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Dutch Authority for the Financial Markets
The Board
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Our ref. EE

Amstelveen, 23 June 2017

Subject: Your report 'Quality of PIE audit firms inspected'

Dear Board,

We appreciate the opportunity to respond to your public report 'Quality of PIE audit firms inspected' dated 28 June 2017. In this letter, we provide our overall reflection on the coherence and outcomes of the inspections of the implementation and embedding of change at KPMG and of the quality of statutory audits.

This response has the support of KPMG's Supervisory Board.

Results

AFM reached a positive conclusion regarding the implementation progress and embedding of change at KPMG in 2016. The results of AFM's quality inspection of statutory audits regarding financial years 2014 and 2015 were deemed unsatisfactory. KPMG acknowledges the outcomes of both AFM inspections.

Below you will find our reflection on these inspections.

Coherence

KPMG believes quality to be the bedrock of the auditor's work. We do our utmost to translate and embed this into our daily working practices. These efforts are inextricably linked to the behaviour of the professional. This behaviour is influenced by a number of factors, including organisational governance and a quality-oriented culture, focused on effective application of improvement measures. The coherence between the improvement process and the quality of statutory audits is therefore clear to us. However, embedding this in practice will take time.

KPMG has come from a starting position that was relatively behind and we have initiated a fundamental improvement process ourselves in 2014. This was also necessary following the unsatisfactory results of quality inspections of statutory audits regarding financial year 2012. With the True Blue programme, KPMG was ahead of the NBA's report "In the public interest", which included 53 improvement measures to initiate drastic changes in areas such as governance, partner structure and partner culture, quality and a quality-oriented culture.



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Embedding fundamental changes in culture and behaviour and translating numerous improvement measures into daily working practices takes time. Positive changes thereto are already visible, but conditioning those changes requires significant and ongoing efforts. It is too early to expect the ultimate impact of all measures taken in 2014 to be entirely visible in the quality of statutory audits for 2014 and 2015.

Results inspection statutory audits

AFM's observations and findings regarding the statutory audits inspected for 2014 and 2015 are generally factually correct. In a number of audit files, these could have been weighed differently in the overall judgement. We believe it is important to note that our analyses and our immediate remedial actions indicated that there was no need to adjust the financial statements in question, nor our audit reports thereon.

Our root cause analyses revealed that certain audit files failed to meet all requirements resulting from a number of different (both in nature and weight) reasons and contextual factors. We have a clear picture of those factors and they are being addressed accordingly.

Dilemmas

We have identified the following specific dilemmas in the realisation of the required changes and improvements.

Learning or sanctioning

With its duty of care in mind, KPMG has introduced a robust system of quality controls. Based on people surveys, a culture survey and informal office sessions, we have learned that KPMG's audit professionals do their utmost to execute engagements within the boundaries of the system of quality controls. At the same time, any engagement involves a complex interaction among applying the requirements of the system of quality controls, professional judgement of individuals and external factors.

The auditor often does not have direct influence on these external factors, but they inevitably have impact on audit quality. These include the impact of mandatory audit firm rotation requiring tremendous effort in the start-up phase at individual engagement level.

In that complexity, it is possible to make mistakes with varying orders of magnitude. The ability to learn from mistakes is an important source of quality improvement at KPMG. The professional should not experience barriers against sharing mistakes or near misses but should be able to learn from mistakes. A consequence (sanction) that is perceived as balanced by the professional who made that mistake, is an important part of this process.

Professional judgement or standardisation

In recent years, we have introduced a number of additional rules and audit requirements to increase the consistent application of our audit methodology. This standardisation is increasingly perceived as a limitation of professional judgement. Professional judgement and the possibility to apply that judgement in different situations is an important pillar of the audit profession.



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Although there may be no conflict as such, (too many) rules can distract from properly applying that professional judgement. We are striving to strike a good balance of rules and behaviour to safeguard that engagements are performed within the boundaries of the system of quality controls, in a way that offers appropriate room for applying professional judgement.

Actions

Improving quality and the related change in culture is our highest priority. We have achieved a lot over the past three years, but we are well aware that we are not there yet. We continue to give highest priority to working on continued improvement and change on the basis of the following themes. Underlying these themes is a solid programme aimed at improving various quality aspects.

Culture and behaviour

- Strengthening a learning organisation as a source for improving quality;
- Follow-up actions in response to culture surveys;
- Continued strengthening mental resilience and versatility of audit professionals;
- Supporting explicit behaviour through implementing the next phase of the KPMG Story.

Quality Time

We are currently conducting a separate root cause analysis into the subject of 'time'. This analysis aims to strengthen the environment in which professionals – both individually and in teams – use their time effectively. And in such a way that the audit is conducted both intrinsically good and meeting quality standards. We will achieve this (and partially already have) by improved retention of experienced professionals, more detailed definition of expected behaviour from professionals, an improved planning process and organisation of our work and better agreements with our clients.

Technical basis

We continue to invest in strengthening the technical basis and a deep understanding and knowledge of the audit methodology. We focus primarily on precision in approach and depth of our audits and consistency in the performance and documentation thereof.

Digital assurance

We invest heavily in technology and digital methods and techniques (digital assurance) to improve quality both structurally and sustainably. With support of these tools, some of which have been made available by our international network, we will ensure that in the near future performing audits will be considerably different from the way these were done in 2014. The end result will be: effective, high-quality audits; efficiency in low-risk areas of audits; an innovative experience for our professionals and better insights for (stakeholders of) our clients.



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We thank AFM for a constructive cooperation during the inspections. KPMG is in the next phase of its change process. We are confident that the high quality we aim for will be reflected in the separate audit engagement files.

Yours sincerely,

A.A. Röell
Chairman of the Board of Management

E. Eeftink
Head of Audit