Report on audit committees

Review of the critical ability of audit committees with respect to financial reporting and audits

March 2015

The Netherlands Authority for the Financial Markets

The AFM promotes fairness and transparency within financial markets. We are the independent supervisory authority for the savings, lending, investment and insurance markets. We promote the fair and conscientious provision of financial services to consumers and private investors, as well as professional and semi-professional parties. We supervise the fair and efficient operation of the capital markets. Our aim is to improve consumers' and companies' confidence in the financial markets, both in the Netherlands and abroad. In performing this task, the AFM contributes to the stability of the financial system, the economy and the reputation and prosperity of the Netherlands.

Disclaimer

This is an English translation of the original Dutch text, furnished for convenience only. In case of any conflict between this translation and the original text, the latter shall prevail.

Contents

1 Foreword 4
2 Summary 7
3 Observations and items of attention 10
3.1 Introduction 10
3.2 Awareness of the consequences of the absence of an internal auditor 10
3.3 The role of audit committees in the selection of an auditor 11
3.4 More attention from the audit committee for internal quality reviews by the audit firm and AFM reviews of the quality of audits 12
3.5 More attention needed with respect to expertise in the audit committee that is appropriate to the complexity of the company 14
3.6 Considerations of supervisory directors when accepting supervisory directorships 15
4 Review findings 17
4.1 Introduction 17
4.2 The duties and expectations of the audit committee regarding reporting and the audit 17
4.3 The selection of the auditor 22
4.4 The way in which the audit committee evaluates the quality of the audit 25
4.5 The level of expertise of audit committees with regard to internal control, reporting and auditing 26
4.6 The motivations and positioning of the supervisory director in the audit committee 33
5 Design of the review 36
5.1 Scope of the review 36
5.2 Approach 38
6 Legislation and regulation 40
6.1 The current legislative framework 40
6.2 Current developments in legislation and regulation 41

1 Foreword

We hereby present the report of an exploratory review conducted by the Authority for the Financial Markets (AFM) in the period from May to December 2014 among supervisory directors on audit committees[1] of 96 Dutch listed companies. 60 supervisory directors completed the questionnaire. We also held interviews with 15 supervisory directors. We were pleased with the positive response. The AFM wishes to express its appreciation to all the supervisory directors who participated in the review.

The AFM's supervision is risk- and problem-driven, and it organises its supervisory projects on the basis of various overall themes. This review was conducted as part of the AFM's theme 'The quality of governance, reporting and auditing is increasing'. This is a prominent theme in the AFM's agenda in 2014 and 2015, as part of the AFM's duty with respect to investor protection. The way in which audit committees fulfil their role regarding reporting and auditing was the central issue in this specific review. While audit committees are not subject to direct supervision by the AFM, they do have our particular attention because of the ever-increasing importance attached by capital providers to the proper functioning of audit committees in the internal governance of companies. Incidents show that there is still ample room for improvement in the internal governance of companies. With this exploratory review, we have attempted to establish how audit committees contribute (or could contribute) to this improvement within the existing governance structure and in practice. The AFM wished to obtain specific insight into the extent to which audit committees take a critical view (critical ability) with respect to reporting and auditing.

The duties and requirements of audit committees in this respect are established by law and in the Dutch Corporate Governance Code. New European regulation that will take effect in the Netherlands in mid-2016 will further strengthen their role, as specific principles in the Dutch Corporate Governance Code will be established in legislation. The statutory provisions are intended to contribute to an adequate system of checks and balances between the shareholders, the external auditor, the supervisory board and the executive board. The AFM welcomes these provisions and is aware of the important role of audit committees (and thereby supervisory boards) in this system of checks and balances**.**

[1] References in this report to 'supervisory directors' refer to the supervisory director in his or her capacity as chair or member of the audit committee or as financial expert as referred to the Dutch Corporate Governance Code.

Audit committees are a focus area for supervisory authorities all over the world, not only in the Netherlands. The US supervisory authority for auditors, the Public Company Accounting Oversight Board (PCAOB) considers audit committees as an important driver of audit quality[2]. In the United Kingdom, the Financial Reporting Council (FRC) provides confidential reports on individual audits it has reviewed to the audit firms concerned. Copies of these reports are provided to the chair of the audit committee of the company concerned[3]. The cooperating financial markets supervisors, associated in the International Organisation of Security Commissions (IOSCO) and the International Forum of Independent Audit Regulators (IFIAR) have also indicated their intention to focus on audit committees. The AFM has been given the opportunity by both these organisations to take a leading role in this area.

Under the new European Audit Regulation (see also section 6), supervisors such as the AFM will monitor the functioning of audit committees. This monitoring will not mean that audit committees will be subject to the supervision of the AFM as a result of the Regulation taking effect. With this report, the AFM provides an overview of existing practice with respect to the functioning of audit committees in anticipation of this monitoring duty. We wish to stress that the findings of this review reflect the opinions of the supervisory directors who were surveyed and interviewed. A factual representation of these opinions is accordingly presented in section 4 of this report. Due to the methods used, one cannot exclude the possibility that there may be cases in future in which the critical ability differs from the representation of opinions used here. Indeed, in practice, the impression that people and organisations, and therefore also audit committees and their members, have of their own performance and critical abilities generally tends more towards the overly positive than the overly negative.

The findings of the exploratory review in any case clearly show that supervisory directors on audit committees are aware of the importance of their role and that they themselves consider that they are well able to fulfil this role with an adequate degree of criticism. Supervisory directors also recognise that they have to meet increasingly higher expectations. The AFM has formulated certain observations and items of attention on the basis of the review findings which are presented in section 3. These could strengthen the role of the audit committee (and thereby of the supervisory board) in the system of checks and balances between shareholders, the auditor and the executive board.

[2] See for example the speech of PCAOB chairman James Doty on 2 May 2014 in Chicago http://pcaobus.org/News/Speech/Pages/05022014_Doty.aspx
[3] https://www.frc.org.uk/Our-Work/Conduct/Audit-Quality-Review.aspx

The AFM hopes that this exploratory review will make a further contribution to a more in-depth dialogue with audit committees. The AFM also hopes that this review will contribute to wider awareness of the role and duties of members of audit committees in the light of the further requirements recently imposed by law and the increased expectations with regard to audit committees. If audit committees exercise their duties with a critical attitude, we expect this to lead to an improvement in the financial reporting of companies and the quality of independent audits.

Ultimately, the AFM's goal is that investors and other stakeholders can justifiably rely on the financial and non-financial information in annual and other reporting and on a well substantiated, professionally critical and independent opinion from the auditor in the auditor's statement.

Gerben Everts

Member of the Executive Board AFM

2 Summary

In the period from May to December 2014, the AFM carried out a review among supervisory directors of Dutch listed companies. The AFM sent a questionnaire to members and chairs of audit committees of 96 companies, and subsequently held interviews with 15 supervisory directors. We received 60 completed questionnaires, representing a response of 62 per cent. In its selection of supervisory directors for the interviews, the AFM took account of a balanced distribution between companies listed on the AEX, AMX and ASCX indices and local stocks. The findings of the review represent, based on the design of the review, the views of the supervisory directors who were surveyed and interviewed. The supervisory directors interviewed have been informed of the review findings.

The results relate to the following five aspects of the review:

1. The duties and expectations of the audit committee regarding the audit and reporting;
2. The selection of the auditor;
3. The way in which the audit committee evaluates the quality of the audit;
4. The level of expertise of audit committees with regard to internal control, reporting and auditing;
5. The motivations and positioning of the supervisory director in the audit committee.

Observations

The main observations based on the review results are listed below (for a more detailed account, see section 3). Based on these observations, the AFM wishes to draw attention to five specific points based on the principle that these could strengthen the role of the audit committee (and thereby the supervisory board) in the system of checks and balances between shareholders, the auditor and the executive board.

1. *Awareness of the consequences of the absence of an internal auditor*

The review shows that supervisory directors consider internal control to be pre-eminently a task for the audit committee – a task to which supervisory directors devote much time and attention. Supervisory directors highly appreciate the internal auditor, because his activities with respect to internal control have a wider scope than those of the external auditor. The AFM wishes to stress that in their annual evaluation of the need to appoint an internal auditor, audit committees should be properly aware of the risks associated with not having an internal auditor and the additional responsibility that this places on the supervisory directors for monitoring and supervising the company's internal risk and control systems.

2. *The role of audit committees in the selection of an auditor*

The questionnaires and interviews show that generally, a member of the audit committee or the supervisory board leads the committee charged with the selection of a new auditor (79 per cent). This model is in accordance with the principles of the Dutch Corporate Governance Code and is a primary basis for companies. A number of supervisory directors stated in the interviews that the CFO also plays or should play a role in the selection process and that this process often includes consultation with the CEO. The AFM understands this, but it has the impression that in practice the influence of the company and in particular the CFO regularly extends beyond simply organising and advising on the selection process. This conflicts with the increasingly generally held view that a situation in which the audited entity actually appoints its own auditor is not appropriate in a properly functioning governance structure. Indeed, European legislation will increase the role of the audit committee in the selection of the auditor.

3. *More attention by the audit committee to internal quality reviews by the audit firm and AFM reviews of the quality of audits*

The review shows that supervisory directors are generally satisfied with their external auditors. It also emerges that the audit committee in almost all cases evaluates the performance of the auditor at least once a year. They usually use their own experiences and information from the company's executive board for this purpose. One cannot exclude the possibility that this information may be incomplete or subjective to some extent. Useful external sources are not always used. Supervisory directors have limited awareness of the findings of the internal quality reviews carried out by the audit firm on audit files or with the findings of reviews by the AFM or other supervisors. The AFM calls on supervisory directors to make use of these sources of information.

The AFM notes that it has been reporting on the findings of its reviews of the quality of audits for each audit firm since 2014. This can provide audit committees with generic information on the quality of individual PIE audit firms. The Minister of Finance also proposes to give the AFM the authority to share its specific findings from its supervision of auditors with respect to individual audits directly with the audit client, or its supervisory board.

4. *More attention needed with respect to expertise in the audit committee that is appropriate to the complexity of the company*

In connection with the increasing complexity of reporting, internal control and the audit, it is important that the supervisory directors themselves possess appropriate expertise. Some supervisory directors stated in the interviews that a supervisory director should preferably have a background as a controller or CFO. The Dutch Corporate Governance Code requires that the audit committee includes a financial expert. Further formulation of principles with respect to the financial expert and expertise in IT in the Dutch Corporate Governance Code could be desirable.

5. *Considerations of supervisory directors when accepting supervisory directorships*

The review shows that supervisory directors take a critical view with respect to accepting supervisory directorships, for example with regard to their confidence in the company's executive board or its internal controls. This may limit the ability of companies that are less in control to attract good supervisory directors, while these are the companies that need good supervisory directors the most.

3 Observations and items of attention

3.1 Introduction

This section presents our principal observations on the basis of the review results. Based on these observations, we have formulated a number of items of attention based on the idea that these could strengthen the role of the audit committee (and thereby the supervisory board) in the system of checks and balances between shareholders, the auditor and the executive board.

The AFM expects audit committees to be able to positively influence the quality of reporting and the audit. For this however, it is necessary that the supervisory directors in an audit committee fulfil their duties with critical ability and due regard at all times. It is important that the audit committee takes a critical position with respect to both the executive board and the auditor, and gives account to the shareholders. Appropriate expertise in the area of internal control, reporting and auditing is needed for this. If necessary, the audit committee must stand up to the executive board and the auditor to play its role fully.

Strong internal supervision can contribute to good reporting and auditing. Critical supervision by audit committees of the company’s executive board with respect to the reporting and the audit is therefore an important indicator for the AFM in its risk- and problem-driven approach to its external supervision. Ultimately, audit committees and the AFM therefore have a common interest in bringing the quality of reporting and auditing to a high level and ensuring that this level is maintained.

3.2 Awareness of the consequences of the absence of an internal auditor

Observations

The supervisory directors show a good understanding of their role with respect to the audit and the reporting. They consider that they fulfil this role with a sufficiently critical attitude. The supervisory directors moreover consider that supervision of the company’s internal risk management and control systems and understanding the procedures carried out by an internal auditor in this respect are an important part of their duties. In the interviews, the supervisory directors indicated that they consider the procedures carried out by the company’s internal auditor to be highly valuable. They also stated that they were aware that the external auditor, unlike the internal auditor, does not focus on all the company's internal risk management and control systems.

Items of attention

According to the Dutch Corporate Governance Code, the audit committee has an important role with regard to the internal auditor**.** Provision V.3.3 of the Code states that in the absence of an internal auditor, the audit committee must assess annually whether an internal auditor is needed and issue a recommendation to the executive board.

The passage in the Dutch Corporate Governance Code regarding the recommendation made by the audit committee with respect to the internal auditor may be included in the review of the Code that has been announced by the Monitoring Committee. In the AFM's view, the question of whether an internal auditor is needed is a matter for the supervisory board; simply making a recommendation to the body that itself is subject to the internal audit is not in the spirit of tighter legislation regarding the fulfilment of the role and duties of audit committees.

The AFM wishes to stress that in their annual evaluation of the need to appoint an internal auditor, audit committees should be properly aware of the risks associated with not having an internal auditor and the additional responsibility that this places on the supervisory directors for monitoring and supervising the company's internal risk and control systems.

3.3 The role of audit committees in the selection of an auditor

Observations

The review shows that 83 per cent of the supervisory directors agree or generally agree with the view that the auditor should be appointed based on the nomination of the audit committee. In the selection process, they consider the composition of the team, the experience of the audit firm and the auditor with ultimate responsibility in the sector, and also the way in which the auditor communicates, to be the most important criteria. Price, according to their statements, is a lesser consideration.

The questionnaire shows that the audit committee is usually leading in the selection of the auditor, to be precise in 79 per cent of the companies where a selection was recently made (45 of the 57 companies concerned). In total, the CEO or CFO was the chair of the selection committee at 12.5 per cent of the companies. This was more frequently the case at companies in the AMX (15 per cent), ASCX (23 per cent) and local stocks (17 per cent) than at the AEX companies (2 per cent). Some supervisory directors stated in the questionnaires that the CFO also plays or should play a role in the selection process and that this process often includes consultation with the CEO.

Items of attention

The AFM understands that the CFO plays a role, but it has the impression that in practice the influence of the company and in particular the CFO regularly extends beyond simply organising and advising on the selection process. This conflicts with the increasingly generally held view that a situation in which the audited entity actually appoints its own auditor is not appropriate in a properly functioning governance structure. The Amending Directive and the Audit Regulation that will take effect in the Netherlands in mid-2016 (see 6.2) among other things provide for greater responsibilities for audit committees with respect to statutory audits, including an explicit role for the audit committee in the selection and nomination of the auditor. There is an overlap between the new obligations pursuant to the new European legislation and the Dutch Corporate Governance Code, meaning that Dutch companies are already complying with some of the new requirements.

All audit committees will have to take a leading role in the selection of the auditor, both formally and in practice. This is a best practice that has already been widely introduced, but with the implementation of the Amending Directive and the Audit Regulation it will become a statutory obligation as well. Auditors and investors will be well advised in their determination of a company’s risk profile to consider the extent to which the audit committee actually does play a leading role in this process. In cases where in practice the selection process is significantly influenced by other parties, this should normally result in a more depth (lower materiality threshold, greater degree of critical attitude) external audit and a higher cost of capital.

3.4 More attention from the audit committee for internal quality reviews by the audit firm and AFM reviews of the quality of audits

Observations

The review shows that supervisory directors are generally satisfied with their external auditors. It also revealed that the audit committee almost always evaluates the performance of the auditor at least once a year. They usually use their own experiences and information from the company's executive board for this purpose.

Supervisory directors have limited awareness of the findings of the internal quality reviews carried out by the audit firm on audit files or with the findings of reviews by the AFM or other supervisors. The interviews reveal that supervisory directors do not have a good understanding of the background to the AFM's findings with respect to the audit. They mostly want to know whether the findings affect the opinion attached to the financial statements.

Items of attention

Since 2010, the AFM has on the basis of previous reviews called on audit firms and audit committees at audit clients to consult with each other regarding the findings of the reviews of the quality of statutory audits[4]. This is especially useful for supervisory boards (and audit committees) in their responsibility for managing the selection and evaluation of the auditor[5] and for ensuring the independence of the external auditor by approving the provision of other services.[6] The appeal from the AFM had the effect that the Big 4 report from 2014, which includes the most recent status of quality assessment of auditors, is an agenda item for more than half of the audit committees.

The scope of the review conducted by the AFM focused on the question of whether the auditor had obtained sufficient and appropriate audit evidence to substantiate his opinion. In the context of its supervision, the AFM does not make any analysis of the reliability of the audited financial statements. It is for the external auditor to check the consequences of the qualification of a statutory audit as 'inadequate' by the AFM for the audit opinion that he issued and to discuss specific files and enter into a general dialogue with the audit committees.[7]

As a result of the mandatory rotation of audit firm as of 1 January 2016, the AFM expects that audit committees will also need this information in addition to other sources to evaluate quality and include this in their considerations before appointing a new auditor.

From the exploratory review, it becomes apparent that audit committees mainly use their own experience of their own role and information from the company. One cannot, however, exclude the

---

[4] See the report General findings regarding audit quality and quality monitoring of 1 September 2010 and the report on Quality of audit and the system of quality control and management at nine PIE licence holders (21 March 2013).
[5] The AFM emphasised this role in its report Results inspection quality of statutory audits Big 4 firms (25 September 2014).
[6] The AFM explicitly discussed this role of audit committees in the report Incentives for Audit Quality (2011). See also the report on Compliance with the transitional arrangement for segregation of audit and advice (27 March 2013).
[7] See also: report on the review of the quality of the Big 4 audit firms, p. 23.

possibility that this information may be incomplete or subjective to some extent. Useful external sources are not always used. The AFM calls on supervisory directors to make use of these sources of information.

Supervisory directors would be well advised to request audit firms to provide information on the findings of internal quality assessments regarding their (proposed) auditor and to use this information in the evaluation and selection of the auditor.

Together with the auditor, supervisory directors could investigate the significance of the reports from the AFM and other supervisors and include this in the evaluation of their auditor. The AFM notes that it has been reporting on the findings of its reviews of the quality of audits for individual audit firms since 2014. The Minister of Finance also proposes to give the AFM the authority to share its specific findings from its supervision of audit firms directly with the audit client, or its supervisory board.

3.5 More attention needed with respect to expertise in the audit committee that is appropriate to the complexity of the company

Observations

Both statutory provisions and the Dutch Corporate Governance Code require that audit committees include a financial expert. Having appropriate expertise within the audit committee is opportune, given the complexity of reporting, internal control and auditing. The review shows that supervisory directors believe that this expertise is present. Contacts with the auditor and the audit firm are an important source of information (68 per cent), as are experience gained by supervisory directors elsewhere (70 per cent). The required expertise was discussed with a number of supervisory directors. In the interviews, various supervisory directors mentioned the importance of having a background as a CFO or qualified accountant for their functioning as a member of the audit committee. Our analysis of the composition of the supervisory boards of ASCX companies, however, shows that many supervisory directors do not have a background in internal controls, reporting and auditing.

The Dutch Corporate Governance Code also specifies IT as a separate field of responsibility for the audit committee. The interviews and the notes to the questionnaire show that many supervisory directors consider expertise in IT to be an important item of attention in the supervision of internal risk management and control systems. They also state that they are sometimes concerned as to whether sufficient specific expertise is represented in the audit committee.

Items of attention

In their supervision of reporting and auditing, supervisory directors ought to be able to build on their own expertise, supported by independent external specialists if needed. Less expertise in the field of internal control, reporting and auditing could lead to a situation in which supervisory directors rely on the auditor for an independent professional opinion in these areas. The supervisory directors may, however, be expected to be able to interpret the rules and pose critical questions to the executive board based on the reporting submitted to them. A direct open and communication line with the auditor remains of great importance to supervisory directors.

The field of IT in particular requires more detailed attention, in relation to internal controls, because of the rapidly increasing digitalisation of virtually all relevant business processes.

In the composition of the audit committee, supervisory directors must therefore also consider the level of expertise that is appropriate to the complexity of the company. In view of the above, further formulation of principles with respect to the financial expert and expertise in IT in the Dutch Corporate Governance Code could be desirable.

3.6 Considerations of supervisory directors when accepting supervisory directorships

Observations

Becoming and acting as a supervisory director is a conscious decision. Making a carefully considered decision is very important for all parties involved. The interviews with supervisory directors also show that the supervisory directors themselves are also selective when accepting supervisory directorships. Matters that are considered include: confidence in the executive board, confidence in the company's internal risk management and control systems and the question of whether the supervisory directorship is appropriate to the their own expertise and experience.

Items of attention

The other side of this critical test by supervisory directors is that companies where there is less confidence in the executive board or the internal control environment may find it difficult to attract expert and critical supervisory directors. And these are the companies that need such people most. Aside from making proper agreements in advance, here too it is the case that a direct open communication and reporting line with the auditor can encourage the implementation of the internal improvements that are needed.

4 Review findings

4.1 Introduction

In this section we present the key review findings from the five aspects of our review. These findings come from the 60 completed questionnaires received and the interviews with 15 supervisory directors.

The supervisory board is charged with supervising the policy of the executive board and the general course of affairs at the company. More specifically, its supervisory function relates to the operation of the internal risk management and control systems, the company's provision of financial information and the relationship with the external auditor (hereinafter, simply 'the auditor'). These duties are usually delegated to the audit committee, a body formed from among the members of the supervisory board.[8]

The company's executive board bears responsibility for the internal risk management and control systems and the provision of financial information. The executive board must provide timely information to the supervisory board (or its audit committee) and the auditor and provide relevant information, so that the supervisory board is in a position to carry out internal supervision and the auditor is able to perform the audit. The auditor then reports his findings from the audit of the reporting to the audit committee. The audit committee in its turn plays an important role in the selection of the auditor and evaluates the latter's independence and remuneration, also in relation to the provision of permitted non-audit services to the company.

4.2 The duties and expectations of the audit committee regarding reporting and the audit

The AFM has identified the duties described in the Dutch Corporate Governance Code that audit committees consider to be the most important and how they perform these duties. The AFM intended to obtain insight into the expectations of supervisory directors with respect to the audit, the work of the auditor that they consider to be important and their expectations regarding

---

[8] Reference in this report to 'audit committee' means the audit committee, or, if the company has no audit committee, to the person or persons who supervise the company's executive board with respect to the operation of the internal risk management and control systems, the financial reporting process and the relationship with the auditor.

communication with the auditor. The AFM also identified the issues from the audit that supervisory directors discuss with the executive board.

Supervisory directors know what they may expect of the audit. Supervisory directors first of all expect the audit to provide information on the quality of the internal control of the reporting process (83 per cent), to provide an opinion regarding the reliability of the financial statements (82 per cent) and certainty with regard to the company's financial position (60 per cent). The full response to the question of what the audit committee expects from the audit is shown in table 1:

Table 1: What does the audit committee expect from the audit? (Respondents were asked to give the three most important answers)

Supervisory directors are involved in the approach to and the findings of the audit. Supervisory directors consider their most important duties with respect to the audit to be the discussion of the audit approach (62 per cent), the discussion of the auditor's findings (87 per cent), monitoring of the follow-up of the findings (53 per cent), and the selection of the auditor (45 per cent). The full response to the question of what are the most important tasks of the audit committee with respect to the audit is shown in table 2:

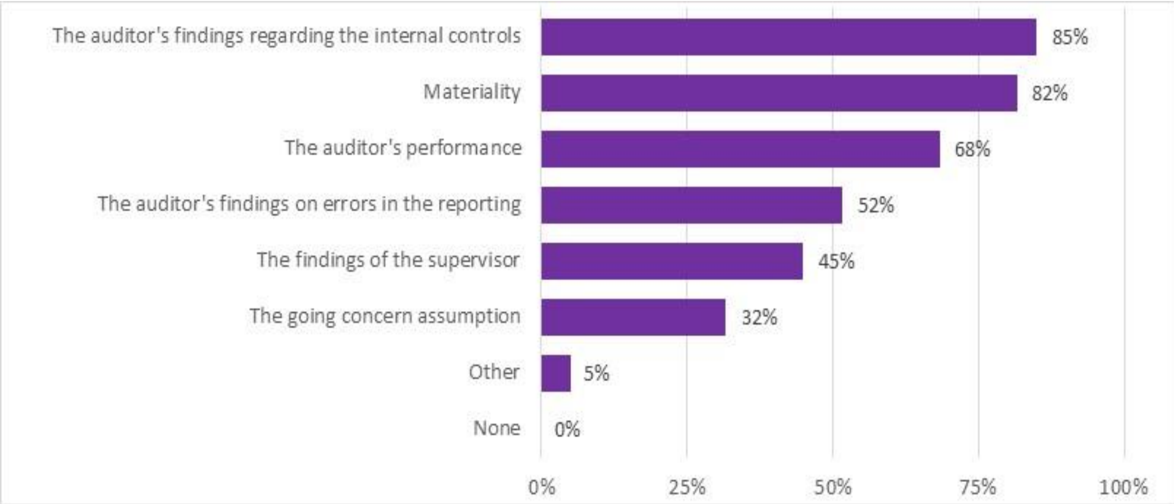
Table 2: What are the audit committee's most important tasks with respect to the audit? (Respondents were asked to list the three most important tasks)

The interviews show that supervisory directors are involved in the auditor's proposed approach to the audit ahead of the start of the audit. They assess whether the auditor identifies the material risks and how he deals with audits conducted outside the Netherlands. Supervisory directors also discuss the coordination of the auditor's own procedures and those of the internal auditor. Lastly, during and upon completion of the audit, supervisory directors discuss the auditor's findings and the follow-up of the auditor's recommendations by the executive board with the auditor.

Dialogue with the executive board. The items discussed by supervisory directors with their executive board in the past year include the auditor's findings with respect to the internal controls (85 per cent), materiality (82 per cent) and the auditor's performance (68 per cent).

The full response to the question on audit-related issues discussed by the audit committee with the executive board is given in table 3:

Table 3: What issues were discussed by the audit committee with the executive board last year with respect to the audit? (Multiple answers permitted)



Supervision of internal control is an important duty of the audit committee, as well as the procedures conducted by an internal auditor in this context. Supervisory directors consider their most important tasks to be supervision of the executive board regarding the operation of the internal risk management and control systems, the provision of financial information, and compliance with recommendations and follow-up of remarks by the internal and external auditors.

The full response to the question on the most important duties of the audit committee is given in table 4:

Table 4: What in your opinion are the most important duties of the audit committee in practice? (Respondents were asked to list the three most important duties)

The provision of financial information by the company (choice of accounting policies, application of and assessment of the effects of new regulations, information on the treatment of estimated items in the financial statements, forecasts, the related work of internal and external auditors, etc.)	90%
The operation of the internal risk management and control systems, including supervision of compliance with the relevant legislation and regulation and supervision of the operation of the codes of conduct	85%
Compliance with the recommendations and follow-up of comments made by internal and external auditors	45%
The role and operation of the internal audit function	23%
The financing of the company	22%
The relationship with the external auditor, including in particular his independence and remuneration and any non-audit work carried out for the company	17%
The operation and control of information and communication technology	12%
Company policy with regard to tax planning and fair contribution	3%
Other	3%

Both in the questionnaire and in the interviews, supervisory directors indicated that in addition to their three choices, there were also other important topics such as financing and tax planning and fair contribution.

This review focuses primarily on the interaction between the audit committee and the external auditor, and was less specifically concerned with the supervision of the executive board by the audit committee as regards a company's internal control or the performance of the internal auditor. However, many supervisory directors stated in the questionnaire that internal control was an important issue for the audit committee in addition to the reporting and the relationship with the auditor. From the interviews, it becomes clear that most supervisory directors place a high priority on having a good and independent internal auditor, because they consider it important that the company itself is in control. Supervisory directors think that an internal auditor is better positioned than the auditor to identify and test company-specific risks. The auditor usually only focuses on the internal control measures relating to the reporting process. The interviews show that good coordination between the internal auditor and the auditor is an important issue for audit committees. They see the auditor as an important and external party that can also express an opinion regarding the performance of the internal auditor.

Communication by the auditor is important. The interviews show that supervisory directors expect the auditor to be a strong sparring partner, with both the executive board and the audit committee. Most of the supervisory directors with whom the AFM spoke value formal and informal communication with respect to the auditor's findings. They expect both findings with respect to tangible issues and comments with respect to issues such as the 'tone at the top'. Supervisory directors consider it important that auditors tell the true story, and that they gain the impression that the auditor stands firm. The interviews show that supervisory directors also have one-on-one discussions with the auditor, and where possible with the internal auditor.

The supervisory directors were generally positive regarding communication with the auditor. The answers to the questionnaire show that nearly 100 per cent of supervisory directors agree with the statement that the executive board and the auditor should share dilemmas openly and in a timely manner. Over 80 per cent of the supervisory directors assessed the quality of the communication by the auditor as good or very good. The question of whether the auditor should also report directly to the audit committee without the intervention of the executive board or the CEO was not unambiguously answered. 52 per cent of the supervisory directors agreed to some extent or completely, and 38 per cent disagreed to some extent or completely.

The auditor's audit function is important. In both the interviews and the questionnaire, supervisory directors stated that they considered the auditor's audit function and opinion with respect to internal controls to be important. A number of supervisory directors specifically emphasised the importance of the auditor's audit function. They considered procedures that are not related to the audit of the financial statements to be of less value.

4.3 The selection of the auditor

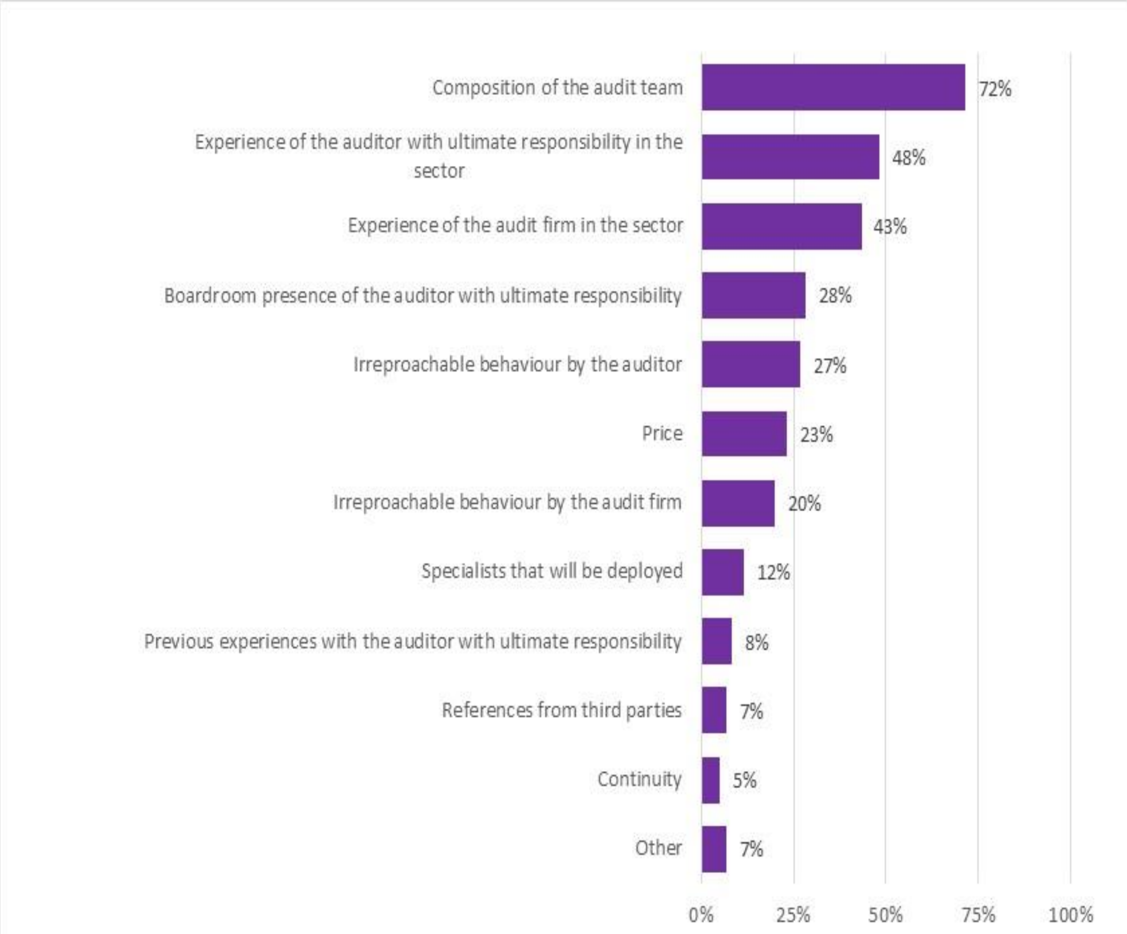
The AFM investigated the role of the audit committee in the selection of a new auditor. What do the supervisory directors look for when making their choice, and what are the deciding factors in their ultimate decision?

The chair of the selection committee for the appointment of the auditor is usually provided by the audit committee. The auditor is appointed at the annual general meeting (AGM) based on a nomination by the supervisory board. The audit committee and the executive board have an advisory role. The supervisory directors consider a proactive role of the audit committee (or the supervisory board) in the selection of the auditor to be an important part of their duties. The answers to the questionnaire show that a large majority of supervisory directors (83 per cent) agree fully or to a large extent with the statement that the auditor should be appointed based on the nomination of the audit committee. A supervisory director or a member of the audit committee was the chair of the selection committee at 79 per cent of companies which had recently selected a new auditor. In total, the CEO or CFO was the chair of the selection committee at 12.5 per cent of the companies. This was more frequently the case at companies in the AMX (15 per cent), ASCX (23 per cent) and local stocks (17 per cent) than at the AEX companies (2 per cent).

Composition of the audit team and experience are important criteria, price is less of a consideration. In the selection of the audit firm, supervisory directors consider the composition of the audit team (72 per cent), the experience of the audit firm in the sector (43 per cent) and the experience of the auditor with ultimate responsibility in the sector (48 per cent).

The full response to the question of what are the most important criteria for the audit committee with respect to the selection of the audit firm is shown in table 5:

Table 5: What are the most important criteria for the audit committee in the selection of the audit firm? (Respondents were asked to list the three most important criteria)



The interviews show that communication and the power of persuasion are important criteria for the selection of an auditor. Supervisory directors need to feel that an auditor has a strong personality who stands firm. The interviews also show that audit committees do not see significant differences between the Big 4 audit firms, and that they have little experience with other audit firms licensed to perform audits of listed companies (other PIE audit firms). Supervisory directors state that if other PIE audit firms are invited to give a quotation, this usually does not lead to their being engaged due to their lack of local presence in other countries and a shortage of specialist expertise.

As shown in table 5, price is not a deciding factor (23 per cent). A number of supervisory directors expressed concern in the interviews regarding the rotation of audit firms as this process involves extensive time and expense concentrated into one or two years. They consider it a duty of the audit committee to monitor that the audit fee does not become too low, and ask questions in this respect if the fees stated in the quotations vary too widely. A number of supervisory directors stated that the number of hours spent by the auditor was an important criterion in the evaluation and/or selection of the auditor. According to the questionnaire, 77% of the supervisory directors had information on the number of hours spent by the auditor.

4.4 The way in which the audit committee evaluates the quality of the audit

The AFM has reviewed how and how frequently audit committees assess their auditor's performance. The AFM also investigated whether supervisory directors are satisfied with the quality of their auditor and what their experience of communication with the auditor is. Audit firms assess the quality of their auditors by carrying out internal quality reviews on performed audits. The AFM reports its review findings with respect to the quality of audits from its supervision of audit firms publicly. The AFM asked the supervisory directors to state the extent to which they were familiar with this reporting.

Annual evaluation of the auditor's performance in almost all cases. The answers to the questionnaire show that 93 per cent of the supervisory directors assess the quality of the auditor once a year or more frequently. It also turns out that discussions with the auditor (98 per cent) and the annual evaluation of the auditor (93 per cent) are the most important sources of information for assessing the quality of the auditor. The interviews show that the way in which the auditor communicates (fulfilling his role) is an important part of the assessment.

A number of supervisory directors also stated in the interviews that other persons involved directly in the audit such as the CFO, the head of internal audit and directors of operating companies are involved in the assessment.

Supervisory directors are satisfied regarding the quality of the auditor. The responses to the questionnaire show that most supervisory directors are satisfied regarding the quality of the auditor (90 per cent) and the communication with the auditor (83 per cent). This also emerged from most of the interviews. In the interviews and the note to the question regarding the possibilities for improving the quality of the audit, the supervisory directors did add a number of critical comments regarding expertise, for example in the field of IT, the substantive feedback (clarity regarding the findings) and on the 'robustness' of the auditor in communication. In the interviews, several supervisory directors mentioned the engagement of specialists to support the audit committee's assessment.

Supervisory directors are generally not aware of internal quality reviews or the AFM's reports on quality. The answers to the questionnaire show there is little awareness of the quality of the auditor from the results of internal quality reviews by the audit firm (28 per cent) or the reports of supervisory authorities such as the AFM, DNB (the Dutch Central Bank) or ACM (The Netherlands Authority for Consumers and Markets). 55 per cent of the supervisory directors were familiar with the AFM's reviews of the quality of audit firms due to oral (37 per cent) or written (15 per cent) reports from the auditor, or because they received a copy of the AFM's report (13 per cent). 45 per cent of the supervisory directors stated that they were not familiar with the public AFM reports (multiple answers were permitted). 80 per cent of the supervisory directors were aware of the findings of the AFM's reviews of reporting by companies (such as the report 'In Balance 2014').

In the interviews, the AFM mentioned the difference between the positive assessment by supervisory directors of their auditor and the AFM's findings in its report on the quality of audits performed by the Big 4 audit firms of September 2014. The supervisory directors that we spoke to knew that the report had been recently published and they stated that they had been approached by the auditor or had placed the report (and the discussion with the auditor) on the agenda for the audit committee. The supervisory directors said that they were not fully aware of the background to the AFM's report. They indicated that they did not feel obliged to 'audit' the auditor's audit files themselves. They also stated that it was not clear to them whether the findings had implications for the correctness of the audit opinions that had been issued.

Mixed reactions to direct contact. The responses to the questionnaire revealed a variety of opinions regarding the various options for direct contact between the AFM and the audit committee. 35 per cent of the supervisory directors considered that contact was not necessary and 39 per cent of them would be in favour of contact through round table meetings, for instance. 13 per cent of the supervisory directors indicated that contact should be at supervisory board level and 25 per cent thought that the audit committee should be able to contact the AFM directly in case of questions.

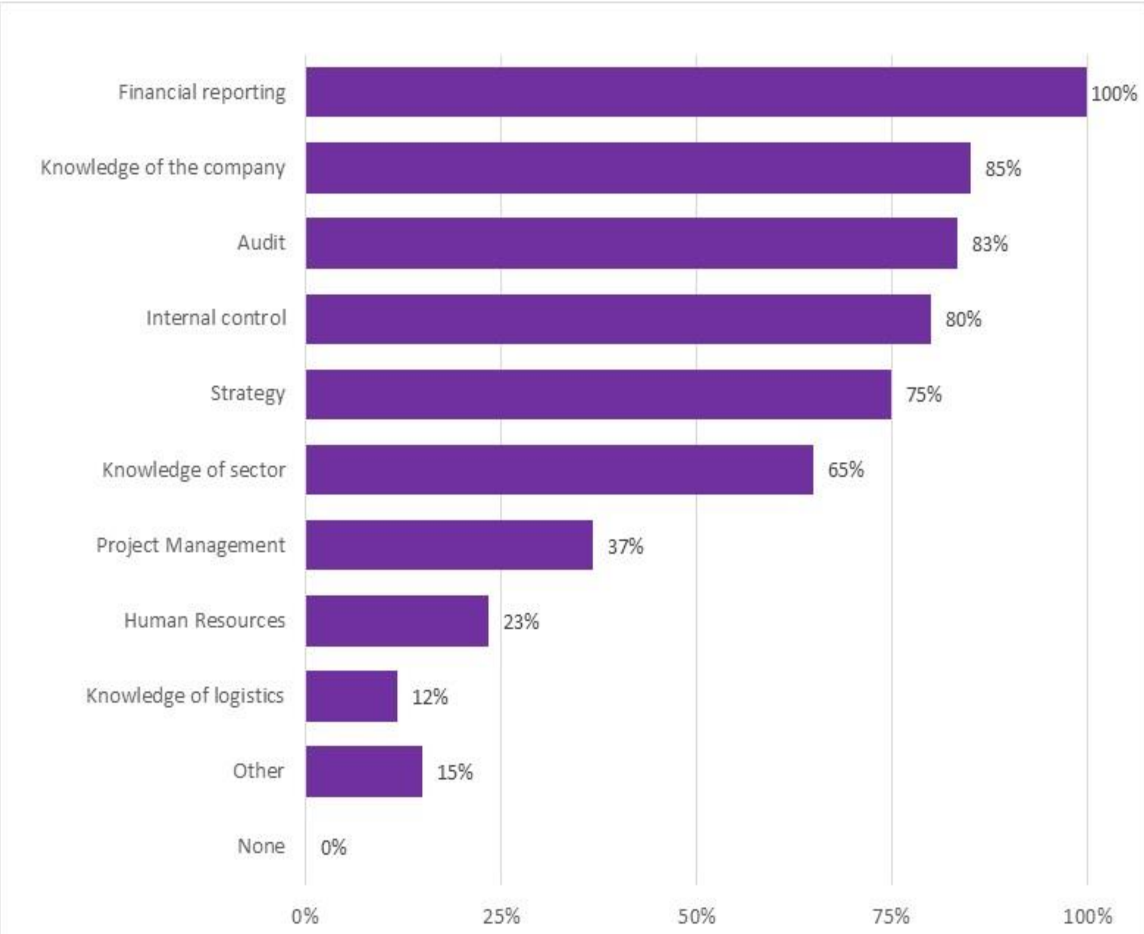
4.5 The level of expertise of audit committees with regard to internal control, reporting and auditing

The AFM asked the respondents to state their most important sources of information for the audit committee with respect to obtaining knowledge of internal controls, reporting and auditing. The AFM also identified the principal duties of the audit committee with respect to the reporting and how the audit committee promotes the quality of the reporting and the audit. Lastly, the AFM considered the backgrounds of supervisory directors of ASCX listed companies.

Supervisory directors think ample relevant expertise is available. The supervisory directors thought there was ample expertise available with respect to internal control (80 per cent), reporting (100 per cent) and auditing (83 per cent). In addition, audit committees possess knowledge of the sector (65 per cent) and the company (85 per cent), and expertise regarding strategy (75 per cent), according to the answers.

The full response to the question on the expertise available to the audit committee is given in table 6:

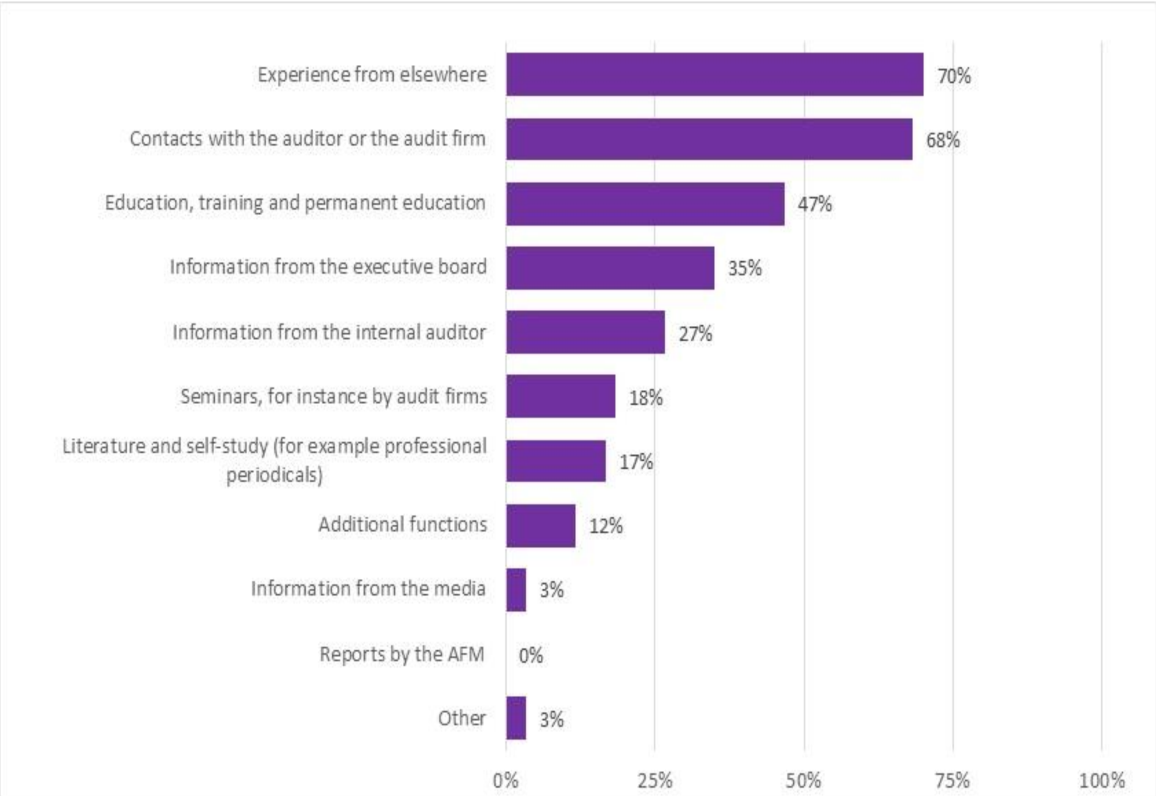
Table 6: What expertise is available in the audit committee? (Multiple answers permitted)



Supervisory directors state that supervisory directors have sufficient expertise. Experience gained by supervisory directors elsewhere (70 per cent) and contacts with the auditor or the audit firm (68 per cent) are the main sources of information for general knowledge regarding reporting and auditing. Supervisory directors also obtain knowledge through education, training and permanent education (47 per cent).

The full response to the question on the most important sources of information for the audit committee is given in table 7:

Table 7: What are in practice the most important sources of information for the audit committee for obtaining general knowledge regarding reporting and auditing? (Respondents were asked to list the three most important sources)



To a question regarding the need for more knowledge, 67 per cent of the supervisory directors stated that they had an occasional need for more knowledge with respect to reporting and 27 per cent said they needed this regularly. 73 per cent of the supervisory directors stated they occasionally needed additional knowledge with respect to the audit and 13 per cent said they needed this regularly.

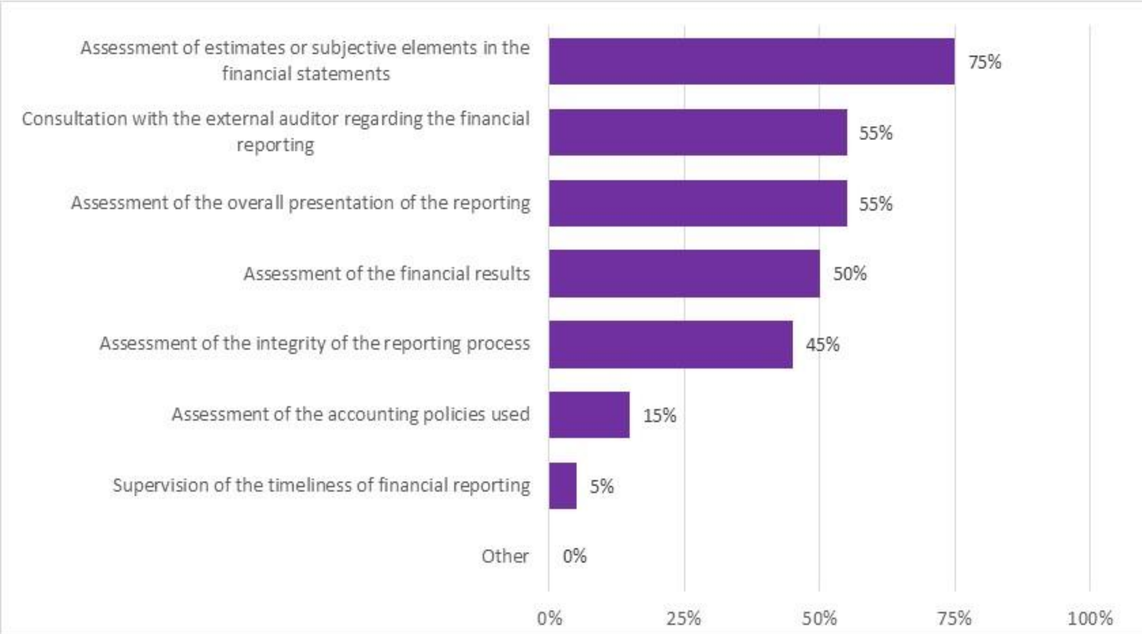
Knowledge must include complex regulation (IFRS) and an increasingly complex environment, also in relation to internal control. Both statutory provisions and the Dutch Corporate Governance Code require that audit committees include a financial expert. There is no further definition of this term. The required expertise was discussed with a number of supervisory directors. Reporting regulations are complex and are continually changing. Internal control is also becoming more complicated due to legislation, developments in IT and internationalisation. A number of supervisory directors stated that they consider their experience as an auditor or CFO to be very important.

In its supervisory activities with respect to reporting, the AFM notes that listed companies do not always have a current or former CFO or qualified accountant on their supervisory boards. In order to obtain further insight into the expertise available to supervisory directors, the AFM identified the backgrounds of the supervisory directors it included in its review for one market segment (the ASCX companies). This shows that many of the supervisory directors have a background as an executive director (CEO), come originally from the banking sector or have experience as a management consultant. It appears that supervisory directors do not generally have a background in reporting, auditing or internal control.

IT expertise in the audit committee is an item of attention. The Dutch Corporate Governance Code specifies IT as a separate field of responsibility for the audit committee. The interviews and the notes to the questionnaire show that many supervisory directors consider expertise in IT to be an important item of attention in the supervision of internal risk management and control systems. This is an area where some of them have concerns regarding an adequate level of expertise in the audit committee.

Involvement of the audit committee in reporting. Supervisory directors consider their most important tasks in relation to reporting to be the assessment of subjective elements in the financial statements (75 per cent), the assessment of the overall presentation of the reporting (55 per cent) and the discussion of the reporting with the auditor (55 per cent). The full response to this question is shown in table 8:

Table 8: What are the most important tasks of the audit committee with respect to reporting? (Respondents were asked to list the three most important tasks)

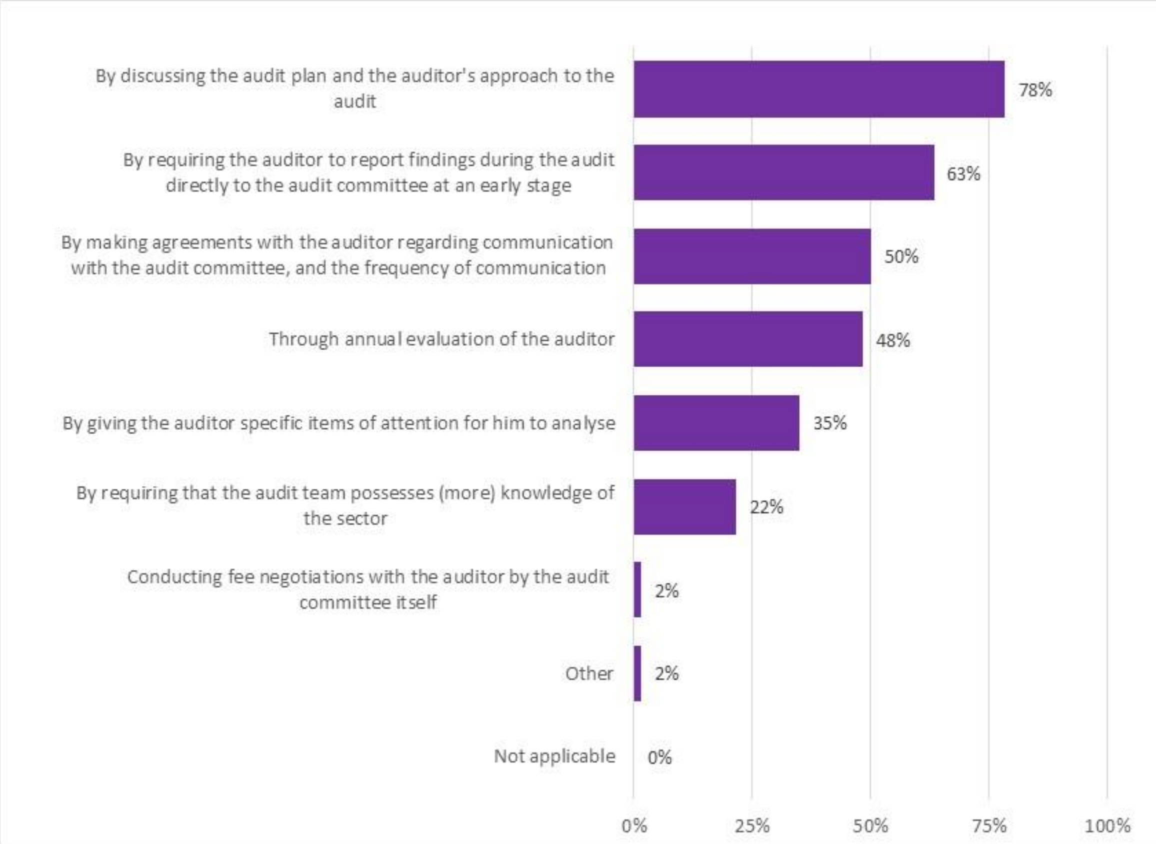


With regard to five (indicated) ways in which audit committees promote the quality of the reporting, it appears that they do this by analysis of various measurement methodologies (75 per cent), assessment of critical items in the reporting (95 per cent), discussions with the auditor (100 per cent) and discussion of the auditor's findings in relation to risk items (98 per cent). The drive towards integrated reporting (42 per cent) seems to be relatively low on the agenda.

Involvement of the audit committee in the audit. The supervisory directors assess the quality of the audit by the auditor mainly through discussion of the audit plan and the auditor's approach to the audit (78 per cent) and by requiring the auditor to report findings during the audit directly to the audit committee at an early stage (63 per cent).

The full response to the question of how the audit committee promotes the quality of the audit by the auditor is given in table 9:

Table 9: How does the audit committee promote the quality of the audit by the auditor? (Respondents were asked to list the three most important ways)

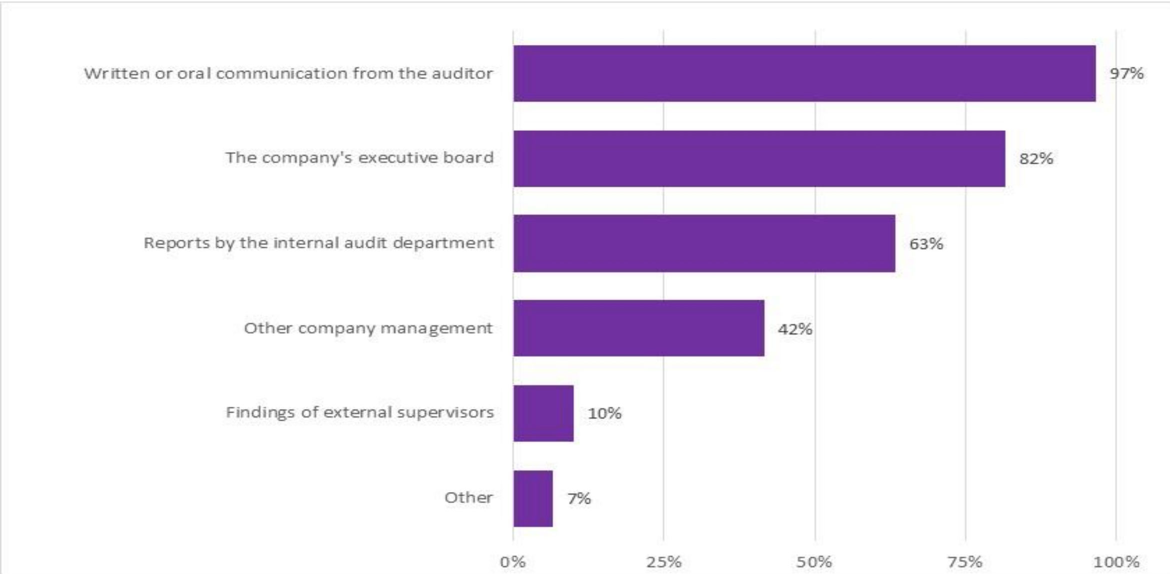


Information from various sources. The executive board is not the only source of information for the audit committee to obtain information regarding the quality of the internal controls and the quality of the reporting. Besides reports from the executive board (82 per cent for internal control and 88 per cent for reporting), information from the auditor (97 per cent and 100 per cent respectively), from the internal auditor (63 per cent and 58 per cent respectively) and from other management in the company (42 per cent and 28 per cent respectively) is important for knowledge regarding the company's internal controls and reporting. Reports from external parties (10 per cent and 17 per cent respectively) are also a source of information. Supervisory directors stated in the interviews that (in the case of large companies) they visit other facilities of the company and that they also talk to business managers, risk officers etc.

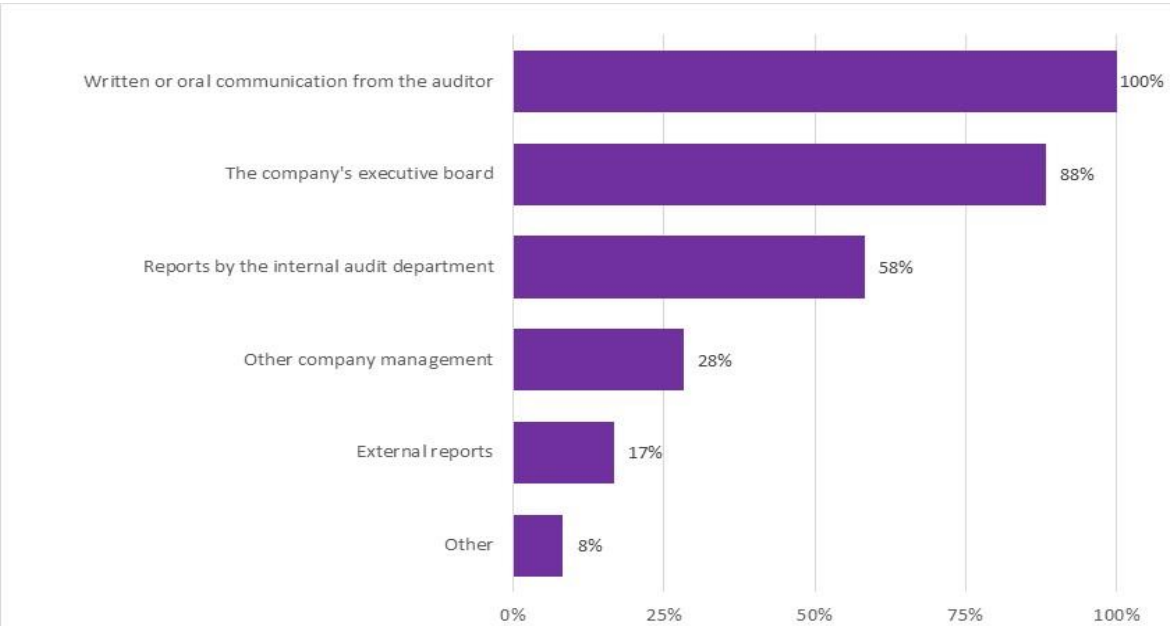
The percentages are shown in tables 10 and 11.

Tables 10 and 11: What are the most important sources whereby the audit committee obtains information on the quality of the internal controls and the quality of the reporting? (Respondents were asked to list the three most important sources)

Internal control



Reporting



In the interviews, supervisory directors stated that the information from the auditor is an important source for the assessment of the reporting process and for forming an opinion regarding the acceptability of the statements by the executive board.

4.6 The motivations and positioning of the supervisory director in the audit committee

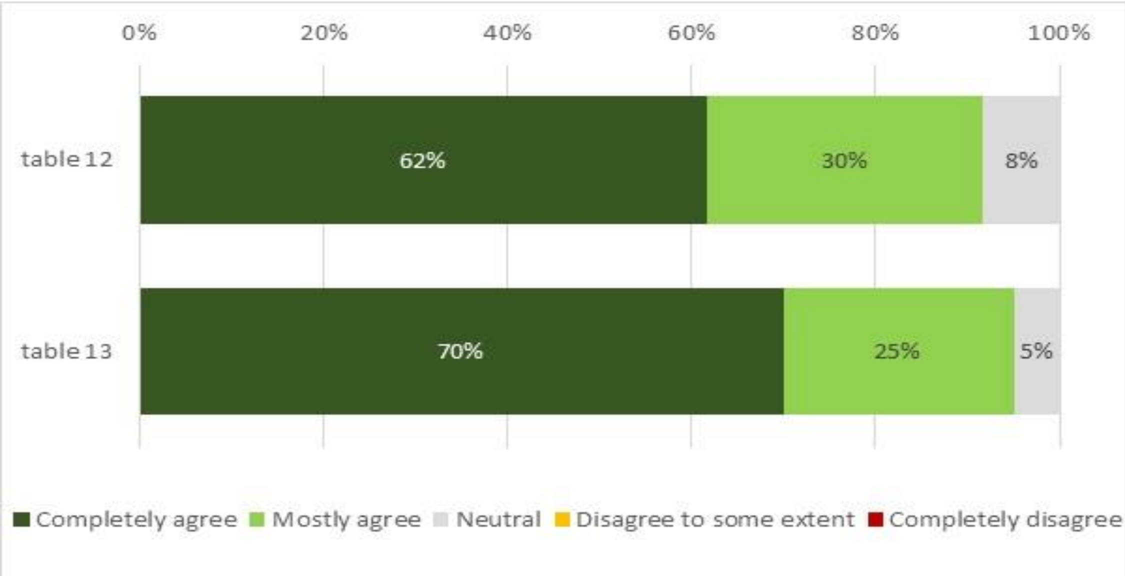
The AFM investigated the motivations for the supervisory directors surveyed and interviewed for deciding to become a supervisory director of a company. Did they experience appreciation from the executive board and other members of the audit committee when they adopted a critical attitude? The AFM also investigated whether supervisory directors would like to report more extensively with respect to the findings from the audit in the annual report and how they approach this issue. Aside from some attention in the questionnaire, these questions featured mainly in the interviews.

Supervisory directors are selective. The interviews revealed that considerations were two-fold when considering whether to accept a supervisory directorship: the ability to apply the knowledge and experience obtained in practice or because a request was made to them due to their knowledge and experience. Knowledge of the company was seen as extremely important. A number of supervisory directors stated that they sometimes had to spend a lot of time learning about the specific features of a company. They mentioned speaking with multiple management layers in the company as part of the process. Supervisory directors generally also stated that they only accept supervisory directorships if these met certain conditions of their own choosing. This could be the existence of an internal auditor, confidence in the executive board and the internal control environment or an affinity with the company and/or its business. For the same reason, supervisory directorships in for example the financial sector were sometimes not accepted because of their complexity.

Appreciation for a critical attitude. In the interviews, supervisory directors stated that they consider it essential to take a critical attitude towards each other and the executive board. Whom one has to deal with (the tone at the top) is seen as important by the supervisory directors. The Dutch Corporate Governance Code states that supervisory boards and audit committees must evaluate their own performance at least once a year. The interviews show that supervisory directors consider this annual self-evaluation to be useful.

The answers of the supervisory directors regarding the statement that a critical attitude by the audit committee towards the executive board is appreciated and a critical attitude within the audit committee towards other members is appreciated are shown in tables 12 and 13:

Table 12 (executive board) and table 13 (internally): A critical attitude by the audit committee towards the executive board is appreciated by the executive board and a critical attitude internally towards other members is appreciated within the audit committee (Respondents were asked to give their opinion with reference to this statement).



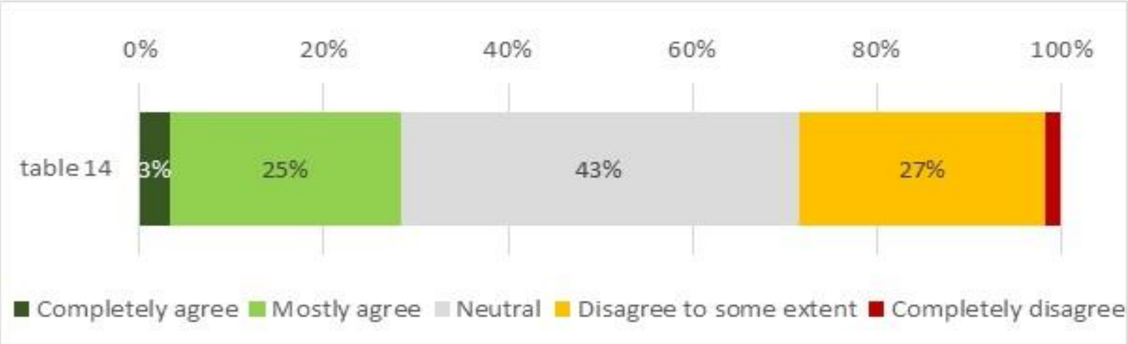
The tables show that supervisory directors agree completely or mostly (92% and 95% respectively) with the statement that a critical attitude by the audit committee towards the executive board and internally within the audit committee is appreciated.

The audit committee is an advisory body to the supervisory board as a whole. Supervisory directors state that they see a danger of the supervisory board 'outsourcing' responsibility for the audit and the reporting to the audit committee. The audit committee guards against this and sees this as an explicit responsibility of the whole supervisory board. Some supervisory directors state that subjects such as strategy are also prepared by the audit committee, since this is where the relevant knowledge is available. Other audit committees focus only on the duties in the Code and consider that other issues should be addressed by the supervisory board as a whole.

Audit committees do not see the AGM as a driver of improvement of the quality of reporting and auditing. In the interviews, besides assessing the AGM reports, the AFM asked supervisory directors to state the extent to which audit committees were questioned critically by shareholders at the AGM. Various supervisory directors stated in the interviews that shareholders were generally interested in subjects other than the reporting and the audit. The questions in the AGM mainly concerned the company's strategy, dividend and remuneration.

No clear picture regarding more extensive reporting requirements. In order to give shareholders more information on which to base critical questions during the AGM, the annual report could contain more extensive information on the findings with respect to the internal controls, the reporting and the audit by the auditor. The AFM asked the supervisory directors to state their views. The majority of the supervisory directors were neutral (43 per cent), or agreed in general (25 per cent) or disagreed (27 per cent). The other percentages are shown in table 14:

Table 14: Statement: it would be useful if the supervisory board or audit committee reported more extensively in the annual report on the findings of the audit and also on how these were addressed.



5 Design of the review

Section 5.1 describes the scope of the review, and the approach to the review is explained in section 5.2.

5.1 Scope of the review

In this review, the AFM asked supervisory directors serving on audit committees to give their views regarding how they see the fulfilment of their role with respect to reporting and auditing. The AFM wished to obtain insight into the extent to which audit committees take a critical view (critical ability) with respect to reporting and auditing. The findings of the review represent, based on the design of the review, the opinions of the supervisory directors who were surveyed and interviewed.

The review covered five areas that relate to the expectations of the AFM with regard to the role that audit committees can play concerning the reporting and auditing as part of the system of checks and balances between the executive board and the auditor:

1. The duties and expectations of the audit committee regarding reporting and the audit;
2. The selection of the auditor;
3. The way in which the audit committee evaluates the quality of the audit;
4. The level of expertise of audit committees with regard to internal control, reporting and auditing;
5. The motivations and positioning of the supervisory director in the audit committee.

1) Here the AFM identified what audit committees consider as their most important tasks, what they expect of the audit and how they perform their supervisory duty in practice. Is the mandatory audit a given for the audit committee, or does it actually add value for the audit committee?

The questions put by the AFM to the supervisory directors focused on the tasks, the expectations they have with respect to the audit, their involvement in the audit approach and their discussions with the auditor regarding his findings and following up the recommendations arising from the audit of the financial statements.

2) The audit committee has an advisory role in the appointment of the auditor. Through the supervisory board, it gives a recommendation to the AGM regarding the selection of the auditor. The selection of a new auditor is a current issue now that the rotation of PIE audit firms will become mandatory with effect from 1 January 2016. The questionnaire and the interviews addressed the process of selecting a new auditor. What do the supervisory directors look for when making their choice, and what are the deciding factors in their ultimate decision?

3) The quality of the auditor must be evaluated by the audit committee and the executive board at least every four years. The AFM asked the supervisory directors how they evaluate the quality of the reporting and the auditor. The AFM asked whether audit committees also made use of information originating from the audit firms and the AFM. The AFM assesses the quality of audits in its regular supervision, but audit firms also do this themselves by means of internal quality reviews of the auditors employed by or affiliated to them.

4) The AFM reviewed the level of knowledge of audit committees with regard to internal control, reporting and auditing. Reporting standards and regulations governing the audit are constantly changing. Knowledge of these regulations and their potential impact on the company requires a corresponding level of knowledge among the supervisory directors. It is not so much that supervisory directors should be expected to know the rules by heart, but they should be in a position to be able to interpret them and put critical questions to the executive board on the basis of the reporting presented to them. Because organisations are becoming increasingly complex, usually with a variety of foreign entities, a broader scope of internal control is an important area of supervision as well as the financial reporting. This means that supervisory directors need to have sound knowledge in order to be able to adequately estimate risks and measures. The supervision of internal control and the functioning of the internal auditor are part of the duties of the audit committee, according to the Dutch Corporate Governance Code. The AFM's review did not specifically focus on how audit committees supervise the internal controls, it focused mainly on the expertise regarding internal controls among supervisory directors.

5) The central question in this reviewed area was what motivates supervisory directors to accept a supervisory directorship and how they position themselves with respect to the shareholders, the auditor and the executive board. What are the considerations that make a person decide to become a supervisory director of a company? Is acceptance of this office affected by the increasing public pressure and increasingly onerous responsibilities? How independently do the supervisory directors position themselves? In the interviews, the AFM addressed the question of the extent to which audit committees are critically approached by shareholders with respect to the reporting and the audit.

5.2 Approach

The AFM conducted the review by sending questionnaires to supervisory directors who chair or are members of company audit committees, and holding more in-depth interviews with 15 of these supervisory directors. If the company in question did not have an audit committee, we approached the chair of the supervisory board. In these cases, we asked that the questionnaire be completed by the person or persons responsible for supervision of the executive board with respect to the operation of the internal risk management and control systems, the reporting process and the relationship with the auditor. The interviews were conducted with the chairs of the audit committees in nearly all cases.

References in the report to ‘supervisory directors’ refer to the supervisory director in his or her capacity as chair or member of the audit committee or as financial expert as referred to in the Dutch Corporate Governance Code. Reference in the report to ‘audit committee’ means the audit committee, or, if the company has no audit committee, to the person or persons who supervise the company’s executive board with respect to internal control, the financial reporting process and the relationship with the auditor.

The questions were formulated on the basis of discussions held by the AFM with stakeholders including Eumedion, the Dutch Association of Securities Issuing Companies (VEUO) and the Corporate Governance Monitoring Committee (MCCG). The input from these discussions was used to send a web-based questionnaire to 96 Dutch listed companies. The questionnaire consisted of 40 questions. To safeguard the privacy of the respondents, the answers to the questionnaire cannot be traced to any individual person or company. The AFM received 60 completed questionnaires, representing a response of 62 per cent. For some questions the respondents were asked to give the three most important answers, meaning that the cumulative percentage of answers to the question may be more than 100 per cent.

The AFM conducted interviews with supervisory directors of 15 companies from across the AEX, AMX and ASCX indices and local stocks. The interviews were held after the supervisory directors in question had completed the questionnaire. In the interviews, the AFM asked more in-depth questions on the five review aspects, and depending on how the conversation developed we discussed various other subjects as well. Reference in the report to ‘a number’, ‘some’ or ‘most’ supervisory directors in relation to the description of the findings from the interviews mean that other supervisory directors could share the views expressed on the subject although this had not been specifically addressed in their interviews.

The AFM has not included any tables per segment in this report, since our analysis showed that there was little difference in the answers to the various segments.

In preparation for the interviews, we identified the extent to which shareholders had asked questions relating to internal control and financial reporting at the AGM. We consulted public minutes of AGM for this purpose.

The AFM hopes this review will contribute further and bring more depth to the dialogue with audit committees. The AFM also hopes that the review will contribute to a wider awareness that the role and exercise of responsibilities of members of audit committees has recently been strengthened and that expectations have increased in this regard. The AFM will consider the findings of this review in its risk- and problem-driven approach to external supervision. This review focused mainly on the supervisory directors themselves. Any subsequent review may also include the opinions of other stakeholders with respect to the critical ability of audit committees.

6 Legislation and regulation

6.1 The current legislative framework

The standards for audit committees of Dutch listed companies are established in Book 2 of the Dutch Civil Code, the Dutch Corporate Governance Code, the Audit Firms (Supervision) Act (Wta) and the Decree on Audit Committees.[9] The provisions of the Wta and the Decree on Audit Committees originate from European legislation. The European legislator included a number of provisions in the Audit Directive of 2006 that apply to audit committees of public interest entities (PIEs), including Dutch listed companies.

The Dutch Corporate Governance Code and the Decree on Audit Committees

The Dutch Corporate Governance Code applies in principle to all listed companies. Section 391 (5) of Book 2 of the Dutch Civil Code obliges companies to include their compliance with the Dutch Governance Code in their annual reports. The principle of ‘comply or explain’ applies here. Companies may decide to deviate, as long as they state adequate reasons for this in their annual report.

The obligation for a PIE to appoint an audit committee or similar body is pursuant to the Decree on Audit Committees. An audit committee must consist of members of the supervisory board or non-executive directors. The Decree also makes certain provisions in the Dutch Corporate Governance Code mandatory for PIEs. This concerns the provisions relating to the scope of the supervision that the audit committee must exercise over the company’s executive board, the mandatory inclusion of a financial expert in the audit committee, the tasks of the audit committee with respect to the role, appointment, remuneration and evaluation of the performance of the auditor and with respect to the relationship and communication with the auditor with the bodies of the company. Moreover, at least one member of the audit committee must be independent and meet the criteria with regard to independence.

Dutch listed companies must apply the other principles in the Dutch Corporate Governance Code relating to the role of the audit committee on the basis of the ‘comply or explain’ principle. The relevant principles in the context of this review are that the audit committee is the first point of contact for the auditor in the event that the latter encounters irregularities in the content of the financial documentation and that the chair of the audit committee should not be the same person as the chair of the supervisory board or a former executive director of the company. In addition, the audit committee should consult with the

[9] Decree of 26 July 2008 for the implementation of Section 41 of Directive 2006/43/EC of the European Parliament and the Council of the European Union of 17 May 2006 concerning statutory audits of financial statements and consolidated financial statements, amending Directives 78/660/EEC and 83/349/EEC of the Council of the European Communities and withdrawing Directive 84/253/EEC of the Council of the European Communities (Decree on Audit Committees).

auditor as often as it considers necessary, but in any case at least once a year, without the presence of the executive board.

Book 2 of the Dutch Civil Code

Section 393 of Book 2 of the Dutch Civil Code includes a provision regarding the appointment of the auditor. The AGM is authorised to make the appointment. If the AGM fails to do so, the supervisory board is authorised, and if this is lacking or unable to act, the executive board. During the General Debate on Accountancy in the autumn of 2014, the Dutch House of Representatives requested that this last option be removed. Moreover, the auditor submits a report of his work to the supervisory board and the executive board in which he reports at least his findings with respect to the reliability and continuity of the automated data processing.

The Wta

The audit committee has a role in assessing the independence of the audit firm with regard to the company. An audit firm conducting a statutory audit of a listed company confirms its independence from the company to the audit committee each year. The audit firm also lists all the services it has provided to the company other than the conduct of the statutory audit each year. Lastly, the audit firm consults each year with the audit committee with respect to threats to its independence and measures taken to mitigate these threats.[10]

6.2 Current developments in legislation and regulation

During the General Debate on Accountancy in the autumn of 2014, the Minister of Finance stated that the AFM should be authorised to share its findings from the supervision of audit firms with the audit clients, or their supervisory boards. In the Minister's view, it is important that the audit client also knows of the existence and nature of shortcomings in the statutory audit conducted by the auditor so that it can take suitable measures if necessary. [11] Under the current confidentiality obligations to which the AFM is subject, this is not currently permitted.

The principal current and future changes to Dutch legislation and regulation for audit committees are driven by changes to European legislation. The European legislator amended the 2006 Audit Directive[12]

[10] §24(a) Wta.
[11] Letter from the Minister of Finance of 25 September 2014, containing response to the AFM report on the Big 4 firms, proposals for the auditing sector and report evaluation (central government).
[12] Directive 2006/43/EC of the European Parliament and the Council of 17 May 2006 concerning the statutory audits of financial statements and consolidated financial statements, to amend Directives 78/660/EEC and 83/349/EEC of the Council and withdrawing Directive 84/253/EEC of the Council (the Audit Directive).

via an Amending Directive[13] and in addition established a new Audit Regulation[14] with requirements for the statutory audits of public interest entities (PIEs). The obligations pursuant to the Amending Directive and the Audit Regulation will take effect in the Netherlands in mid-2016. There is an overlap between the new obligations pursuant to the new European legislation and the Dutch Corporate Governance Code. Accordingly, Dutch companies are already complying with some of the new obligations. The Amending Directive mainly prescribes greater responsibilities for the audit committee with respect to the statutory audit. The preamble to the Amending Directive states that audit committees play a decisive role in contributing to high quality statutory audits[15]. The changes that the Amending Directive will introduce include stricter requirements regarding the independence of the audit committee members and an explicit role for the audit committee in the selection and nomination of the auditor. The Amending Directive also states that the audit committee must supervise the conduct of the statutory audit, and in this context should involve the findings and conclusions arising from inspections by public supervisory authorities. Furthermore, the audit committee must monitor the independence of the auditor and the correct application of the prohibition of non-audit procedures. Finally, the Amending Directive states that the audit committee must inform the leading or supervisory body of the company of the result of the statutory audit and must give account of how the statutory audit has contributed to the integrity of the reporting, and describe the role of the audit committee in this process.

The Audit Regulation contains specific requirements for the statutory audit of PIEs. The Audit Regulation gives further details of the role of the audit committee in the appointment of the auditor of a PIE. In addition, the Audit Regulation obliges the auditor to prepare an additional report for the audit committee. In this additional report, the auditor explains the results of the statutory audit performed and includes information with respect to his communication with the audit committee, his findings in relation to (suspected or identified) non-compliance, to the extent these findings are considered to be relevant to the ability of the audit committee to perform its duties. The audit committee is also assigned a further task with respect to the application of permitted exceptions to general rules governing fees, non-audit services and the length of the audit engagement.

The Audit Regulation states that supervisory authorities such as the AFM must monitor the performance of audit committees. This monitoring does not mean that audit committees are to be subject to supervision by the AFM. The AFM's intention with this empirical report is to identify current practice, also in anticipation of this monitoring task.

[13] Directive 2014/56/EU of the European Parliament and the Council of 16 April 2014 to amend Directive 2006/43/EC concerning the statutory audits of financial statements and consolidated financial statements (Amending Directive Audit).

[14] Regulation 537/2014 of the European Parliament and the Council of 16 April 2014 concerning the specific requirements for the statutory audits of financial statements of public interest entities and withdrawing Decree 2005/909/EC of the Commission (the Audit Regulation).

[15] This is notable, since the 2006 Directive merely stated that audit committees contribute to reducing operational and compliance risks to a minimum and to increasing the quality of reporting.