

Grip on quality

Outcomes of the review of internal quality reviews and quality of statutory audits at PIE audit firms

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The Dutch Authority for the Financial Markets

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1 Summary

The six PIE audit firms¹ have been working on sustainably improving the quality of their statutory audits since 2014, with the aim of obtaining (greater) grip on quality. Since that time, the AFM has conducted several reviews of the elements of quality. This AFM review again included the elements of quality, in particular the internal quality review (IQR), in which the PIE audit firms carry out a self-assessment of their completed statutory audits. The IQR is an important instrument for sustainably safeguarding quality. In an IQR, the audit firm reviews the quality of completed statutory audits, after issuance of the auditor's opinion. The IQR can identify and remedy deficiencies across the organisation and prevent them occurring in the future.

The AFM reviewed how the PIE audit firms designed and execute their IQRs, and how this contributes to the quality objectives and a quality-oriented culture. In addition, we assessed whether the IQR provides insight into the level of quality achieved in statutory audits. We did this by comparing the results of the IQRs for 18 statutory audits with our own findings from our inspection of the quality of statutory audits.

AFM positive on the design and execution of IQRs in 2020

The AFM is positive with respect to the formulation by the PIE audit firms of the elements reviewed, selection, execution, weighting, communication, and remediation of IQRs in 2020. These firms are obtaining insight into the level of quality achieved by measuring this. They are using the results of the IQR to monitor, adjust and further improve the quality of statutory audits. The IQRs have been carefully designed and aimed at ensuring consistent performance with expert reviewers. They have also organised a predictable process and support the reviewers and employees involved in the weighting of observations and findings. The sharing of personal learning experience by the statutory auditors involved in the IQR encourages learning by others.

AFM mostly positive regarding insight into the level of quality achieved by IQRs

The AFM is mostly positive regarding the insight provided by the IQRs regarding the level of quality achieved. For the vast majority of the statutory audits reviewed, 15 out of 18, the IQRs came to a similar conclusion as that of the AFM. In three cases, the AFM came to a different conclusion regarding the statutory audit.

Possibilities for strengthening the IQR

In the conduct of our review, we identified several possibilities for the PIE audit firms to strengthen their IQRs:

- Some PIE audit firms could give greater prominence to the use of IQR as an educational resource in their objectives. To increase attention to learning, the educational objective needs to be given the same importance as the objective of obtaining insight.
- The boards of these firms can strengthen the learning from the IQR through greater projection of an open culture with respect to errors.
- The scope of the IQR can be expanded to include audit issues or current themes to obtain a broader view of the statutory audits performed.
- Learning during the execution of an IQR can be strengthened by formulating desirable behaviour of the statutory auditors and the reviewers, by training them on aspects of behaviour and by encouraging the reviewers to identify learning points during the execution of the IQR.
- Combining the insights from remediation of findings and the IQR can be used to increase insight into the level of quality achieved and thereby identify lessons to be learned by the firm as a whole.

¹ BDO Audit & Assurance B.V.; Deloitte Accountants B.V.; Ernst & Young Accountants LLP; KPMG Accountants N.V.; Mazars Accountants N.V. and PricewaterhouseCoopers Accountants N.V.

Possibilities for renewing the IQR

We also see possibilities for the audit firms to renew the IQR based on the insights obtained:

- Using technology, such as ‘machine learning’, for example to identify connections between the qualification of the IQR and the features of the statutory audit;
- Focusing the IQR more on the selection of statutory audits and obtaining a broader and more detailed picture of the portfolio of statutory audits, for instance by involving statutory audits in different sectors and with various levels of engagement risk;
- Clarification in the qualification systems of when an audit is satisfactory or unsatisfactory, for a more consistent insight into quality for the users of financial statements.

Use possibilities and engage in dialogue on the quality of statutory audits

The AFM urges the PIE audit firms to work on the possibilities for strengthening and renewing the IQR. Audit firms, supervisory boards (**SBs**), audit committees and users of financial statements, such as investors and creditors, can use the findings of this review for a more in-depth dialogue on the quality of statutory audits.

Key terms

The following is a list of key terms that give context when reading this report.

Term	Definition
Internal quality review (IQR)	The IQR is a quality safeguard. In an IQR, the audit firm reviews the quality of completed statutory audits, so after issuance of the auditor's opinion. In the execution of an IQR, important aspects include the scope of the review, the items that are reviewed, the depth of the procedures and the degree of detail.
Qualification	A qualification of an IQR or by the AFM is an opinion that states the degree to which the quality of a statutory audit is satisfactory.
Quality cycle	The quality cycle is based on the plan-do-check-act cycle aimed at continuous improvement. This is an ongoing cycle for planning actions (plan), carrying them out (do), verifying whether their results are as intended (check) and adjusting the execution on the basis of this check (act).
Quality objectives	The quality objectives express policy in achievable and measurable terms and describes the desired outcome that the audit firm strives to achieve.
Quality-oriented culture	A quality-oriented culture focuses on a continuous central priority for high-quality statutory audits that take account of the public interest.
Quality change	The AFM defines the quality change process as the embedding of 1) an effective quality-oriented culture, 2) the quality cycle and 3) the quality safeguards. The quality change process is explained in section 5.
Quality safeguards	The quality safeguards are methods, procedures and measures included in an audit firm's quality control system. They are meant to ensure that the statutory auditor who issues the audit opinion can do so in an expert, independent, principled and recognisable way.
Learning organisation	A learning organisation is an organisation that enables its employees to adjust the execution of statutory audits to a continually changing environment through training, development and encouraging initiative.
Engagement risk	An audit firm assesses the risk of an audit engagement, for instance whether there are risks associated with its independence and what actions may be taken to mitigate these risks.
Open culture with respect to errors	A firm has an open culture with respect to errors if it facilitates active communication regarding errors and allows its employees to admit to errors, as part of acting humanely.
Public-Interest Entity (PIE)	A PIE is an organisation that affect the interests of large groups due to its size or social function. PIEs include listed companies, insurers and credit institutions.
Statutory audit	A statutory audit is an audit of the financial reporting of an enterprise for public use that is specifically designated as a statutory audit in the Audit Firms Supervision Act (Wet toezicht accountantsorganisaties, or 'Wta'). This concerns the audit of financial statements of medium-sized and large companies, municipalities, provinces, and various financial enterprises, for instance.

2 Review of the IQR and the quality of statutory audits

The six PIE audit firms² have been working on sustainably improving the quality of their statutory audits since 2014, with the aim of improving their grip on quality. Since that time, the AFM has conducted several reviews of the elements of quality. We have published our reports of these reviews in recent years.³

Review focused on elements of quality

We carried out a further review of the PIE audit firms, starting at the end of 2020.⁴ The review consisted of:

- 1 a review of the design and execution of IQRs, with aspects of the quality cycle and the quality-oriented culture;
- 2 an inspection of the quality of statutory audits; and
- 3 a review of the impact and working practices of the SBs, that we published earlier in 2021.⁵

IQR is important for achieving quality

IQR is an important instrument for sustainably safeguarding quality. In an IQR, the audit firm reviews the quality of completed statutory audits, after issuance of the auditor's opinion. The IQR can identify and remedy deficiencies across the organisation and prevent them occurring in the future. It thus contributes to improving the functioning of an audit firm and, in combination with other initiatives, helps to create a learning organisation.

It is important that an IQR provides insight into the quality of statutory audits: what went well, and what can be improved? During an IQR, a statutory auditor can be prompted to think with questions, observations, and findings. After completion of the IQR, feedback is given so that lessons for improvement can be shared. It is important that there is support for these observations and findings. Transparent sharing of insights in an open dialogue with the statutory auditors and employees is also important. The example set by the behaviour of board⁶ and the statutory auditors is an important element in how errors are dealt with in the organisation.⁷

Review of insight into the IQR and the quality of statutory audits

With this review, our aim is to obtain insight into how the PIE audit firms have designed and executed their IQRs, and how they aim to use this instrument to achieve their quality objectives and a quality-oriented culture. This will enable audit firms to reflect on their IQRs and strengthen them where necessary. The review of the IQRs involves elements of both exploration and evaluation.

² Appendix 1 shows the market share and certain features of the PIE audit firms.

³ See the AFM reports in 2015, 2017, 2019 and 2020: https://www.afm.nl/nl-nl/professionals/doelgroepen/audit_firms/publicaties/rapporten.

⁴ See the AFM's 2021 agenda: <https://www.afm.nl/nl-nl/verslaglegging/agenda-2021>

⁵ See the AFM website: <https://www.afm.nl/nl-nl/professionals/doelgroepen/accountantsorganisaties/publicaties/rapporten>

⁶ In this report, the AFM uses the term 'board' to refer to the (co-)policymakers of the audit firm.

⁷ See the AFM report of October 2017: <https://www.afm.nl/nl-nl/nieuws/2017/okt/onderzoek-open-foutencultuur>.

*Exploratory part of the review*⁸

The exploratory part of the review concerned the obtaining of insight into the design and execution of IQRs in 2020. For this, we concentrated on five aspects of the IQR:

- The selection of statutory auditors and statutory audits;
- The execution of the IQR;
- The weighting and qualification;
- The communication of the results of the IQR; and
- The remediation of the audit based on the IQR.

Assessment part of the review

In the assessment part of the review, we assessed whether the IQRs provide insight into the level of quality achieved in statutory audits. We did this by comparing the qualification in the IQR with our review of the same statutory audit. This involved an inspection of the quality of 18 statutory audits that were also reviewed by an IQR in 2020. We were not aware of the qualification when selecting these IQRs.

Continued encouragement of focus and commitment

The AFM encourages the PIE audit firms to maintain and increase their focus and commitment (of resources) to sustainable quality improvement to achieve and maintain the necessary change. We accordingly continually renew our supervision. Since 2015, our reviews accordingly have focused on aspects of culture and behaviour as well as the quality of statutory audits and the system of quality controls. The AFM will continue its risk-based supervision of the PIE audit firms by increasing the frequency of its inspections of the quality of statutory audits.

⁸ The insights from the exploratory part of the review do not involve any implication as to whether the policy for IQRs and the policy for remediation comply with legislation and regulation and operate effectively. The AFM has not assessed whether this policy complies with legislation and regulation in this review. See Section 5 for a description of the review methodology.

3 IQR provides insight into quality and encourages learning

This section describes the insights obtained from the exploratory part of the AFM's review of how the PIE audit firms designed their IQRs and how this contributes to the achievement of their quality objectives and a quality-oriented culture.⁹ This description is partly based on experiences of the statutory auditors, employees and reviewers we interviewed. The differences between the IQRs at the various PIE audit firms and the experiences of the statutory auditors, employees and reviewers may be useful to these organisations when reflecting on their IQRs. We also share certain good practices.¹⁰

AFM positive on the design and execution of IQRs in 2020

From its review, the AFM has a positive impression of how the elements of IQRs reviewed in 2020 have been designed by the PIE audit firms. They obtain insight into the level of quality achieved by measuring this. They use the results of the IQR to monitor, adjust and further improve the quality of statutory audits. The IQRs have been carefully designed and are aimed at ensuring consistent execution with expert reviewers. They have also organised a predictable process and support the reviewers and employees involved in the weighting of observations and findings. In addition, based on the qualifications, the IQR enables comparison of the quality of statutory audits at the PIE audit firm, both in time and across the statutory audits. The sharing of personal learning experience by the statutory auditors involved in the IQR encourages learning by others. This also applies to other ways in which they communicate the results of the IQR to their organisation.

Possibilities for strengthening the IQR

The AFM sees several possibilities for further strengthening on aspects of the IQR in the context of continuous improvement and optimisation of the system of quality control. In this report, these possibilities are marked with a loupe (magnifying glass). The possibilities concern obtaining deeper insight and strengthening the potential for learning, with reference to the following elements:

- The use of IQR as an educational resource could be given greater prominence in the objectives of some of the PIE audit firms. To increase attention to learning, the educational objective needs to be given the same importance as the objective of obtaining insight.
- To obtain a broader view of the quality of the statutory audits performed, the scope of the IQR can be expanded to include audit items or current themes, such as the use of technology in the audit and estimation uncertainties.
- Learning during the execution of an IQR can be strengthened by formulating desirable behaviour on the part of statutory auditors and reviewers, by training them on aspects of behaviour and by encouraging the reviewers to identify learning points during the execution of the IQR.
- Greater expression of an open culture with respect to errors by the board at the PIE audit firms can also strengthen the learning of the IQR.
- Combining the insights from remediation of findings and the IQR can be used to increase insight into the level of quality achieved and thereby identify lessons to be learned by the firm as a whole.



The AFM urges the PIE audit firms to work on the possibilities for increasing insight and strengthening the learning of the IQR.

⁹ These insights do not involve any implication as to whether the policy for IQRs and the policy for remediation comply with legislation and regulation and operate effectively. See Section 5 for a description of the review methodology.

¹⁰ Good practices are examples of how audit firms have designed their IQRs. Alternative interpretations that are appropriate to the specific features of the audit firm concerned are also possible.

Possibilities for renewing the IQR

We also see possibilities for renewing aspects of the IQR (marked in this report with a light bulb) and inspiring the audit sector:



- Using technology, such as ‘machine learning’, for example to identify connections between the qualification of the IQR and the features of the statutory audit;
- Focusing the IQR more on the selection of statutory audits and obtaining a broader and more detailed picture of the portfolio of statutory audits, for instance by involving statutory audits in different sectors and with various levels of engagement risk;
- Clarification in the qualification systems of when an audit is satisfactory or unsatisfactory, for a more consistent insight into quality for users of financial statements.

3.1 Formulating and adjusting the IQR objectives

Audit firms formulate the objectives of their IQRs and adjust the execution of the IQR in realising these objectives. The objectives of the IQR contribute to the quality objectives of the audit firm. The quality objectives are an expression of the firm’s mission, vision, and strategy.

An audit firm monitors the realisation of its quality objectives and adjusts the execution if its quality measures are not sufficient effective. This reappears in what is called the quality cycle, which is based on the plan-do-check-act cycle aimed at continuous improvement. The IQR provides relevant (management) information that can lead to the taking of (additional) quality measures at both organisation and statutory audit level.

The review shows that the PIE audit firms have formulated objectives designed to obtain insight into the level of quality achieved. The degree to which the IQR objectives are designed to promote learning varies from one firm to another.

Some PIE audit firms could increase the use of the IQR as an educational resource in their objectives through a greater focus on learning in their policy, the tone at the top, the execution of the IQR and the communication of the results. For this, the learning objective needs to be given the same importance as the objective of obtaining insight.



IQR objectives focus on insight into quality and learning from findings

Based on the review most PIE audit firms have paid attention to both obtaining insight into the level of quality of statutory audits achieved and encouraging learning in the formulation of their IQR objectives. The degree to which the IQR objectives focus on learning varies from one firm to another. Firstly, the objectives focus on establishing whether a statutory audit meets professional standards and relevant legislation and regulation and obtaining insight into the effectiveness of the quality control system. Secondly, the objectives focus on learning, for instance by identifying ‘good practices’, increasing knowledge of audit methodology and promoting an open culture with respect to errors. In the experience of the statutory auditors¹¹, the IQR focuses on both improving quality and (encouraging) learning.

¹¹ Reference in this report to the experiences of statutory auditors, employees and reviewers concerns the statutory auditors, employees and reviewers who we interviewed.

Good practice: The board monitors the impact on the quality-oriented culture

The board of a PIE audit firm targets a certain percentage of adequate IQRs and a culture in which errors are permitted. The board has been given a target by its SB for a certain percentage of adequate IQRs in 2020 and the years to come. Any consequences for the audit practice and the statutory auditor of failure to achieve this target are considered by the board in the context of a culture in which errors are permitted.

The PIE audit firms obtain insight and adjust in realising the IQR objectives

The PIE audit firms obtain insight into the level of realisation of their IQR objectives by means of reports, among other things. Most of these firms evaluate their IQR on an annual basis. This considers the results of the IQR, the experiences of those involved and the potential improvements for realising the IQR objectives.

We see several examples in which PIE audit firms adjust substantive, procedural or behavioural aspects of the IQR, depending on the insights obtained from these evaluations. Adjustments may involve the allocation of additional capacity to achieve sufficient depth in the IQR. This may also entail changes to the IQR policy in terms of scope and depth and a change to the scope of the IQR to be able to assess the effectiveness of other quality safeguards, such as case-based coaching¹² and the engagement quality control review (EQCR). Adjustments are also made to encourage learning based on experiences of the statutory auditors, employees and reviewers involved in the IQR. This may for example concern adjustment to the consequences of qualifications and the training of reviewers with respect to conduct. The aim of the PIE audit firms here is to increase the contribution of the IQR to the quality objectives and a quality-oriented culture (including the learning organisation).



The audit firms can renew their IQRs by further investigating the possibilities for the application of technology. This may for example involve data analysis or machine learning. Machine learning can be used to analyse findings, and thus check whether the features of the statutory audit correspond to the qualification. This can provide management information.

3.2 Insight from selection of statutory audits

An audit firm obtains insight into the level of quality achieved in its statutory audits by regularly selecting statutory audits and reviewing them. By regularly selecting statutory auditors in its IQRs, an audit firm also encourages learning in its organisation. The NBA report 'In the Public Interest' cites the importance of the IQR prior to appointment as the statutory auditor.¹³

The review shows that the IQR is conducted with regular selection of statutory auditors and a risk-based selection of the statutory audits. The PIE audit firms also obtain insight into compliance with the quality control system by identifying subjects or themes in the IQR.

The scope of the IQR can be expanded to include audit issues or current themes, such as the application of technology in the audit and estimation uncertainties due to Covid-19, in order to obtain a broader insight in the quality of the executed statutory audits.



¹² Case coaching aims to support the audit teams during the statutory audit by means of instruction on professional matters.

¹³ See the NBA report 'In the Public Interest' of 25 September 2014 https://www.nba.nl/globalassets/projecten/in-het-publiek-belang/in_het_publiek_belang_rapport_25_september_2014.pdf.

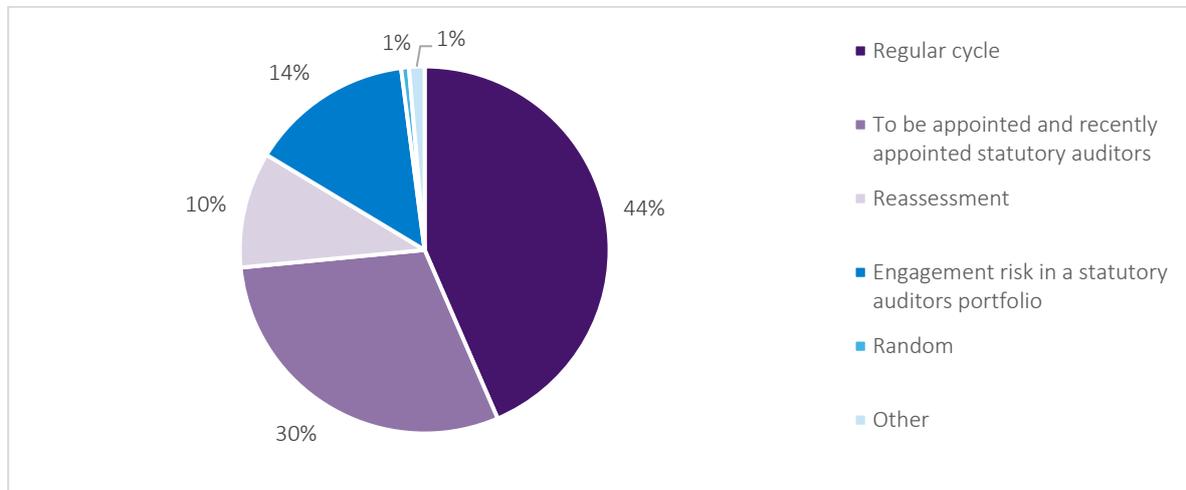
Regular selection of statutory auditors

The PIE audit firms select each statutory auditor for an IQR at least once every three years (based on a regular cycle). This involves a risk-based selection of a statutory audit for each statutory auditor. This regular cycle means that selection is relatively predictable for the statutory auditors. Some PIE audit firms also select statutory auditors randomly.

Most PIE audit firms select statutory auditors with an inadequate qualification in the previous year for the IQR (reassessment) to measure the development of quality by the statutory auditor. In addition, employees who are candidates for appointment as a statutory auditor and recently appointed statutory auditors are selected. The engagement risks in a statutory auditor’s portfolio may also be a reason for selection of the statutory auditor concerned.

Figure 1 shows the primary reasons for selection of the statutory auditors for the IQRs performed in 2020.

Figure 1 Reasons for selection of the statutory auditors for the IQRs performed in 2020



The selection of statutory audits is risk-based

The PIE audit firms select statutory audits on a risk basis. They select statutory audits with higher client or engagement risk to obtain insight into the level of quality achieved in the most high-risk engagements. The extent to which statutory audits with a lower client or engagement risk are selected varies from one firm to another. Table 1 shows the number of statutory audits and the number of IQRs in the most recent years.

Table 1 Number of statutory audits and number of IQRs¹⁴

	2018	2019	2020
Total number of statutory audits by PIE audit firms	11,088	10,176	9,194
Total number of IQRs by PIE audit firms	157	123	133

Specific subjects or themes involved in the IQR

The PIE audit firms include specific subjects and themes in their IQRs. This also gives them insight into compliance with their quality control system. Some PIE audit firms take account of distribution across the quality safeguards taken. For example, to obtain insight into the effective operation of the EQCR and file

¹⁴ Based on the information of the six PIE audit firms obtained from the AFM Audit Firms Monitor 2018 up till 2020 and on information provided to the AFM by these organisations during the review. In the Monitor audit firms provide information on their most recent closed fiscal year and executed statutory audits in that year,

coaching. They also select subjects such as independence and the use of specialists in the IQR. Some PIE audit firms also select themes such as going concern and corruption.



The audit firms can renew their IQRs by focusing more on statutory audits than on statutory auditors in their selection. They can also obtain a broader and more in-depth view of their portfolio of statutory audits by involving statutory audits from various sectors and with varying degrees of engagement risk. The IQR can thus also devote attention to themes and subjects that the audit firm wishes to monitor in a more general sense, such as the application of technology in their statutory audits and allocation of personnel to engagements (project management).

3.3 Consistent execution of the IQR provides insight and encourages learning

An audit firm obtains insight into the level of quality achieved through consistent execution of its IQRs. This provides a comparable view of the level of quality achieved over time and across its statutory audits. The use of expert reviewers with sufficient time available is also a contributing factor. Attention to behavioural aspects in the execution of the IQR promotes the concept of a learning organisation. It is also important that the process is predictable.

The review shows that the PIE audit firms have designed their IQR with care and strive for consistency in both the scope and depth of their IQRs. It also shows that they aim to have the IQR competently executed. In addition, the review confirms that the PIE audit firms are facilitating this predictability of the process.

Learning during the execution of an IQR can be strengthened by formulating desirable behaviour on the part of the statutory auditors and the reviewers, by training them on aspects of behaviour and by encouraging the reviewers to identify learning points during the execution of the IQR.



PIE audit firms strive to ensure consistent and competent conduct of the IQR

The PIE audit firms wish to have their IQRs conducted consistently by expert reviewers. The IQR is a responsibility of the person responsible for the process who is employed in compliance, risk and quality management or the technical expertise department. At some PIE audit firms, the IQR is managed internationally.

Consistent execution through guidelines and standardisation

The PIE audit firms facilitate consistent execution of the IQR, among other things with a digital reporting tool. They also issue guidelines with respect to scope and depth. For consistent execution, they use a standardised questionnaire, usually based on a questionnaire developed by their international network. Most of these questionnaires contain questions on items in the financial statements and audit issues, such as independence and the use of specialists. Most PIE audit firms work with a permanent group of reviewers, supplemented with statutory auditors and senior employees. This permanent group of reviewers are not involved in the statutory audit to be reviewed and they conduct several IQRs, which helps to ensure consistent execution. Some PIE audit firms also use international reviewers.

Statutory auditors experience varying degrees of scope and depth in the IQR

The statutory auditors experience varying degrees of scope and depth in the IQR. Some experience depth in the IQR, while other statutory auditors experience limited review time and depth. For example, they note imbalance between the complexity and scale of the statutory audit and time allotted for the conduct of the IQR. At the same time, in the experience of the statutory auditors and employees, the reviewers are objective by abstaining from personal preferences.

Use of expert reviewers important

The PIE audit firms aim to use expert reviewers with knowledge and experience, also with reference to the sector concerned. It is important that the reviewers can understand the risks in the statutory audit and ask critical questions regarding the audit approach and the audit procedures performed. The reviewers are trained for this and instructions are given and flyers made in which attention is drawn to professional and procedural aspects.

Behaviour is a relevant element of training and guidelines for reviewers

In their training, the PIE audit firms also devote attention to the behaviour displayed by the reviewers and the statutory auditors in the IQR. The extent to which behaviour is a part of the training and guidelines varies from one PIE audit firm to another. Most PIE audit firms for example mention specific items of attention in a collective 'kick-off meeting' of the reviewers and disseminate guidelines with expectations and responsibilities in the IQR. Expectations with respect to the behaviour of the reviewers are described in the policy. Some PIE audit firms also devote attention in their training to desirable behaviour on the part of the reviewers. The aim here is to ensure that the statutory auditors feel that they are heard by the reviewers, that the statutory auditors have the attitude of preparedness to learn, and that the reviewer reaches a joint understanding regarding the identified facts.

Statutory auditors experience a constructive tone from reviewers

The reviewers experience that behavioural competences are important for proper execution of the IQR. How they communicate affects the behaviour displayed by the statutory auditors and the employees. The reviewers note for example that an open, factual, and non-judgemental attitude helps learning from the findings. A majority of the statutory auditors and employees experience a constructive tone on the part of the reviewers. They experience this as helping them to learn from their discussions with the reviewers, for instance because the reviewers explain to them why they are asking certain questions. Mention of 'good practices' and 'nice to haves' also contributes to learning.

Good practice: Training reviewers on behavioural aspects

One PIE audit firm trains its reviewers once a year on substantive and behavioural aspects prior to the IQR cycle. The training of the reviewers on behavioural aspects includes attention to communication styles and techniques, conflict management and how the reviewer's attitude has an effect on the (learning) experience of the statutory auditors and employees.

PIE audit firms facilitate a predictable process

The PIE audit firms aim to increase learning from the findings by means of a predictable process. In a predictable process, a statutory auditor knows what is expected of them, the responsibilities are clearly defined and they understand how important the IQR is for the audit firm to learn and improve. The PIE audit firms aim thereby to increase acceptance of the findings to promote learning by the statutory auditors. For instance, the PIE audit firms offer support during the process, define expectations and responsibilities and target timelines. This support features questions on the process, differences of opinion, a kick-off presentation, and the interpretation of questions from the reviewer.

Reviewers supported during the IQR

The support given to reviewers during the IQR varies in intensity. Some PIE audit firms support their reviewers with professional support on sector-specific issues and by engaging employees that provide process support to keep the reviewers aware of the tone of the discussions and the relevance of their questions.

Statutory auditors experience more lengthy discussions of findings

The average time taken for the IQRs executed in 2020 varied from around six weeks to four months. The PIE audit firms issue timelines to those involved in the IQR, for example for the field work for the IQR, the availability of the statutory auditors and the reviewers, or the response times for answering questions. Most of the statutory auditors experienced more lengthy processing times, for instance if there were discussions on potential findings. Some statutory auditors consider a lengthy processing time to be a hindrance to learning.

3.4 Insight into quality through qualifications

Audit firms use a system of qualifications for their IQRs. The qualification is based on weighting the findings and the observations. A qualification system is useful for obtaining a comparable view of the results over time and across the statutory audits. This applies in both the Dutch organisation and its international network. A qualification system thus contributes to insight into the level of quality achieved. Qualifications may have consequences for those involved in an IQR, for instance for the remuneration, appointment as a statutory auditor or a feeling of personal value (professional pride). This makes it more difficult to accept errors and to be prepared to learn from them. It is important that audit firms strive to create an open culture with respect to errors. The degree to which this is experienced contributes to acceptance of the results of the IQR and therefore also to learning within the organisation.¹⁵

The review shows that each PIE audit firm has its own qualification system in its IQRs with a varying number of qualification categories.

The boards of these firms can strengthen the educational value of the IQR through greater projection of an open culture with respect to errors. A qualification in an IQR can often have consequences that may be an obstacle to learning, such as delay in promotion or lower remuneration.



Qualification systems vary from one firm to another

The PIE audit firms use a qualification system to be able to compare the level of quality achieved over time and across statutory audits. These qualification systems vary from one firm to another. The audit firms have a qualification system with three or four categories. The five PIE audit firms using three categories vary in the way in which they qualify the middle category as adequate or inadequate. At two of these firms, the middle category is consistently qualified as inadequate. At two other firms, whether the middle category is qualified as adequate or inadequate depends on issues such as the severity of the findings in the specific case. One of these firms has divided the middle category into two sub-categories, with one sub-category qualified as adequate and the other as inadequate. The PIE audit firm using a qualification system with four categories qualifies the two higher categories as adequate.

Qualification dependent on nature of the findings

Each PIE audit firm explains how a qualification arises in its policy. This depends on the nature and number of findings. They distinguish between significant and other findings, or between findings with low, medium or high impact. The various categories of findings provide insight into the aspects on which the PIE audit firm can improve. It is helpful to the audit firms in their qualification and also for comparison over time and across statutory audits.

Five PIE audit firms use several categories of findings. When determining the weight of a finding, these five firms consider whether professional regulations have been met, whether material or additional procedures

¹⁵ See <https://www.afm.nl/nl-nl/nieuws/2017/okt/esma-aandachtspunten-verslaggeving-2019>.

should be performed and whether additional audit evidence has to be obtained. One firm makes no distinction between findings in its policy.

Opinion forming relevant in weighting of findings

Each PIE audit firm's policy at the same time leaves room for the reviewers and the employees involved in the weighting to form opinions. It may therefore be the case that other employees reach a different opinion. The weighting becomes more objective if several people are involved in the weighting process, such as a panel or committee.



Audit firms can renew their IQRs by clarifying the meaning of an adequate or inadequate qualification. This contributes to a more uniform insight into quality for the users. This is also relevant to the sector's ambition to increase the transparency of factors that can contribute to quality. The IQR results are a part of the expected introduction of audit quality indicators (AQIs).¹⁶

It also puts the clients for statutory audits in a better position to choose between providers of statutory audits and promotes competition between the audit firms on quality. In addition, audit committees will be able to make a better comparison when selecting an audit firm.

Encouraging statutory auditors to learn from findings

The PIE audit firms devote attention to learning from the IQR in their IQR objectives. To be able to learn, it is important that the statutory auditors accept the findings and associated qualifications. An open culture with respect to errors contributes to this. It is also important that the qualification is a logical consequence of the findings and that it is experienced as justified in the light of the findings. The firms accordingly devote attention to how the consequences of qualifications are experienced and that there is mutual consultation during the IQR. The statutory auditors and employees experience the IQR as stressful and take a qualification personally. They frequently experience an IQR as the moment they are being assessed, on their professionalism. Some statutory auditors think that much depends on an IQR, such as their personal reputation, an appointment, and the likelihood of being the subject of an IQR in the following year.

Statutory auditors and employees experience uncertainty regarding the weighting

A majority of the statutory auditors and employees experience uncertainty regarding the weighting, for example because this is determined by a panel. They also experience uncertainty, because of the professional judgement in the weighting process, they have little or no idea whether findings will lead to a negative qualification. On the other hand, the statutory auditors experience no surprise because of the qualification if there is greater clarity in the IQR on the impact of a finding on the qualification.

PIE audit firms devote consideration to the consequences of a qualification

Most PIE audit firms carefully consider the consequences of a qualification. Because there are several categories within a qualification of 'inadequate', the consequences of this vary. The firms attach different consequences to new findings or recurring findings or defer the consequences of a negative qualification. The readiness of a statutory auditor to learn is also an element in the determination of the consequences. Some PIE audit firms distinguish between human error and reckless conduct and support the statutory auditors in learning and improving, for example by means of a reflection interview on their learning experiences, potential for improvement and necessary resources.

Statutory auditors experience that making errors is allowed

The majority of the statutory auditors experience that they are allowed to make errors, for example because they are not judged immediately on the basis of errors. The statutory auditors also experience that the nature

¹⁶ Consultation document 'Audit Quality Indicators' – Coordinators for Future of the Audit Sector <https://internetconsultatie.nl/agiaccountancysector>.

of the error and their readiness to learn are taken into account in the determination of the consequences of a qualification.

Good practice: Include readiness to learn in the determination of consequences of an IQR qualification

The board of a PIE audit firm expresses its understanding that anyone can make an error, and that errors are allowed. It makes a distinction between human error and risky or reckless conduct. If an error occurs, this firm considers the readiness of a statutory auditor to learn and their active expression of this attitude when determining the consequences for the statutory auditor in question.

Discussion of observations and findings

The PIE audit firms enter into mutual consultation on the observations and findings of an IQR. This contributes to acceptance of the findings. During the IQR, the reviewers strive to reach agreement with the statutory auditor on the established facts and the description of the findings. The statutory auditors and employees experience that they can enter into dialogue with the reviewers regarding the facts and findings, for instance to give an explanation or refine the description of the findings.

The PIE audit firms also offer the possibility of objection to a qualification. Some statutory auditors make use of this option. The extent to which they feel they are listened to in this process varies. Some statutory auditors feel they have no input or do not receive any further explanation or clarification of the qualification of the IQR when they need this. Some statutory auditors experience the weighting as unjustified, for instance due to the substantiation of the qualification and because they think the weighting is too severe for the nature of the findings.

3.5 Communication on the outcome of the IQR encourages learning

By communicating the results of the IQR in the audit firm, the firm obtains insight into the level of quality realised at multiple levels and can learn how it can improve quality.

The review shows that the PIE audit firms communicate the outcomes and findings and that the statutory auditors and employees acknowledge that they learn from this. The firms also aim to encourage learning by communicating the results of the IQRs in various ways.

Communication of results contributes to learning

The PIE audit firms communicate the outcomes of their IQRs in various ways, for instance in (regular) professional meetings, (online) training and newsletters. The findings are also discussed in peer supervision sessions or collective meetings of various job categories. Sharing of personal learning experiences by statutory auditors encourages others to learn from an IQR. It shows them how the statutory auditors deal with errors, reflect on their own conduct and what they have learned. Expression of personal learning experiences, room to ask questions on individual cases and selection of lessons for specific groups encourages learning in the firm.

Good practice: Reflection on IQR results, findings, and experiences

At one PIE audit firm, the statutory auditors as a group reflect on the IQR results, findings, and experiences. The statutory auditors experience that allowing oneself to be vulnerable in front of a group makes an impression and contributes to learning.

3.6 Remediation contributes to learning

Measurement of the level of quality achieved is inextricably linked to any remediation procedures needed, at the level of both individual statutory audits and the system of quality control. By law, audit firms and statutory auditors are obliged to remedy deficiencies in a statutory audit.¹⁷ This involves the remediation of deficiencies and preventing repetition in the future. This means that procedures are carried out to support the auditor's opinion with sufficient and appropriate audit evidence. This may also entail a change to the auditor's opinion. Remediation also contributes to learning in the organisation, due to, for instance, the preparation of a remediation plan.

The review shows that the PIE audit firms remedy findings based on IQRs qualifying a statutory audit as inadequate.

Combining the insights from the remediation and the IQR can be used to increase insight into the level of quality achieved and thereby identify lessons to be learned by the firm as a whole. Learning from the results of the IQR may be enhanced, for instance by carrying out a root cause analysis at firm level and drafting a learning plan.



Policy on remediation of findings varies

Most PIE audit firms have a policy that states that the statutory auditor must amend findings¹⁸ from the IQR retrospectively (in the audit in question).¹⁹ The times at which other findings and observations are remedied retrospectively however varies. The policy of some firms states that remediation is dependent on the impact of the finding or observation, while at other firms this is decided separately for each individual statutory audit. Findings and observations with a limited impact are included prospectively by the PIE audit firms (in the new audit year). The employees involved in the remediation plan and in the execution of the remediation procedures vary per firm. At one firm, the technical expertise department evaluates and authorises the remediation plan prior to the execution of the remediation procedures. At another firm, the technical expertise department makes a professional assessment of whether the remediation procedures have been performed correctly based on the remediation plan.

PIE audit firms aim to learn from the remediation

The PIE audit firms also aim to learn from the findings with the remediation at statutory audit level. For example, they carry out a root cause analysis in case of serious findings. They also support the statutory auditors in remediation. This can contribute to learning from the findings. For example, they do this by getting the statutory auditor to reflect in the remediation plan on the findings, causes and limitations in the achievement of quality. The statutory auditors and employees at most of the PIE audit firms feel that the clarity of and support in the remediation helps them to learn from the findings.²⁰

¹⁷ The requirements for remediation are stated in Sections 14(a) and 25(b) Wta.

¹⁸ Findings that among other things relate to the obtaining of sufficient and appropriate audit evidence.

¹⁹ The AFM has not assessed in this review whether the remediation policy complies with legislation and regulation.

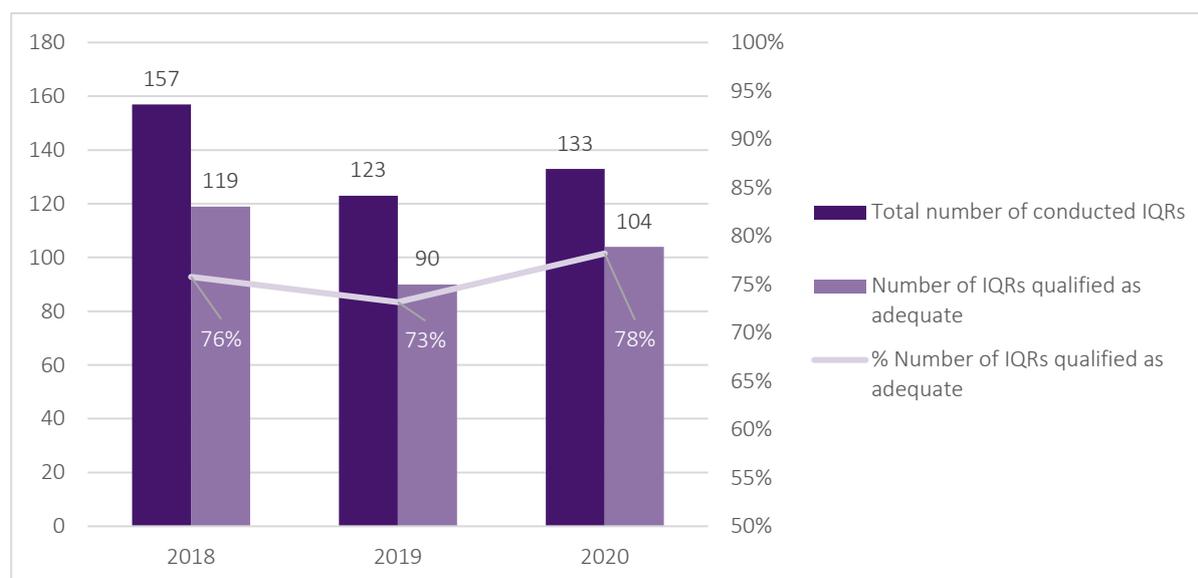
²⁰ The execution of remediation procedures did not apply to some of the auditors and employees interviewed by the AFM.

4 IQR provides good insight into quality for most of the inspected statutory audits

In the evaluation element of the review, the AFM considered the quality of 18 statutory audits²¹ that were also reviewed in the IQRs conducted by the six PIE audit firms in 2020. This allowed the AFM to establish whether the IQR delivered the same insight as its own inspection.

The PIE audit firms conduct their IQRs annually. Figure 2 shows the total number of IQRs conducted by these firms in 2018 to 2020 and the number qualified as ‘adequate’.

Figure 2 Total number of IQRs conducted in 2018 to 2020 and the number qualified as ‘adequate’.^{22 23}



AFM mostly positive regarding the insight into the level of quality achieved by the IQRs

The AFM is mostly positive regarding the insight provided by the IQRs regarding the level of quality achieved. For the vast majority of the statutory audits inspected, the IQRs came to a similar assessment as that of the AFM. This comparison gives information on the accuracy and critical content of the results of the IQRs conducted in 2020. The review also shows that the execution and weighting of the IQRs differs from the review by the AFM in certain respects.

The AFM also defined certain relevant items of attention for the quality of statutory audits from its analysis of the findings of the IQRs and the AFM review of the quality of statutory audits.

²¹ Three statutory audits per PIE audit firm.

²² Based on information provided by the PIE audit firms to the AFM for this review. The results of the IQRs are stated in the transparency reports from the PIE audit firms.

²³ By comparison: the percentage of audits without serious deficiencies in the 2020 IFIAR Survey of Inspection Findings was 66%. <https://www.ifiar.org/activities/annual-inspection-findings-survey/>.

4.1 For the majority of the statutory audits reviewed, the IQR gives the same qualification as the AFM's inspection

Qualification by AFM same as the IQR for 15 out of 18 statutory audits

The AFM has compared the qualification in the IQR with the results of its own inspection of the quality of statutory audits. For 15 of the 18²⁴ statutory audits inspected, the IQRs of the PIE audit firms gave the same or a stricter qualification as the inspection by the AFM. For 3 of the 18 statutory audits reviewed, the qualification in the IQR was more positive than that of the AFM.

The AFM qualified 12 statutory audits in total as 'adequate' and 6 as 'inadequate'.²⁵ This needs to be interpreted with an appropriate degree of caution. The inspection encompassed a limited number of statutory audits. In our selection of these statutory audits, we specifically focused on statutory audits for which an IQR was conducted in 2020.²⁶ The AFM inspected statutory audits with both 'adequate' and 'inadequate' qualifications in their respective IQRs.²⁷ The AFM is not making any statement regarding the quality of all statutory audits.

Figure 3 shows the distribution of the number of statutory audits inspected and whether the qualification in the IQR corresponds to that of the AFM.

Figure 3 Comparison of qualifications in IQR and the AFM review

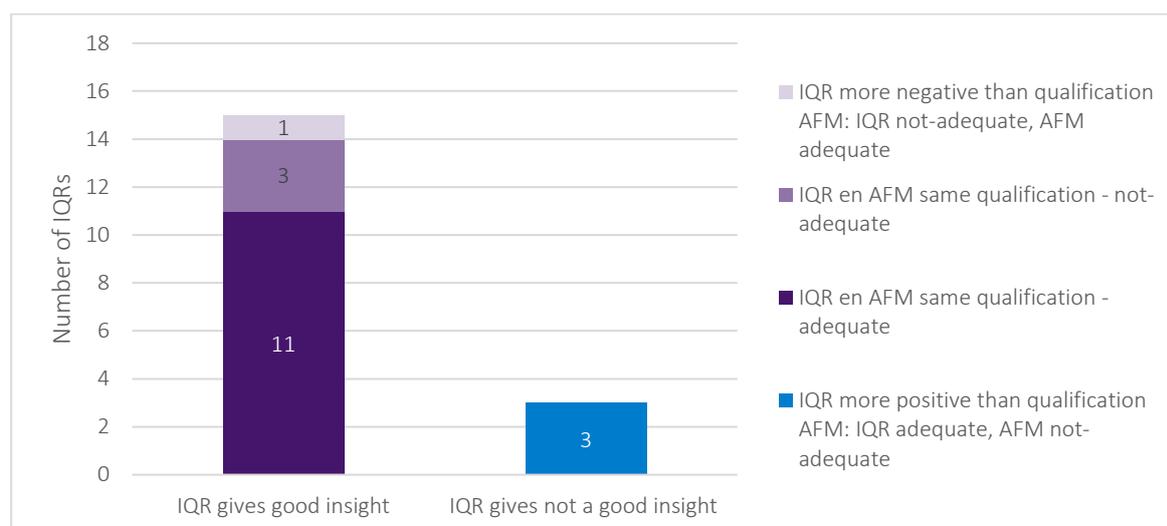


Figure 3 shows that:

- For one statutory audit, the qualification in the IQR was more negative than the qualification in the AFM inspection. In this case, the PIE audit firm in question identified findings in a part of the statutory audit that was not inspected by the AFM.
- For three statutory audits, the IQR was more positive than the AFM. The AFM identified findings here that were not identified in the respective IQRs. The differences may arise because the PIE audit firms executed and weighted the IQR differently than the AFM in its inspection. Further explanation is given below.²⁸ We

²⁴ The AFM reviewed 7 statutory audits of PIE audit clients and 11 statutory audits of non-PIE audit clients.

²⁵ A total of 14 statutory audits were qualified as 'adequate' in their IQRs, with 4 qualified as 'inadequate'.

²⁶ In prior inspections of the quality of statutory audits, the AFM applied several criteria in its selection, including variation in market segments, the presence of quality safeguards, variation in locations of the audit firms and first year and final-year audits. Due to these various criteria and the risk-based selection of the IQRs, the qualifications cannot be compared in terms of numbers.

²⁷ The AFM did not know the qualification of the IQR at the time the selection was made.

²⁸ The AFM also did not carry out any explanatory sreview and accordingly describes only its observations.

requested the PIE audit firms to remedy the identified deficiencies, to investigate the causes and to take measures to prevent deficiencies in the future.

Execution of the IQR differs from the AFM's inspection in certain respects

The IQR and the AFM both focus on the question of whether sufficient and appropriate audit evidence has been obtained. The execution of the IQRs of the PIE audit firms differs from the AFM's inspection of the quality of statutory audits in certain respects.²⁹ This has no implications regarding either proper or improper conduct of the IQR.

In their IQRs, most of the PIE audit firms review one or more material elements in the statutory audit (focus area) and assess whether the statutory auditor has obtained sufficient and appropriate audit evidence to substantiate their opinion. The AFM also inspected the quality of statutory audits on the basis of a focus area. For this focus area, the AFM inspected whether the statutory auditor obtained sufficient and appropriate audit evidence in accordance with the Standards³⁰ on which to base their opinion with respect to the financial statements.

The IQRs of the PIE audit firms differ from the AFM's inspection in terms of scope. They review several elements of the statutory audit in their IQRs, such as independence, engagement acceptance, materiality, and risk assessment procedures. We focused on establishing whether sufficient and appropriate audit evidence had been obtained for the focus area, and therefore not on elements not directly associated with this. In appropriate cases, the AFM did review other elements, when relevant.

For one PIE audit firm, the IQR differed from the AFM's inspection in terms of depth. In its IQR, this firm reviewed only the audit procedures for the assertion(s) for which the statutory auditor had identified a significant risk for the focus area. For example, the significant risk with respect to 'cut-off of the revenue'. We however focused on the obtaining of sufficient and appropriate audit evidence with respect to all the assertions³¹ identified by the statutory auditor for the selected focus area. In this instance, this concerned assertions regarding the occurrence, accuracy, completeness, and cut-off of revenue.

Qualification systems in the IQRs differ from the AFM's qualification methodology

The qualification systems for the IQRs of the PIE audit firms are not the same as the qualification methodology used by the AFM. The PIE audit firms have a qualification system with three or four categories (see section 3.4). The AFM's qualification system has two categories: 'adequate' and 'inadequate'. We do not categorise findings for allocation of a qualification. The severity of the finding(s) on which a qualification is based is established based on the entirety of the audit procedures for a focus area, and whether sufficient and appropriate audit evidence has been obtained.

Comparability of qualifications is relevant for users of financial statements

The comparability of the various qualifications of the audit firms is relevant for users of financial statements. These include audit committees, as they use quality as a criterion in the selection of an audit firm. The comparability of the results of the IQR with the results obtained by the supervisor is also relevant for them. For the sake of comparability, the distinction of 'adequate' and 'inadequate' is used, see for example the NBA

²⁹ The differences are described in section 3.3.

³⁰ Further regulations regarding audit and other standards (Nadere voorschriften controle- en overige standaarden, or NV COS).

³¹ In an audit, the reliability of the financial statements is the central requirement. Assertions are aspects of reliability and are the auditor's objectives in their audit at the level of individual items in the financial statements.

Dashboard Accountancy.³² The International Forum of Independent Audit Regulators (IFIAR) also uses two corresponding categories as a measure of quality³³: ‘finding’ and ‘no finding’.³⁴

4.2 Relevant areas of attention from inspection of the quality of statutory audits

In this section, the AFM lists certain relevant areas of attention for high-quality execution of statutory audits arising from the IQRs and the AFM’s review. These areas are relevant for users of the financial statements, as they can also contribute to the dialogue on the quality of statutory audits between statutory auditors, companies, SBs and audit committees and users of the financial statements. We have included a number of suggested questions that SBs and audit committees can put to their statutory auditor and other representatives of the audit firms in this respect in appendix 2.

4.2.1 Audit of estimates

The audit of estimates by the statutory auditor is a complex process. Some elements in the financial statements cannot be exactly measured by the audit client and can only be estimated. The impact of Covid-19 for instance means that there are great uncertainties that complicate the predictability of market developments. This estimation uncertainty leads to risks in the audit.

Among other things, the inspection shows that in the inspected statutory audits several statutory auditors did not adequately evaluate the reasonableness of the assumptions underlying estimates by the management. For example, these statutory auditors obtained information solely to assess whether the underlying assumptions were reasonable but failed to verify the statements provided on the basis of source documentation.

It is important that, in addition to the requirements, statutory auditors also devote attention to the applicability-related and other explanatory texts in the Standards and evaluate whether they have obtained sufficient and appropriate audit evidence. It is also important that the statutory auditor and the audit client (including the SB and the audit committee) discuss the estimates to be made by the audit client at a sufficiently early stage. Accordingly, in addition to requirements for the statutory auditor, the revised Standard 315³⁵ also has significance for the company, such as regarding the design of internal controls. This also affects the diligence of the estimation process, for example in the determination of the size of provisions. The mutual dialogue on responsibilities and expectations contributes to adequate reporting and auditing of such items.

4.2.2 Use of work by other parties in the audit

In many cases, a statutory auditor uses procedures performed by others in their audit, because they do not have sufficient expertise, they do not have direct access to the necessary information, or to increase the efficiency of their audit. Statutory auditors accordingly use procedures of valuation experts, actuaries, IT specialists, the control clients’ internal audit service and auditors from service organisations used by the audit client. To be able to use the work of others, it is important that the statutory auditor makes a critical assessment of the work of others in order to evaluate whether this work provides them with sufficient and appropriate audit evidence. This evaluation is essential, as the statutory auditor bears full responsibility for the quality of the statutory audit.

³² See the NBA website <https://www.nba.nl/dashboard/kwaliteit/de-accountantsorganisaties-en-de-beoordeling-van-kwaliteit/>

³³ In the context of its agreements with the six largest international networks (BDO, Deloitte, EY, Grant Thornton, KPMG and PwC), IFIAR monitors the percentage of ‘finding’ as a measure of quality. In 2019, IFIAR reached a new agreement that there will be a commitment to reduce the number of audits by PIE audit firms for which a ‘finding’ is identified by the supervisors affiliated to IFIAR by at least 25% in four years’ time.

³⁴ See the ‘2020 Inspection Findings Survey’ report of 15 March 2021 <https://www.ifiar.org/activities/annual-inspection-findings-survey/>.

³⁵ Revised Standard 315 ‘Identification and estimation of risks of material difference by obtaining insight into the entity and its environment’, applying to financial years beginning on or after 15 December 2021.

Among other things, the inspection shows that in the inspected statutory audits several statutory auditors did not adequately evaluate whether the audit evidence provided by the work of a valuation expert was appropriate for their audits. For instance, the statutory auditor did not adequately test the reasonableness and relevance of the assumptions and methods of the valuation expert that they used in their audit.

It is important that the statutory auditor and the audit client, including its SB and audit committee, enter into dialogue on the extent to which the work of other parties is used in the statutory audit and the related challenges for the statutory auditor.

4.2.3 Technology in the audit

The use of data analytics in statutory audits has increased. This mainly concerns the application of data analysis in the execution of substantive procedures. First, it is important when using data analysis that the statutory auditor is critical regarding how the data is obtained and performs procedures to establish that the data are reliable. The statutory auditor therefore has to perform procedures to establish that these overviews, lists and databases are sufficiently uncorrupted to provide reliable information. After this, the statutory auditor has to establish whether the information obtained from the data analysis qualifies as sufficient and appropriate audit evidence.

Among other things, the inspection shows that in the inspected statutory audits several statutory auditors failed to perform sufficient procedures to establish the reliability of the information used in the data analysis and failed to perform sufficient procedures to follow up on identified differences.

It is important that statutory auditors understand how their audit clients use new technologies, but also how these can be used for an effective statutory audit. Technology indeed has the potential to fundamentally change the reporting process, by means of artificial intelligence and machine learning, as well as data analytics. For SBs and audit committees, it is important to understand whether the statutory auditor experiences limitations in the use of technology in their audit.

4.2.4 Communication by the auditor with the SB and audit committee

The statutory auditor communicates to the SB and the audit committee on various subjects. These bodies are an important link in the chain of parties ensuring proper reporting and the related assurance provided by the auditor or audit firm. Among other things, they monitor the quality of the statutory audit. The AFM has explored this subject, which relates to a previous AFM review titled “The role of audit committees in the selection of a statutory auditor and monitoring the statutory audit”³⁶ with respect to the communication between the audit committee and the auditor.³⁷

The exploratory review showed that the nature and frequency of written and oral communication by statutory auditors varies, depending on the context of the audit client. The number of written reports varied and included at least the auditor’s report in each of the statutory audits reviewed by the AFM. In addition, in some cases there were also written reports on the engagement confirmation and the audit plan. The frequency of oral communication for the statutory audits reviewed by the AFM varies from one to ten times per year. Oral communication usually occurs in the presence of the management, but there are also sessions at which the statutory auditor and the SB and audit committee communicate without the attendance of management. Oral

³⁶ See the AFM report of February 2021: <https://www.afm.nl/nl-nl/professionals/nieuws/2021/feb/aanbevelingen-auditcommissies>

³⁷ This review shows that the audit committee meets formally with the auditor without the management in attendance on one or more occasions per year, and that there were several occasions involving informal contact between the chair of the audit committee and the auditor. It is important that in their dialogue with statutory auditors, SBs and audit committees determine the information necessary for their procedures in the context of the company to be audited. The audit committees see the auditor as ‘the eyes and ears’ of the audit committee for subjects such as the IT environment, fraud and matters such as the observed mentality in the workplace.

communication usually takes place during the audit process. For two of the statutory audits reviewed by the AFM, this occurred on only one occasion on completion of the audit.

The subjects communicated by the statutory auditor to the SB and the audit committee were more or less the same for both PIE and non-PIE audit clients. For some of the statutory audits reviewed by the AFM, the statutory auditor in question raised several non-mandatory subjects, such as the impact of Covid-19, risk management, culture, IT, remuneration and developments relating to internal supervision.

It is important that communication between the statutory auditor and the company, including its SB and audit committee, is strengthened. This can involve proactive and more frequent initiation of dialogue on the wishes and needs of the SB and audit committee and the subjects that the statutory auditor considers to be important for them. This dialogue may also involve the nature and frequency of this communication.

4.2.5 Impact of Covid-19 on statutory audits

Covid-19 is an unforeseen and impactful event, with a huge effect on business and society as a whole. The pandemic and its consequences have also had a large impact on the PIE audit firms and on the audit procedures of statutory auditors. The AFM has conducted an exploratory review of how these firms have dealt with Covid-19 in 2020. This shows that the PIE audit firms have taken various quality and other measures to address Covid-19 and its consequences³⁸ and have thereby supported their statutory auditors in the execution of statutory audits. It is important that audit firms and statutory auditors continue to adapt to unforeseen and impactful events.

PIE audit firms have adapted their consultation policy

The PIE audit firms have adapted their consultation policy with respect to the going concern assumption because of Covid-19. For instance, this entailed the decision of whether to include a paragraph emphasising certain circumstances in relation to Covid-19, a mandatory consultation on virtual stock-taking and the execution of audits of a group in countries outside the Netherlands.

Support of audit practice through consultation, training, and guidelines

The PIE audit firms have supported their audit practice by facilitating (professional) consultations and providing training and professional guidelines dealing with the (potential) impact of Covid-19 on statutory audits. This (online) training addresses professional, procedural and behavioural elements. Examples of this training include the impact of Covid-19 on the audit and the financial statements, and the practical challenges of an audit performed remotely.

Involvement of an engagement quality control reviewer made mandatory in some cases

Some PIE audit firms have made the involvement of an engagement quality control reviewer mandatory for the assessment of the audit procedures arising from the consequences of Covid-19.

Statutory auditors perform additional procedures

The statutory auditors have performed additional procedures in the conduct of individual statutory audits, including procedures relating to the going concern assumption. One example of this is that the risk analysis has been re-evaluated.

³⁸ Covid-19 was officially declared to be a pandemic on 11 March 2020.

5 Description of the review methodology

In this section, the AFM describes the methodology used for the IQR review and its inspection of the quality of statutory audits, including two exploratory studies. This review was conducted at the six PIE audit firms.

By law³⁹, the AFM makes a risk-based assessment of the quality control system for statutory audits at the PIE audit firms at least once every three years.⁴⁰ These assessments are intended to help the audit firms prevent any deficiencies in their quality control systems and take remedial action where necessary. We inform the stakeholders, including audit committees, and the audit firms of the outcomes. With our interventions, including these assessment, our intention is to encourage the PIE audit firms to maintain and increase their focus and commitment (of resources) to quality improvement to achieve and continue the necessary change. Our ultimate aim is to contribute to a justified restoration of confidence in auditors, audit firms and the audit opinion.

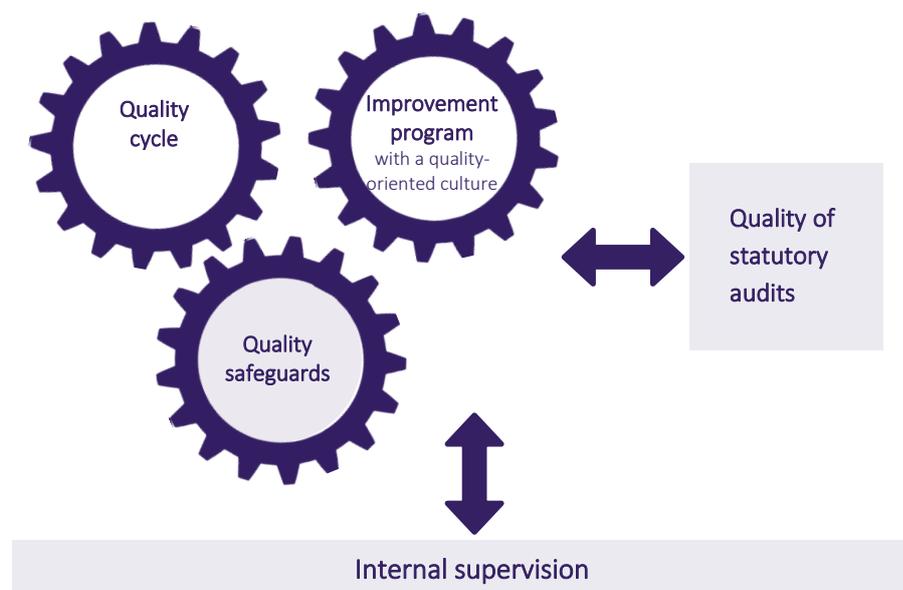
5.1 Review of the quality improvement process

The AFM carried out its review of the quality improvement process and its elements in conjunction. Since 2014, the PIE audit firms have been applying a structured approach to improving the quality of statutory audits (the change process). The change process 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 information, which in turn provides important input for the quality cycle 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 execution of audit procedures, and thus on the quality of statutory audits. The internal supervision is designed so that the board of the audit firm is successful in improving quality and takes decisions that are in the public interest. These elements are shown in diagram form in figure 4.

³⁹ Section 48a Wta and Article 26 EU Regulation 537/2014.

⁴⁰ The letter from the Ministry of Finance to the House of Representatives of 2 February 2021 titled "Opvolging brief kostenkader AFM ten aanzien van accountancysector en aanbieder voortgangsrapportage Kwartiermakers toekomst accountancysector" (Follow-up letter on cost structure for the AFM with reference to the audit sector and presentation of progress report on coordinators for the future of the audit sector) proposed a change to the cost structure for 2021-2024. This is due to the increased frequency with which the AFM will assess the quality of statutory audits at the PIE audit firms and will conduct limited thematic reviews. This change to the 2021-2024 cost structure has been declared by the House of Representatives to be controversial and will not be debated until a new government is formed. See: <https://www.rijksoverheid.nl/documenten/kamerstukken/2021/02/02/opvolging-brief-kostenkader-afm-ten-aanzien-van-accountancysector-en-aanbieder-voortgangsrapportage-kwartiermakers-toekomst-accountancysector>

Figure 4 Overview of the elements of quality improvement



The AFM continually renews its supervision, and since 2015 its reviews have focused on behavioural and cultural aspects as well as the quality of statutory audits and the systems of quality control. The AFM has also focused on the preconditions required for quality and thus placed central priority to quality safeguards. This approach is in line with the recommendations of the Committee on the Future of the Audit Sector (Commissie Toekomst Accountancysector, or **Cta**) to review 1) the quality of statutory audits; 2) the system of quality control, and 3) factors affecting quality such as the culture at audit firms, the governance of audit firms and the remuneration systems in place.

5.2 Review of the IQR

The AFM has conducted an exploratory study of the design and execution of IQRs in 2020 for five elements of the IQR and of how the IQR aims to contribute to the achievement of the quality objectives and a quality-oriented culture at the audit firm. We also assessed whether the IQR has provided insight into the level of quality achieved in statutory audits. In addition, the AFM reflected on the insights obtained and the possibilities for improvement and renewal in this report.

5.2.1 The review focused on five elements of the IQR

The IQR is the result of Article 9 of the Audit Firms Regulation (Verordening accountantsorganisaties, or **VAO**), which requires audit firm to establish rules regarding the execution of regular internal quality reviews of completed engagements for the execution of a statutory audit. The Article is an elaboration of the requirement set in Sections 9(a) and 22 of the Dutch Audit Firms (Supervision) Decree (Besluit toezicht Accountantsorganisaties, or **Bta**). This requires the audit firm to ensure compliance with the system of quality control and evaluate its system of quality control once a year.⁴¹

In its review, the AFM focused on five elements of the IQR⁴²: selection, conduct, assessment, communication, and remediation. These elements were chosen because:

⁴¹ The conduct of a regular internal quality review of completed statutory audits is one, but by no means the only element of the evaluation of compliance with the system of quality control.

⁴²The AFM has not assessed whether the policy for the IQRs and the policy for remediation complies with legislation and regulation in this review.

- With the **selection** of the statutory auditors and statutory audits, the audit firm forms an impression of the level of quality achieved. The selection is thus the basis for the impression that the IQR gives of the statutory audits portfolio at the PIE audit firm.
- The **execution** of the IQR provides insight into the level of quality achieved by conducting the IQR consistently in terms of both scope and depth, by the engagement of reviewers with sufficient knowledge, experience, and available time and by facilitating a predictable process.
- The level of quality achieved in statutory audits is expressed in a **weighting** of findings leading to a qualification. This is relevant for comparison between audits and over time.
- The **communication** of the results of the IQR is an important driver for a learning organisation.
- The **remediation**, which is mandatory under the Wta⁴³, is a means of learning from the IQR.

5.2.2 The review involves elements of both an exploratory part and an assessment part

Exploratory part of the review

This part of the review focused on obtaining insight into IQR. In this exploratory part of the review, the AFM did not arrive at an opinion as to whether the IQR meets an expectation or a standard. The exploratory part gave rise to observations that provide insight into the design and execution of IQRs and how this contributes to achieving quality objectives and a quality-oriented culture. This will enable audit firms to reflect on their IQRs and strengthen them where necessary.

Assessment part of the review

The assessment part of the review focused on establishing whether IQR provides insight into the level of quality achieved. The degree of compliance with policy was also evaluated.

The AFM conducted its own inspection of 18 IQRs conducted in 2020. For these IQRs, the AFM assessed whether the qualification and findings with respect to the focus area correspond with or differ from the AFM's own review. The AFM based its review on the same audit file as was involved in the IQR.

For its opinion regarding insight into the level of quality achieved, the AFM used a qualitative interpretation and provided insight into the correspondences and the differences.

Review conducted digitally

The AFM conducted its review during the Covid-19 pandemic. Since holding interviews physically was not possible, the AFM conducted its interviews digitally. The AFM's experience was that conducting the review digitally was indeed possible, subject to certain conditions, and that this was a good alternative in a period in which physical interviews were not possible.

5.2.3 The AFM based its review on document analysis, interviews, and data

The AFM used several sources of information for its review. The AFM carried out a desktop analysis based on documents it had requested, such as the IQR policy, internal reports, and evaluations. The AFM also used the data received from the PIE audit firms such as the number of IQRs conducted, the reasons for selection of statutory auditors and the focus areas under investigation. The AFM also asked for the IQR reports including the qualification for the statutory audits reviewed by the AFM. These were requested during the inspection of the quality of these statutory audits. When selecting the statutory audits and at the start of the inspection, the qualification in the IQR was not known to the AFM.

In addition, the AFM held semi-structured (in-depth) interviews and group interviews. For the exploratory part of the review, around seven interviews were held for each PIE audit firm with the board, the statutory auditors

⁴³ The requirements for remediation are stated in Sections 14(a) and 25(b) Wta.

and the (senior) managers, the person responsible for the IQR process and the people involved in the execution of the IQR (the reviewers and the employees involved in the weighting). With these interviews, the AFM obtained insight into both the design and execution of the IQR as experienced by the statutory auditors, employees and reviewers. The review questions were discussed during these interviews. The interviews were recorded verbatim as far as possible in order to enable the purest possible analysis. Where the AFM makes statements in this report that are based in part on interviews and discussions of the experiences of the statutory auditors, the employees and the reviewers, this refers to the employees who were interviewed.

The AFM analysed and classified the information obtained from the desktop analysis for each review question. This means that the information obtained was analysed in small pieces (segmented) and then linked (classified) to the various review questions. The supervisors of the AFM carried out the classification independently and discussed the results with each other. This increased the reliability of the review and reduced sensitivity to biases. The AFM then compared the analysis of the five elements by means of consistency sessions.

The AFM also held interviews for the assessment part of the review, discussing the results for the statutory audits it reviewed with the reviewers of the IQR and the employees involved in the assessment. These interviews were held to obtain insight into the execution and weighting of findings of the selected IQRs.

5.3 Inspection of the quality of statutory audits

In this section, the AFM describes the design and conduct of its inspection of the quality of statutory audits. The AFM also made an exploratory study of two subjects, namely how the PIE audit firms had responded to the impact of Covid-19 and communication by the auditor to the SBs and audit committees.

5.3.1 Selection of focus area of statutory audits

The AFM selected a total of 18 statutory audits from the list of statutory audit engagements for the inspection. The AFM selected statutory audits for which the PIE audit firm had completed its IQR. The AFM did not select any statutory audits that it had reason to believe contained deficiencies. The qualification in the IQR was not known to the AFM at the time it made its selection. In previous reviews of the quality of statutory audits, the AFM applied several criteria in its selection, including variation in market segments, the presence of quality safeguards, variation in locations of the Big 4 audit firms and first year and final-year audits. Due to these different criteria, the qualifications are not therefore comparable.

The auditor's opinions for the inspected statutory audits were issued in the period from February 2020 to June 2020. The related IQRs were completed in the period from May 2020 to December 2020.

The AFM focused on a material element of the audit, known as a focus area. One focus area was inspected in each statutory audit, usually including the associated topics or items. This focus area was also assessed in the IQR. The choice of these focus areas was also based on the nature and size of the business of the audit client. Many of the focus areas selected involved an element of estimation.

5.3.2 The quality of statutory audits is qualified as 'adequate' or 'inadequate'

In each statutory audit, the AFM inspected whether the statutory auditor obtained sufficient and appropriate audit evidence in accordance with the Standards⁴⁴ on which to base their opinion with respect to the financial

⁴⁴Further regulations regarding audit and other standards (Nadere voorschriften controle- en overige standaarden, or NV COS).

statements.⁴⁵ The AFM accordingly measured the quality of the result of the audit, and not the quality of the audit process. If the statutory auditor obtained sufficient and appropriate audit evidence for the focus area⁴⁶, the AFM qualifies the quality of a statutory audit as 'adequate'.⁴⁷ In other cases, the AFM qualifies the quality of a statutory audit as 'inadequate'.

For its inspection of the quality of statutory audits, the AFM requests the statutory auditor to explain their audit of the focus area based on the information in the audit file. The AFM's insight into the audit evidence obtained is based on the audit file, in combination with the explanation from the statutory auditor. The AFM strives to complete this process in a period of six to eight weeks.

5.3.3 Sharing of conclusions and findings with audit committees for PIE statutory audits

The PIE audit firms are obliged to share the AFM's principal conclusions and findings with the audit committees of the PIE audit clients concerned, if the AFM has published its principal conclusions and findings and these are based in part on the inspection of the statutory audit concerned. This obligation applies regardless of the nature of the AFM's conclusions and findings with respect to the statutory audit concerned. The audit firm must share this information within ten business days of such publication and provide a copy of this⁴⁸ to the AFM without delay.⁴⁹

Since the review findings in this report do not state the names of the audit firms concerned, this obligation does not apply. In the spirit of this requirement, the AFM has requested the PIE audit firms to share a copy of the part of the final firm-specific review report relating to a specific statutory audit for a PIE audit client with the relevant audit committee.

⁴⁵ This means that the AFM establishes 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 execution 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.'

⁴⁶ Audit evidence has to be both 'sufficient' and 'appropriate'. These two qualifications are linked. The term 'sufficient' is the measure for the quantity of the audit evidence. The term 'appropriate' is the measure 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.

⁴⁷ The AFM does not exclude the possibility that there may be serious deficiencies in elements of the statutory audit not reviewed 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.

⁴⁸ The copy provided to the AFM must be a copy of the correspondence sent to the audit committee.

⁴⁹ See Section 48(a)(7) and (8) Wta.

5.3.4 Exploratory reviews relating to Covid-19 and communication to SBs and audit committees

The AFM conducted two exploratory reviews in relation to Covid-19 and communication by statutory auditors to SBs and audit committees. The aim of these studies was firstly to obtain insight into how the PIE audit firms had taken account of the impact of Covid-19 on the execution of statutory audits, including the going concern assumption. The second aim was to obtain insight into how and how frequently statutory auditors communicate with SBs and audit committees regarding their statutory audits. The SBs and audit committees are an important link in the chain of parties ensuring proper reporting and the related assurance provided by the auditor or audit firm.

For these exploratory reviews, the AFM carried out a desktop analysis based on the documents requested from the PIE audit firms on these two matters. The AFM also collected information on both matters for each statutory audit reviewed by means of questionnaires. The AFM does not form opinions based on exploratory reviews.

5.4 Reports on the results of the review

5.4.1 Firm-specific reports

Draft review reports on quality of statutory audits

During the conduct of the inspection, the AFM circulated draft inspection reports including its provisional conclusions. For those statutory audits provisionally qualified as ‘inadequate’, the findings were also included. These draft review reports are confidential. Other findings were shared orally during the review.

Furthermore, in its inspection of the quality of statutory audits, the AFM requested the 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 remedy the deficiencies and to take measures to prevent them occurring in future. The AFM has not assessed the remediation procedures resulting from its findings in this inspection. The AFM also requested that a root cause analysis be conducted.

After completion of each inspection of a statutory audit, the AFM provided oral feedback on its provisional findings and positive observations to a member of the board of the audit firm, among others. Approximately two months after completion of its inspection, the AFM held a ‘reflection interview’ with the statutory auditor and other representatives of the audit firm.

Draft review report on the IQR and exploratory reviews relating to Covid-19 and communication to SBs and audit committees

In early October 2021, the AFM circulated a draft review report stating the results of the exploratory and assessment parts of the review of the IQR and the studies relating to Covid-19 and communication to SBs. These draft review reports are confidential.

Assessment of reactions to draft review reports

After receipt of the draft review reports, the PIE audit firms were given the opportunity to submit their reactions in writing. 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 reviewed the responses of the PIE audit firms. This may have led to adjustments to the facts, findings and conclusions stated.

Final review reports

The AFM has included the results of its assessment of the reactions from the PIE audit firms to the draft review reports in a final review report. The final conclusions and findings of the review of the quality of statutory

audits were circulated in early October 2021. The final review reports of the IQR review and the studies relating to Covid-19 and communication with SBs and audit committees were circulated in mid-November 2021. These final review reports are confidential.

5.4.2 Public report

The PIE audit firms have had the opportunity to indicate factual inaccuracies in this public report. The AFM has accordingly amended the report where relevant.

5.5 Limitations of the review

The manner in which the review was conducted means that the results are subject to limitations. The AFM lists these limitations below.

No assessment of whether the IQR is sufficient

The AFM was not able to establish whether there is a causal relation between the elements of the IQR it reviewed and the quality of statutory audits. The AFM has accordingly not assessed whether the IQR is sufficient to sustainably ensure the quality of statutory audits.⁵⁰

The AFM has compared the similarities and differences between the IQRs and its own inspections. In cases where the qualification of the IQR and the AFM's review correspond, this does not necessarily mean that the scope and depth were the same in each case. The AFM moreover did not draw any conclusions regarding the accuracy of the IQR.

The AFM has not assessed whether the policy for IQRs and remediation complies with legislation and regulation in this review.

No opinion as to whether the response to Covid-19 was adequate, or if the auditor's communication was adequate

In its exploratory reviews, the AFM did not assess whether the response to Covid-19 was adequate or whether the auditor's communication was adequate.

No comprehensive review conducted

The AFM did not carry out a comprehensive review of all aspects of the IQR nor of the quality of statutory audits. The results stated in this report should be seen in this context. The absence of comments or remarks should therefore not be understood to mean that no other omissions may exist.

No statistical sample taken

The AFM did not perform a statistical sample. The AFM has not drawn any conclusions regarding all IQRs, or the quality of all the statutory audits performed by the PIE audit firms. Due to the review methodology, it is also not possible to draw conclusions regarding sub-populations within the statutory audits selected, for instance comparing statutory audits of PIE clients with statutory audits of non-PIE audits.

⁵⁰ Ensuring means that something is definitely up to standard and remains up to standard.

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

The fact that a statutory audit is qualified as 'inadequate', or an assessment by the IQR as inadequate, does not necessarily mean that the audited financial statements are incorrect. The financial statements may still give a true and fair view of the size and composition of the assets and the result. However, in the case of an 'inadequate' audit, at the time of issuing their audit opinion the statutory auditor had not obtained sufficient appropriate audit evidence to substantiate their opinion regarding 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 to users 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.

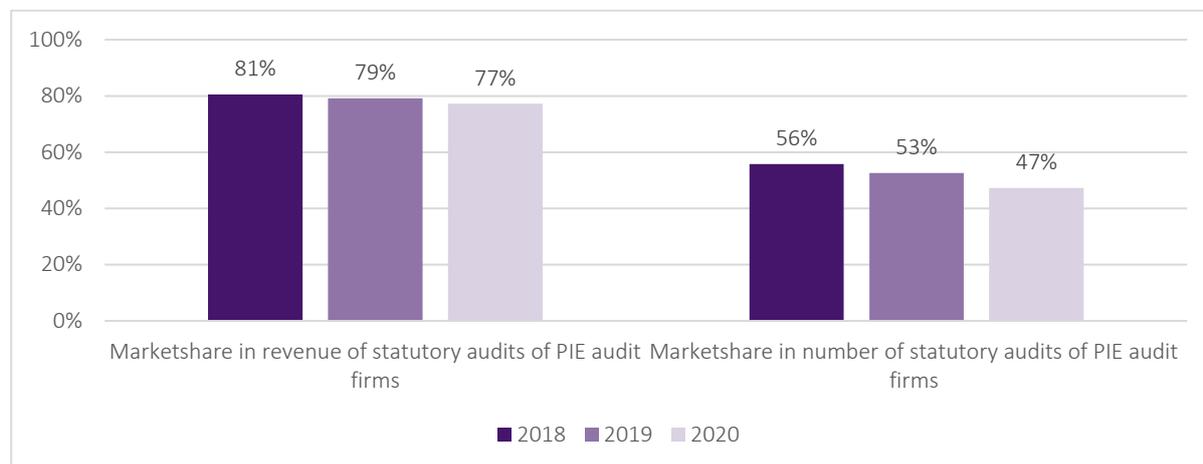
The audit firm and the statutory auditor must⁵¹ remedy the deficiencies and obtain sufficient and appropriate audit evidence to show that the financial statements are free of material misstatements. If the audit firm conducts adequate remediation procedures, it may be seen subsequently whether the audit opinion originally issued 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.

⁵¹ The requirements for remediation are stated in Sections 14(a) and 25(b) Wta.

Appendix 1 Market share and features of PIE audit firms

The market share of the six PIE audit firms in this review is 77% (€885 million in revenue from statutory audits) of the total market of the revenue from statutory audits in the Netherlands. Of the total market of the number of statutory audits in the Netherlands, these firms have a market share of 47% (9,194 statutory audits).

Figure 1 Market share of PIE audit firms⁵²



Each PIE audit firm has its own business culture, its own quality control system and all of them belong to an international network. Each audit firm therefore has its own particular structure, also with respect to the improvement of the quality of statutory audits. There are however also statutory regulations that set additional requirements with respect to the structure of their organisation. Compared to firms with a normal Wta licence, they must meet additional requirements in relation to governance (the appointment of a supervisory board), the suitability of executive and supervisory directors and independence. For the system of quality control, several 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.

⁵² Based on the information of the six PIE audit firms provided in the Audit Firms Monitor 2018 up till 2020.

Appendix 2 Suggested questions for SBs and audit committees

The following is a list of some suggested questions that SBs and audit committees can put to their statutory auditors and other representatives of the audit firms regarding the results of the IQR and certain areas of attention relevant to good quality execution of statutory audits, arising from the IQR and the AFM's review.⁵³ This can enhance the dialogue between the SBs and audit committees and their statutory auditors.



Monitoring the statutory audit and its quality

- How has the auditor responded to the published general findings by the supervisor?
- Was the statutory auditor or the statutory audit selected for the IQR? If so, how did the auditor respond to the engagement-specific findings by the supervisor and in the IQR?
- What were the findings (if applicable) in the IQR? How did the statutory auditor address the findings in the IQR?
- Which items in the financial statements or other issues were involved in the remediation (if applicable)?
- To what extent will (or may) the results of the IQR affect the audit approach for the next financial year?



Audit of estimates

- Did the statutory auditor identify deficiencies in their analysis of significant management estimates? If so, how was the effect of these deficiencies evaluated?
- How did the statutory auditor evaluate potential tendencies of management with regard to complex estimates? Were potential indicators identified and how were these addressed?
- What were the critical aspects in the estimation uncertainties in the items involving estimation, and to what extent were these discussed with management? What were the results of these discussions?
- How did the statutory auditor evaluate the procedures carried out by an expert (if applicable)? What (additional) audit procedures did the statutory auditor perform on the procedures carried out by the expert?

⁵³ See also: <https://www.afm.nl/nl-nl/professionals/doelgroepen/effectenuitgevende-ondernemingen/auditcommissies> and the newsletter of 17 December 2020 <https://www.afm.nl/nl-nl/nieuws/2020/december/aandachtspunten-accountants-corona>



Use of technology in the audit

- Did the statutory auditor use automated tools and techniques to improve the quality of the audit evidence obtained? If so, how did this affect the audit approach and the audit evidence obtained?
- Did the statutory auditor's use of technology in the audit keep pace with audits of similar companies in the same sector? If not, what was the reason for this?
- Did the statutory auditor experience limitations (such as older information systems, lack of availability of the required data) with respect to using technology in the audit?



Remote execution of an audit

- Which elements of the upcoming audit does the statutory auditor expect to perform remotely, and what is the reason for remote execution of these elements?
- How is the audit firm addressing the risks to quality specifically relating to remote execution of an audit?
- To what extent has the statutory auditor made changes to their risk analysis due to remote execution of the audit? Which additional audit procedures address this?
- How does the statutory auditor deal with audits of financial statement line items or financial statements when physical presence is not possible but is desirable (such as stock-taking and the testing of general IT controls)?



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