

To the Members of the Board of the
Netherlands Authority for the Financial Markets
P.O. Box 11723
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Datum
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Behandeld door
L. Albers /
M.J. van der Vegte

Ons kenmerk
4050/AA/gdr

Onderwerp
Public response to the results of the inspection on the change process and the
quality of statutory audits

Dear Members of the Board,

This letter contains the requested public response to the results of the Netherlands Authority for the Financial Markets (AFM) inspection on the implementation and safeguarding of the Audit Quality Transformation process (hereinafter "change process"), the quality of individual statutory audits at Deloitte Accountants B.V. (hereinafter "Deloitte") and the correlation between these results. We appreciate the opportunity, and hereby provide you with our consent, to include this response in the generic report (hereinafter "report"), which is to be published on 28 June 2017. The structure of our response is as follows: (i) the results, followed by (ii) our reflection, and concluding with (iii) how we intend to continue our journey.

1. Results

The AFM is positive on the progress and safeguarding of our change process

We concur with the results in the report Dashboard 2016¹ in the areas "Control", "Behaviour and Culture", and "Internal Oversight", whereas we recognise the good practices and agree with the areas that can be further improved. The AFM's positive general picture of the progress of implementing and safeguarding the change process at Deloitte (Table 1), provides confirmation of the course we have set in recent years.

The overall picture aligns with the results of our own periodic evaluation of our quality control system, the ongoing impact analyses in respect of our quality agenda initiatives, our causal factor analyses and the Tone-at-the-Top surveys we have been performing each quarter since 2014, all of which we use as input for our continuous improvement cycle. Realising an effective programme for sustainable change takes time and

¹ Final report Dashboard 2016 - Investigation: Implementing and safeguarding the change process Deloitte Accountants B.V., reference no. KaRm-17051606

a lot of efforts. Implementing such a comprehensive change programme takes time and requires significant effort.

The support for and the active commitment to the change agenda can be seen in all layers of our organisation. It is rooted in the joint mindset on quality.

Table 1 – AFM Dashboard 2016 General overview qualifications pillars and general picture

Overall results: POSITIVE									
Control <i>The Board actively drives the quality agenda and monitors its effects</i>			Behaviour and Culture <i>The Board is not yet using the dialog with partners and professionals to full effect</i>				Internal Oversight <i>The Oversight Committee is critical towards the Exec Board and the Organization</i>		
In control	Causal factor analyses	Culture survey	Long term vision	Culture focused on Quality	Tone at the top	Performance evaluation and promotions professionals	Performance evaluation and promotions partners	Progress in enhancing governance structure	Effective working Supervisory Board
Close to meeting expectations	Close to meeting expectations	Behind on expectations	Close to meeting expectations	Close to meeting expectations	Close to meeting expectations	Meeting expectations	Meeting expectations	Meeting expectations	Close to meeting expectations

AFM confirms that the majority of statutory audit engagements are meeting the standards

We concur with the overall conclusion that the majority of our statutory audits are adequate (Table 2). This result is in line with our own expectations and the demonstrably upward trend we have observed in the results of our own Practice Reviews over the past three years.

Our Practice Review focuses on extensive inspection of all individual external auditors once audit engagements have been completed. Through increasing the robustness of this process we have substantially raised the bar since 2013. The AFM recognises these efforts as a leading practice and confirms: “the bar has been raised quite considerably”. It has been a major game changer for us. All of our external auditors² have been inspected internally (multiple times) in recent years.

Table 2 – Results of examined statutory audits Deloitte

	PIE	Large non-PIE	Other non-PIE	(Semi-) public	Total
Number of “adequate audits”	3	1	1	-	5
Number of “inadequate audits”*	-	-	1	2	3
Total examined audits	3	1	2	2	8

² External auditor as referred to in the Audit Firms (Supervision) Act article 1f “the natural person who is employed by or is associated with an audit firm or audit office and who is responsible for performing a statutory audit”.

** Two of the three statutory audits that the AFM considers to be "inadequate" regard audits related to the 2014 financial year; the third "inadequate" statutory audit relates to the 2015 financial year.*

2. Our reflection

Positive result on all inspected audits of Public Interest Entities

Both the AFM and the Public Company Accounting Oversight Board (PCAOB) consider *all* inspected audits of Public Interest Entities (PIE) to be adequate (Table 2). The inspected audits of large non-PIEs are adequate, too. We consider this result to be an acknowledgement of the major effort our professionals have put into the strong focus on our responsibility towards society and the public interest.

Narrowing nature and severity of inspection findings

The audits where improvements should still be made particularly regard audits of relatively smaller companies and audits in the (semi-)public sector. The conclusion after completing the remediation procedures performed in respect of those files is that the auditor's report issued earlier on can be maintained. The evaluation of inspection results shows that the nature and severity of inspection findings are narrowing compared with the inspection performed by the AFM in 2011/2012. Given the nature and detailed level of the findings, a significant step has clearly been made forward. We have been involved in a constructive dialogue with the AFM on how to weigh findings. This dialogue will be continued in the coming period. Additional and considerable measures and safeguards have been implemented since 2015, involving the acceptance and effective performance of audits of smaller companies and of (semi-)public sector entities.

Success factors for a good audit quality

Causal factor analyses teach us that success factors for a good audit quality are a combination of the right mindset, adequate project management and the stability and commitment of the audit team, with sufficient use of experts. Other factors include the level of professionalism at clients, the extent in which companies are in control and whether they have adequate systems of internal control. Sustainably changing behaviour across the full breadth of our organisation takes time and our professionals have been under great pressure over the past years. Not only because of the change process and all initiatives aimed at improving audit quality, but also due to the considerable extra effort ensuing from mandatory audit firm rotation and transition of PIEs. This is why we have taken various measures to mitigate our workload and why we were forced to make specific choices in our client portfolios in recent years. We greatly appreciate the efforts of our professionals throughout this period.

Our quality agenda focuses on creating the required conditions to ensure audit quality. In this respect we identify a clear link between results of the AFM inspection on audit quality transformation and the quality of statutory audits.

Furthermore, we follow up on individual internal and external inspection results through (i) causal factor analyses (focusing both on aspects of good quality and improvement areas), (ii) remediation of the findings identified for the assessment as to whether the issued auditor's report can be maintained, (iii) preparing personal enhancement plans and (iv) incorporating all of this in the assessment and remuneration of the external auditor involved.

Integral change agenda focused on the public interest

Our role of acting in the public interest is integrated in our global purpose: to make an impact that matters. Every day, Deloitte and its staff are fully committed to making a relevant and meaningful impact on society. This refresh of our purpose has led to reflecting on the what, how and why of our social role and quality is intrinsically linked to everything we do. Our professionals are distinctly aware of the essence of high quality.

The mindset of all our professionals reflects on the public interest and its positive development can be seen in the attention our professionals have for socially relevant topics. This includes fraud and corruption risks, a substantial increase in notifications by Deloitte of unusual transactions and our focus on the quality of engagements involving uncertainty about the related audit client's going concern.

This goes to the heart of our change process that started with addressing the attitude and behaviour of our professionals. We see a clear link with the AFM's positive opinion on the progress and safeguarding of the complete change process at Deloitte. Reflection has resulted in concrete and specific investments in quality and sharp choices in, amongst other things, the number and type of audits in our portfolio - both in terms of the risk involved but also in terms of managing the workload. The latter issue drew the attention of the media to the audits of municipalities.

The clear change initiated in 2013 - especially at a cultural level - takes *time* and requires *consistency*. It is precisely this approach that now yields results.

Next phase in the process: continuing to build on the adaptive change

Right from the start, Deloitte's change agenda has featured both a top-down and a bottom-up element. Its bearers of change focus both on structural and regulatory aspects (technocratic) but specifically on cultural aspects, too, including attitude and behaviour (adaptive).

- *Top-down*: in areas with an immediate need for creating a sense of urgency and change - this includes the sharp choices Deloitte makes in whether or not to accept an engagement, managing the workload, tightening the quality standards and enforcing them. The AFM, too, acknowledges its usefulness and impact.

Our endeavour to create a quality-focused culture has meant we put great emphasis on attitude and behaviour. The measures we have taken include positive rewards for good audit quality, proactively involving the younger generation through a "Young Professional Audit Quality Board", working with

exemplary behaviour and role models. Another important factor is to include attitude and behaviour in assessments, promotions and remuneration.

- *Bottom-up:* rooted in the strong conviction that this, ultimately, will be the process that leads to support and commitment, and long-term cultural and behavioural change. This includes assigning all individuals the responsibility of ownership as regards to their quality enhancement, being allowed to make mistakes in this process and learning from them, and giving them room to develop their own initiatives.

The support for and the active commitment to the change agenda within our organisation shows an upward trend; both in terms of actual measurements (such as Tone-at-the-Top surveys) and behaviour that can be monitored. This involves the many initiatives developed by the external auditors within the various (sector) groups. Other fields where concrete desired behaviour can be observed include the results of causal analyses, impact reviews and dialog sessions, and our audit quality indicators - such as the level of commitment by the external auditor and the number of consultations.

3. Finally

Results confirm we are on the right course and we continue the journey

Contemplating on the activities and results as a whole, a selection of which we have explained in this public response, we have confidence in the journey we have embarked on, focusing on continuously enhancing the quality we deliver in our statutory audits. All the more so considering the AFM inspection results. Apart from the positive conclusion on our change process, the AFM considers the majority of the statutory audits it has assessed to be adequate. The positive opinion on all of the inspected audits of PIEs is part of this. It is equally in line with the positive assessment by the PCAOB, which did not include any findings on the three files selected.

We are fully aware of the hard work still required for our quality agenda. Following the results of the inspected files relating to the 2014 and 2015 financial years, the AFM wants us to tackle the change process with more urgency. We have taken up this challenge and will continue the journey. We will firmly pursue the enhancement of the audit quality, continuously focusing on how the expectations of society in relation to (the role of) the auditor will develop. Furthermore, we will set the bar high for our own ambitions. Supported by the Supervisory Board, our partners and staff, everyone at Deloitte is filled with positive energy to continue this journey with each other.

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Continuing on this journey is impossible without the input and feedback of our stakeholders, amongst which is the AFM. We therefore highly appreciate the critical mirror they hold up to us and we are pleased to be involved in the constructive dialog on this.

Kind regards,

Deloitte Accountants B.V.

P.J. Bommel

Chairman of the Executive Board

E. Robbe

Chief Quality Officer

L. Albers

Function Leader Audit

M.J. van der Vegte

Senior Audit Partner