements of the quality change. These three elements are shown in diagram form in figure 11.

Figure 11 Overview of the three elements of the quality change<sup>66</sup>



The assessment of (the elements of) the quality change was carried out in combination with the inspection of the quality of the statutory audits. After all, the improvement programme is having a positive effect on the quality safeguards and encourages continuous attention to quality at a strategic level. The implementation of quality safeguards gives the audit firm relevant management and other information regarding its compliance with legislation and regulation, which in turn provides important input for the quality circle and can lead to (additional) quality measures being introduced at organisational level or at statutory audit level. The quality safeguards then have a positive effect on the performance of audit procedures, and thus also on the quality of statutory audits.

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<sup>66</sup> The quality circle is shown in visual form in figure 5. The review model used for the improvement programme is shown in visual form in figure 12.

#### 4.1.1 Objectives for the formulation of the expectations for 2018

In 2015, the AFM established medium to long-term objectives for the PIE audit firms that would contribute to the improvement and sustainable safeguarding of the quality of statutory audits. Among other things, these objectives were based on the (problem) analyses and proposals for improvement as described in the NBA report 'In the Public Interest'<sup>67</sup> and the recommendations of the AFM in past years as a result of its inspections. These medium to long-term objectives were shared with the sector in 2015 in the public report published in October 2015.<sup>68</sup>

#### Expectations established on the basis of legislation and regulation and principles for good governance

The medium to long-term objectives formed the basis for the expectations for 2018 regarding the improvement programme, the quality circle and the quality safeguard of root cause analyses. The Audit Firms Supervision Act (the Wta), the EU regulation<sup>69</sup> and derived legislation and regulation formed the basis for the expectations for 2018 with respect to the quality safeguards of client- and engagement acceptance and -continuation, consultation, EQCR, IQR and the remuneration of statutory auditors. The expectations for 2018 were thus formulated on the basis of the Wta, the EU regulation and derived legislation and regulation with respect to the quality control system as well as the principles for good governance and supervision, such as the Dutch corporate governance code. This concerns legislation and regulation<sup>70</sup> in relation to:

- the quality control system such as: Sections 18 and 22 Wta, Sections 8 and 22 Audit Firms Supervision Decree (Besluit toezicht accountantsorganisaties, or 'Bta'), Section 2 Accounting Firms Regulation (Verordening accountantsorganisaties, or 'VAO'); and
- the ethical and controlled business operation: Section 21 Wta.

The expectations for 2018 were discussed and shared in writing with the other PIE audit firms and included in [part 3](#) of this report.

#### 4.1.2 Assessment of the improvement programme

The AFM has assessed the embedding of the improvement programme in the period from 1 January 2018 to 31 December 2018<sup>71</sup>, and evaluated the extent to which the expectations for 2018 were met. The AFM grouped the expectations for 2018 in a model consisting of six elements (figure 12). These six elements are based on insights relating to change management.<sup>72</sup>

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<sup>67</sup> See the NBA report '[In the Public Interest](#)' of 25 September 2014.

<sup>68</sup> These medium to long-term objectives were shared with the sector in 2015 in the public report published in October 2015. See the AFM report of 15 October 2015 '[Dashboard 2015: Change and improvement measures](#)'.

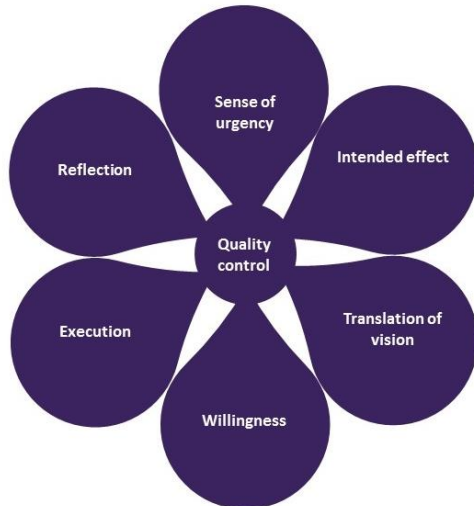
<sup>69</sup> EU regulation (no. 537/2014); requirements for statutory audits of financial statements of PIEs.

<sup>70</sup> The references stated here are based on the version of the regulations of 1 January 2017.

<sup>71</sup> The AFM did not include changes to the embedding of the improvement programme made after 31 December 2018.

<sup>72</sup> This involved the following sources, among others: S. Ten Have, W.D. Ten Have, A.B. Huijsmans, N. van der Eng, *Veranderkracht: Succesvol doelen realiseren*, Amsterdam: Mediawerf, 2013. P.F. Drucker, *The theory of the business*, Harvard Business Review: 1994. J.P. Kotter, *Leading change: why transformation efforts fail*, Harvard Business Review:

Figure 12 The model of the AFM



These elements consist of the following:

1. **Sense of urgency:** Management can motivate employees to change by clearly expressing the sense of urgency of change.
2. **Intended effect:** An explicit description of the intended effect to change is needed to provide direction for the change and communicate the relevance of the change to the employees.
3. **Translation of vision:** The degree of success of a change depends among other things on the extent to which the management has translated its vision into clearly defined expectations with respect to the conduct of the employees.
4. **Willingness:** Willingness concerns the motivation of the management and employees to make the change a success.
5. **Execution:** Execution concerns the decisions taken and the initiatives applied (structure, processes and systems of an organisation, employee behaviour) to make the change a reality.
6. **Reflection:** Firstly, reflection concerns monitoring whether the change initiatives taken are having the desired effect. Secondly, it concerns the assessment of how the change is affecting the employees and how they are learning from the change.

[Part 3](#) of this report gives further details of each element of the model and explains the AFM's expectations for 2018.

#### Qualitative qualification used for each element of the model

For each element, the AFM has assessed whether the expectations for 2018 have been met. A qualification in words is given for each element of the model. The qualifications used and their meanings are given in table 1.

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1996. E.H. Schein, *So how can you assess your corporate culture?* J. V. Gallos, *Organization Development: A Jossey-Bass Reader*, San Francisco: Jossey-Bass. A. Cozijnsen, *De 7 V's van verandermanagement*, Amsterdam, Pearson Benelux, 2014.

Table 1 List of qualifications used and their meanings

|                                 |  |
|---------------------------------|--|
| In line with expectation        | The other PIE audit firm meets the expectations for an element of the model.   |
| Nearly in line with expectation | The other PIE audit firm meets most of the expectations for an element of the model. Not more than one expectation for an element of the model is not met. |
| Short with expectation          | The other PIE audit firm fails to meet more than one expectation for an element of the model.  |
| Well short with expectation     | The other PIE audit firm fails to meet several or all of the expectations <sup>73</sup> for an element of the model.                                       |

[Part 3](#) of this report includes the tables for the six elements of the model with the expectations for 2018 and the qualifications used.

#### 4.1.3 Assessment of the quality safeguards and the quality circle

The AFM has first of all assessed the embedding of the six quality safeguards in the period from 1 January 2017 to 31 December 2018, testing the extent to which these quality safeguards are embedded by establishing the extent to which they have met the requirements of legislation and regulation and the expectations for 2018. Secondly, the AFM assessed the quality circle for these quality safeguards in the period from 1 January to 31 December 2018, and assessed the extent to which the expectations for this were met. In its assessment, the AFM focused on six quality safeguards that it requested in its report of 28 June 2017<sup>74</sup> to give special attention:

1. **Client- and engagement acceptance and -continuation (portfolio management):** Prior to the acceptance or continuation of a statutory audit engagement, a critical evaluation by the audit firm of its client portfolio in relation to risk profile, available time, people and resources is relevant to the determination of whether the firm can safeguard quality in its performance of the statutory audits.
2. **Consultation:** Consultations help to increase professional knowledge and its application in order to ensure consistent performance in statutory audits. Consultations provide the management with relevant information, for instance regarding the need for additional quality measures.
3. **EQCR:** An EQCR is designed to prevent serious deficiencies in the quality of a statutory audit prior to issuance of the audit opinion. An audit firm can use the information from EQCRs to obtain insight into the actual quality of a statutory audit and detect deficiencies, which can for instance be used to implement organisation-wide quality measures aimed at sustainably improving the quality of statutory audits.

<sup>73</sup> This means a greater number of expectations than for 'below expectation'.

<sup>74</sup> See the AFM report '[Quality at PIE audit firms reviewed](#)' of 28 June 2017.

4. **IQR:** An IQR is an important measure for audit firms to obtain insight into the level of quality achieved. With this measure, an audit firm also evaluates the degree of compliance with its quality control system and thus obtains information as to whether the standards in legislation and regulation have been met. This information can enable an audit firm to identify the factors that contribute or hamper quality and detect and correct deficiencies at organisation wide level and prevent these occurring in future.
5. **Root cause analysis:** to obtain insight with regard to the factors that have contributed to an 'inadequate' or an 'adequate' statutory audit, is essential to be able to implement the appropriate quality measures in order to achieve the firm's objectives with respect to quality and other aspects. This information can enable an audit firm to identify the factors that contribute or hamper quality and detect and correct deficiencies at organisation wide level and prevent these occurring in future.
6. **Remuneration of statutory auditors**<sup>75</sup>: A remuneration policy in which the quality is the decisive factor is relevant in order to encourage desirable behaviour and a quality-oriented culture, and is thereby relevant to achieve the sustainable safeguarding of the quality of statutory audits.

The AFM selected around five examples in order to assess compliance with the firms' policy with respect to the quality safeguards client- and engagement acceptance and -continuation, consultation, EQCRs, IQRs and root cause analyses. The AFM selected around three examples for its assessment of the quality safeguard remuneration of statutory auditors. In this selection, the AFM focused in each case on the statutory audits inspected. The other selections were random and were also not based on signals where the AFM had reason to believe that there were deficiencies.

[Part 3](#) of this report gives further details of each quality safeguard and explains the AFM's expectations.

### Qualitative qualification used for each expectation for each quality safeguard

The AFM assessed whether the other PIE audit firms had met expectations with respect to the six quality safeguards. The AFM tested three expectations for each quality safeguard. A qualification in words is given for each expectation.

Firstly, the AFM assessed whether the policy for the quality safeguards of client- and engagement acceptance and -continuation, consultation, EQCR, IQR and the remuneration of statutory auditors complies with legislation and regulation. The AFM used a qualitative qualification in this respect to state whether the policy complies with legislation and regulation or not. The qualification that a policy 'does not comply with legislation and regulation' is applied by the AFM regardless of the nature and scale of the elements of the policy that do not comply with legislation and regulation. Due to the absence of specific legislation and regulation with respect to root cause analyses, the AFM used a different qualification for this quality safeguard that

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<sup>75</sup> In this respect, the AFM focused on statutory auditors who are also shareholders.



corresponds to its assessment of the improvement programme. See table 1 in section 4.1.2 of this report.

Secondly, for the six quality safeguards the AFM assessed whether the policy for these quality safeguards had been complied with. The AFM used a qualitative qualification in this respect to state whether the policy was complied with or was not complied with. The qualification that the ‘policy was not complied with’ is applied by the AFM regardless of the nature and scale of the elements that were not in compliance with the policy and regardless of whether the policy complies with legislation and regulation. In cases where there was no policy, compliance was not assessed.

Lastly, the AFM assessed whether a quality circle had been applied for the six quality safeguards. The AFM used a qualitative qualification here that corresponds to its assessment of the improvement programme. See table 1 in section 4.1.2 of this report.

[Part 3](#) of this report includes the tables for the six quality safeguards assessed with the expectations and the qualifications used.

#### 4.1.4 The assessment of 2018 follows the assessment of 2016

The six elements of the improvement programme as shown in figure 12 (green) cover most of the pillars in the assessment of 2017. In addition, certain elements of the review of 2017 appear in the assessment of the quality circle and the quality safeguards (blue) (figure 13).

Figure 13 Assessment 2018 compared to assessment 2016



In the 2018 assessment, the AFM did not include four elements of the pillars in its 2017 assessment. The culture survey is not a specific element of the assessment. The culture survey is included in the assessment of the improvement programme if the audit firm carried out a culture survey during the assessment period. The HR employees are not part of the assessment of the quality safeguards due to the absence of requirements in legislation and regulation regarding the remuneration of employees other than statutory auditors. The ‘establishment internal supervision’ is not included in this assessment, since the AFM concluded in 2017 that the other PIE audit firms either met or nearly met expectations with respect to this element. The AFM has included the element of the pillar internal supervision of ‘functioning of internal supervision’ in its suitability tests in 2019 as a result of the statutory requirements coming into effect.

The element 'willingness' in the improvement programme is new, since this assessment goes further than the 2017 assessment with respect to the embedding of the improvement programme. The element 'willingness' therefore does not appear in figure 13.

#### 4.1.5 Qualitative qualification for each element of the quality change

The AFM classified the findings of its assessment according to the three elements of the quality change: the improvement programme, the quality circle and the quality safeguards.<sup>76</sup> The AFM has used a qualitative qualification for each element in section 3.1 of this report.

The qualification for the element 'improvement programme' is based on the average<sup>77</sup> of the qualifications for the elements of the improvement programme; sense of urgency, intended effect, translation of vision, willingness and execution. The qualification for the element 'quality circle' is based on the qualification of the element 'reflection' in the improvement programme and the average of the qualifications of the quality circle for the six quality safeguards assessed. The element of reflection concerns the monitoring of the improvement programme and reflection on progress and the effect of the change initiatives in place, and thus is a quality circle for the improvement programme.

The qualification for the element 'quality safeguards' is based on the average of the qualifications of whether the policy complies with legislation and regulation or meets the expectations for 2018 and the average of the qualifications of whether the policy for the six quality safeguards is complied with.<sup>78</sup> The AFM has used the following qualifications for each element of the quality improvement process: **in line with expectation**, **nearly in line with expectation**, **short with expectation**, **well short with expectation** or untested.

[Part 3](#) of this report contains a further explanation of the qualification per element of the quality improvement process.

#### 4.1.6 Conduct of the assessment

The AFM used various information sources for its assessment of the improvement programme, the quality safeguards and the quality circle. The assessment started with a desk research based on the documents that the AFM requested from the other PIE audit firms in May 2018. The AFM then held in-depth and other interviews with the board of directors, the employees in staff departments such as the compliance officer or the officer responsible for HR, a number of statutory auditors and a number of employees. The interviews with employees were held in groups. The number of interviews at each audit firm was approximately 12 for the improvement programme and approximately 9 for the quality safeguards. These interviews provided insight

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<sup>76</sup> See sections 4.1.2 and 4.1.3 for further details.

<sup>77</sup> The average qualification per element is calculated on the basis of a 4-point scale rising from 1 (well short with expectation, policy does not comply with legislation and regulation, policy is not complied with or policy has not been tested), 2 (short with expectation), 3 (nearly in line with expectation) and 4 (in line with expectation, policy complies with legislation and regulation or policy is complied with).

<sup>78</sup> The qualifications are based on the primary conclusions and findings. The primary conclusions and findings at each PIE audit firm are presented in [part 2](#) of this report.

into matters such as how people conduct themselves in the organisation and how the quality circle is embedded in the organisation. For the element 'quality safeguards', additional use was made of information obtained from the inspection of the quality of the three statutory audits. Lastly, the AFM carried out desk research on the basis of documents it received in January 2019.

The information obtained from interviews and documents was assessed and analysed in combination and related to the relevant expectation. A qualification was assigned for each expectation.<sup>79</sup> On completion of each sub-assessment, the AFM notified its observations orally to the members of the board of directors and the supervisory board of the audit firm concerned.<sup>80</sup>

In addition, the AFM used a survey to obtain insight into the experiences of employees with respect to a quality-oriented culture and therefore the improvement programme as well. The survey included questions on the various elements of the model.<sup>81</sup> The findings of the survey, shown in scores from one to seven, show how the employees of the other PIE audit firms (the respondents) experience the change. The findings of the survey are described in section 3.2 of this report. With the cooperation of the audit firm, the survey was set out via the AFM to the statutory auditors and the employees working in the statutory audit practice of the audit firm. The survey was completed anonymously by the respondents and the responses are not traceable to individual respondents.

## 4.2 Inspection of the quality of the statutory audits

This paragraph describes how the AFM designed and carried out its inspection of the quality of statutory audits at the other PIE audit firms.

On the basis of legislation and regulation, the AFM inspected the quality of a number of statutory audits performed in 2017 and 2018 and which were subject to quality safeguards. This part of the assessment was not intended to form a general impression of the quality of statutory audits; it gives indications regarding the embedding of the quality safeguards.

### 4.2.1 Selection of statutory audits and focus areas within these statutory audits

The AFM requested each of the other PIE audit firms to provide a list of all their statutory audit clients for its inspection of the quality of statutory audits. The AFM inspected a total of 14 statutory audits of which 10 related to non-PIE audit clients for the 2016 financial year, and 4 related to PIE audit clients for the 2017 financial year.<sup>82</sup> The presence of an EQCR and/or IQR was the starting principle in the selection of these statutory audits. The AFM did not select statutory audits for which it had reason to believe that it included deficiencies. The AFM's selection was not risk-based.

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<sup>79</sup> See [part 3](#) of this report.

<sup>80</sup> See section 4.3 for a description of the written reports.

<sup>81</sup> All the questions were put using a 7-point scale rising from 1 (disagree) to 7 (agree).

<sup>82</sup> Due to the limitation of the scope of the assessment at GT, the AFM inspected the quality of two statutory audits (for the 2016 financial year) of non-PIE audit clients at GT.

In the statutory audits selected, the AFM focused on material elements in the audit known as the focus areas. Two focus areas were usually inspected in each statutory audit, including the related subjects or items. The focus areas were largely determined by the nature and size of the activities of the audit client. This means that for many of the statutory audits the AFM reviewed the audit of the revenue and one other item in the financial statements that due its nature or size was also of material significance for the impression of the financial statements in question. These areas included construction contracts, debtors, inventory and intangible assets (including goodwill). Many of the items selected involved an element of estimation.

#### 4.2.2 Conduct of the inspection

For the inspection of the quality of the statutory audit, the AFM requests the statutory auditor to explain the parts of the statutory audit selected by the AFM on the basis of the documentation in the audit file. The AFM focuses specifically on the issue of whether the statutory auditor has adequately applied an attitude of professional scepticism. Based on the audit evidence and the explanation from the statutory auditor, the AFM obtains insight into the procedures performed and forms a conclusion regarding the quality of the audit performed. After completion of each inspection, the AFM shared oral their provisional conclusions and findings to the statutory auditor and other representatives of the audit firm.

Approximately two months after completion of its inspection, the AFM holds a 'reflection interview' with the statutory auditor and other representatives of the audit firm regarding the inspection process and its written report with their provisional conclusions and findings.<sup>83</sup>

#### 4.2.3 Judgment by the AFM

In each statutory audit inspected, the AFM assessed whether the statutory auditor obtained sufficient and appropriate audit evidence in accordance with the auditing standards<sup>84</sup> to substantiate his opinion with respect to the client's financial statements.<sup>85</sup> In its inspection, the AFM focused on material elements of the statutory audit. If the statutory auditor obtained sufficient and appropriate audit evidence for these material elements<sup>86</sup>, the AFM qualifies the performance of the statutory audit as 'adequate'.<sup>87</sup> In other cases, the AFM qualifies the

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<sup>83</sup> See section 4.3 for a description of the written reports.

<sup>84</sup> Further Regulations on Audit and Other Standards (Nadere voorschriften controle- en overige standaarden, or NV COS).

<sup>85</sup> Since the qualifications 'sufficient' and 'appropriate' in relation to audit evidence are in most cases inextricably linked, in this report the AFM does not distinguish between findings relating to insufficient audit evidence and findings relating to inappropriate audit evidence. The AFM generally uses the formulation 'insufficient and inappropriate audit evidence' in its conclusion that the quality of the statutory audit inspected is qualified as 'inadequate'.

<sup>86</sup> Audit evidence must be both 'sufficient' and 'appropriate'. These two qualifications are intrinsically linked. The aspect 'sufficient' is the criterion for the quantity of the audit evidence. The aspect 'appropriate' is the criterion for the quality of the audit evidence. Appropriate means that the audit evidence is relevant and reliable so that this information constitutes substantiation for the opinion of the statutory auditor.

<sup>87</sup> This means that the AFM has established whether the statutory auditor has complied with paragraph 17 of Further Regulations on Auditing and Other Standards 200 (NV COS 200) 'General objectives of the independent auditor, as well as the performance of an audit in accordance with the Standards': "To obtain a reasonable level of assurance, the auditor shall obtain sufficient and appropriate audit evidence in order to reduce the audit risk to an acceptably low level, thus enabling the auditor to draw a reasonable conclusion on which they can base their opinion."

performance of the statutory audit as 'inadequate'. The AFM does not exclude the possibility that there may be serious deficiencies in elements of the statutory audit not inspected by the AFM. A qualification of 'adequate' does not therefore constitute a general opinion by the AFM regarding the substantiation of the statutory auditor's opinion regarding the financial statements as a whole.

### 4.3 Written reporting

This section describes the written reports the AFM has issued with respect to the assessment.

#### 4.3.1 Firm-specific reporting

Each other PIE audit firm was sent a draft report of the AFM's assessment at the end of April 2019 stating its provisional conclusions and findings on the three elements of the quality change. In addition, the AFM issued reports during the assessment period stating its provisional conclusions and findings with respect to the statutory audits inspected that had provisionally been qualified as 'inadequate'. These firm-specific reports are confidential.

The other PIE audit firms were given the opportunity to give an oral and a written response to these firm-specific reports. In these responses, they were able to state that they consider the facts stated to be incorrect or incomplete, stating their reasons and supported by information where necessary. The AFM has assessed the responses of the other PIE audit firms. This may have led to adjustments to the AFM's conclusions and findings, or the facts stated. The AFM included the result of this assessment in a final review report which was circulated at the beginning of July 2019. This report detailed the AFM's conclusions and findings with respect to the three elements of the quality change as well as its conclusions and findings with respect to the quality of the statutory audits inspected.

Furthermore, in its inspections of the quality of statutory audits the AFM requested the other PIE audit firms to assess whether the deficiencies found also occur in other elements of the statutory audit inspected or in other statutory audits performed, for instance in other audits by the statutory auditor concerned or in statutory audits in the same sector. The AFM also reminded them of their responsibility to remediate the deficiencies and to take measures to prevent them occurring in future. In order to prevent the deficiencies occurring in future, the AFM requested them to carry out a root cause analysis to obtain insight with regard to the factors that have contributed to an 'adequate' or an 'inadequate' statutory audit.

#### 4.3.2 Public reporting

In mid-July 2019, the AFM informed the other PIE audit firms in writing that it intended to publish the primary conclusions and findings of its assessment in a public report with the application of Section 48a (6) Wta. They were given the opportunity to state their position, either orally or in writing, with respect to the intention to publish. The AFM has assessed these statements of position. The AFM has included the result of this assessment in a decision to publish and

circulated this in mid-October 2019. The primary conclusions and findings at each other PIE audit firm are presented in [part 2](#) of this report. The content of this report is based on this information. The other PIE audit firms were given the opportunity to give a written response to the decision to publish. These written responses can be found on the AFM website.<sup>88</sup>

#### 4.4 Limitations of the assessment

The manner in which the assessment was conducted means that the conclusions that can be drawn from the findings are subject to limitations. The AFM explains this further below.

The AFM has not assessed whether the improvement programme, the quality circle and the quality safeguards are sufficient to sustainably safeguard the quality of statutory audits

The assessment gives an indication of whether the elements of the improvement programme, the quality circle and the quality safeguards assessed contribute to (sustainably) safeguard the quality of statutory audits. The AFM is, however, not able to assess the extent to which these elements affect the quality of the statutory audits inspected. In its assessment, the AFM did not establish whether there is a causal connection between the elements of the improvement programme, the quality circle and the quality safeguards assessed and the quality of statutory audits. The AFM has accordingly not assessed whether the improvement programme, the quality circle and/or the quality safeguards are sufficient to sustainably safeguard the quality of statutory audits. The AFM is, however, able to conclude that in the case of statutory audits qualified as 'inadequate', the quality safeguards failed to prevent this.

No comprehensive assessment of all aspects of the improvement programme, the entire quality control system and the entire statutory audit

The AFM has not carried out a comprehensive assessment of all aspects of the improvement programme and the entire quality control system. In addition, the AFM's inspection of the quality of statutory audits focused on a number of items and did not involve an assessment of the entire statutory audit. It may therefore be the case that deficiencies exist in the elements not included by the AFM in its inspection. The findings in this report should be seen in this context. The absence of comments or remarks therefore does not mean that no other omissions exist.

No statistical sample taken

The AFM has not taken a statistical sample. The inspection findings can therefore not be projected onto the improvement programme as a whole, the quality control system as a whole or all the statutory audits performed by the other PIE audit firms. This also means that the findings in terms of the numbers of 'inadequate' audits cannot be compared with the previous inspections by the AFM or between audits of different financial years. Due to the methodology, it is also not possible to draw conclusions regarding sub-populations within the statutory audits selected, for instance comparing statutory audits of PIE audit clients with statutory audits of non-PIE audit clients.

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<sup>88</sup> See the [AFM website](#).

An 'inadequate' performed audit does not mean that the financial statements are incorrect

The fact that a statutory audit is qualified as 'inadequate' does not necessarily mean that the audited financial statements are incorrect. The financial statements may still present a true and fair view of the size and composition of the capital and the result. However, in the case of an 'inadequate' audit, the statutory auditor had at the time of issuing their audit opinion not obtained sufficient appropriate audit evidence to substantiate their opinion with regard to this true and fair view. The public, which includes investors, banks, creditors, financial analysts and consumers, has to be able to rely on the stated opinion. The public interest with respect to a statutory audit concerns the assurance provided by the statutory auditor with respect to the financial statements. If the auditor's primary function is to provide assurance to the public, this function is worthless if confidence in the auditor's opinion is lost.

The AFM does not express an opinion with regard to the accuracy of the audited financial statements, and has also no authority to interfere with the substance of audit opinions issued.<sup>89</sup> In its inspection, the AFM therefore focuses on the substantiation of the opinion in the auditor's report with sufficient and appropriate audit evidence.

With the introduction of the Additional Measures Audit Firms Act (Wet aanvullende maatregelen accountantsorganisaties)<sup>90</sup> the audit firm and the statutory auditor are obliged to remediate the deficiencies and to obtain sufficient and appropriate audit evidence to show that the financial statements are free of material misstatements. When the audit firm carries out adequate remediation procedures, it may emerge at a later stage whether the opinion included in the audit report was correct or not. This does not affect the fact that at the time of issuing their audit opinion the statutory auditor had not obtained sufficient substantiation for their opinion and had therefore provided assurance to the users of the financial statements and the audit report without this being justified.

No further qualification of deficiencies

The AFM uses the qualifications 'inadequate' or 'adequate' in its inspection of the quality of statutory audits. The severity of the deficiencies that led to the conclusion of 'inadequate', that sufficient and appropriate audit evidence had not been obtained to substantiate the opinion regarding the financial statements as a whole, mean that the statutory auditor should not have issued their audit opinion. Accordingly, it is not relevant whether there were one or several deficiencies and the AFM has not further qualified the deficiencies. The AFM only reports in writing the statutory audits qualified as 'inadequate' to the audit firms and states the basis on which it has reached this conclusion.

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<sup>89</sup> Article 23 (1) EU Regulation

<sup>90</sup> [Additional Measures Audit Firms Act](#).

## Own interpretation and the risk of socially acceptable responses in the survey

In their responses to the survey, the respondents have interpreted the terminology used in the questions according to their own terms of reference. These terms of reference are not necessarily the same as the terms of reference used by the AFM in its assessment. There is also a risk that the respondents may have given answers that they consider to be socially acceptable.



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