



Allies in Governance 2.0

Towards a sustainable relationship between
the Audit Committee and the Internal Audit Function

September 2016



The Institute of
Internal Auditors
Netherlands

Royal Netherlands
Institute of Chartered
Accountants

NBA LIO

Working group

Hans Nieuwlands RA CIA CGAP CCSA

Johan Scheffe RA RO CIA

Drs. Bianca Steentjes RO EMIA

Drs. Heiko van der Wijk RA CIA

© IIA Netherlands and NBA

All rights reserved. Full or partial duplication, publication on other sites, multiplication in whatever other form and/or commercial use of this information is not permitted, unless express prior written permission has been given by the IIA or NBA LIO.

Contents

Foreword	4
Management summary	5
1 Background	7
2 Structure and survey	8
3 Demographics of the survey population	9
4 Duties and responsibilities within the governance structure	10
5 Charter of the Internal Audit function	12
6 Positioning of the Internal Audit function	13
7 Appointment and dismissal of the Chief Audit Executive	14
8 Assessment of the Internal Audit function	16
9 Audit plan of the Internal Audit function	19
10 Report of findings and follow-up	21
11 Presence of the Chief Audit Executive at the meetings of the Audit Committee	23
12 Conduct and culture (soft controls)	24
13 Collaboration with the external accountant	26
14 All the recommendations at a glance	28

Foreword

You have in front of you the report '*Allies in Governance 2.0*', the joint survey of the IIA Netherlands and NBA LIO. This report on the relationship between the Audit Committee and the Internal Audit function is the follow-up to the survey '*Allies in Governance*' from 2008.

In the meantime, a lot has changed in the way we think about governance and in the shape the three-way relationship between the Audit Committee, the external accountant and the internal auditor has taken. In recent years, the internal auditor has earned a fully-fledged place at the governance table. Internal Audit functions provide the directors and supervisory directors of the big firms and institutions in the Netherlands with insight into and assurance about the design and effectiveness of governance, risk management and internal control measures.

This progress is already partly reflected in the proposals for adjusting the Corporate Governance Code. Here, the internal audit role is more prominently visible. We are pleased with this recognition even if, in our opinion, the functions of the internal and external auditor could have been elaborated a notch deeper.

Directors and supervisory directors will find key conclusions and useful descriptions of best practices in this report. Especially at companies where the design of the Internal Audit function has only just started and the level of maturity is still under development, boards and supervisory directors can fulfil a positive, active stimulating role. For example, think of making demands about the quality of the Chief Audit Executive to be appointed, the correct positioning of the IAF, formalising duties and authorities in the Internal Audit Charter, working on the frequency and content of the contact moments and safeguarding the quality of the year plan.

It is vital that an Audit Committee think properly about internal and external auditors functioning complementarily beside one another. Supervisory directors could leverage their influence to discourage unnecessary overlap between these functions, but certainly also to avoid gaps in the different audit forms. That requires diligent coordination and planning of activities and mutually sharing of information between internal and external auditors. It is advisable to ask probing questions about this in an Audit Committee.

We from the professional organisations IIA and NBA support both the fledgling and mature Internal Audit functions with advice and assistance, professional guidance, training, methodology and quality assurance, ambition and maturity models, so that they can develop optimally into valued allies in governance.

We trust that this survey will also prove inspirational to you in making a solid contribution towards that goal.

Amsterdam, 13th September 2016

John Bendermacher RA, CIA
Chair IIA Netherlands

Jos Motzheim RA, CIA CRMA
Chair NBA LIO

Management summary

In a properly balanced and structured corporate governance framework, the Audit Committee (AC), the Interne Audit Function (IAF) and the external accountant (EA) rely on each other. The IAF is increasingly seen as an essential element of the organisation's governance. The IAF supports the AC by providing insight into and assurance about the design and effectiveness of the governance, the risk management and the internal control measures. The AC is in a position to create the correct prerequisites and conditions for the IAF that optimise the IAF's independence and objective functioning and promote the complementary functioning of the IAF and the EA.

The relationship between the AC and the IAF was first formalised in the original Dutch Corporate Governance Code (the Code) in 2003. Five years later, the Royal Netherlands Organisation of Chartered Accountants (NBA) (then NIVRA) and the Institute of Internal Auditors Netherlands (IIA) surveyed the practice at the time and published the findings and best practices in *'Allies in Governance'* (2008). In the spring of 2016, the IIA and the NBA jointly set up a working group to look anew at the relationship between the AC and the IAF. In connection with the proposal to revise the Code, in which the AC, IAF and EA triangle features prominently, the working group also focused on the relationship between the IAF and the EA.

The main conclusions from the survey are:

- The formal relationship between the AC and the Chief Audit Executive (CAE) is generally well structured. This relationship is defined in the IAF charter.
- Most ACs are aware of the importance of appointing a qualified CAE. They are therefore also involved in their appointment or dismissal. This involvement can be further improved if every chair of an AC has an interview with the prospective CAE prior to the latter's appointment.
- Almost all the ACs (80%) are involved in assessing the CAE. This improves his functioning because his objectivity is better guaranteed if his performance appraisal is not only prepared by people directly involved.
- The CAE is seen as a valuable discussion partner and, in most organisations, is present at the entire AC meeting. This enables the CAE to share insights with the AC, also in areas that he has not (yet) studied. It also gives the CAE important information that he requires in fulfilling his job.
- In most organisations, the chairs of the AC and CAE have bilateral discussions several times a year, which strengthens the independence and the bond of trust. To function optimally as 'trusted advisor' to both the chair of the board and that of the AC, transparency about the content of these discussions is essential.
- The AC discusses the audit plan and the available resources. Changes in the audit planning are discussed annually (at least) with the CAE. Restricting the available resources has an impact on the choices that have to be made when preparing the audit plan. It is important that the AC understands which risks cannot be covered with the available resources. Better insight by the AC can result in adaptation of the available resources in order to achieve the desired audit coverage.
- The AC can strengthen the assessment of the effectiveness of the IAF by agreeing a wide range of KPIs in consultation with the CAE. The IAF's quality control and improvement programme has to be part of it.
- Given the increasing relevance of culture and conduct as part of the organisations' governance, ACs should discuss the audit approach in this field with the CAE. Not all CAEs currently feel themselves up to the task of picking up this gauntlet. The IIA and the NBA should offer the members support in this area by assisting them in developing an approach through training and publications.
- In view of the proposal to revise the Code, there should be a new approach to the collaboration between the IAF and EA, centred on the question of where they encounter and complement one another in the overall field of financial and non-financial information. Optimisation of the relationship between the IAF

and the EA and opportunities to improve the organisation's governance in partnership should be put on the AC's agenda. An option is to report jointly each year to the board and the AC on the design, existence and operation of the governance and the risk management and internal control systems.

1 Background

In September 2008 the NBA¹ and the IIA published their report 'Allies in Governance'². This survey provided insight into the way in which IAFs and ACs were working together at the time. The report also discussed a number of best practices at this level.

In February 2016 the Monitoring Committee Corporate Governance (MCCG) published its proposal to revise the Code. The report emphatically pointed to the importance of internal audit to the Board of Management (BoM), the Supervisory Board (SB) and the AC. This is only logical given the trend seen in preceding monitoring reports, but also in view of the developments in financial institutions following the introduction of the Banking Code, Insurers' Code and the requirements arising from, among other things, Basel III and Solvency II. Other sectors (such as healthcare, education and housing associations) are developing their own codes of conduct, which increasingly focus on risk management and control.

The boards of the IIA and the Internal and Public Accountants' Members Group (LIO) of the NBA (LIO) set up a working group in 2016 to look into how this collaboration is now being given shape. The proposal to revise the Code assumes that the activities of the IAF and the EA are complementary. As the relationship between the IAF and EA is becoming more relevant as an element of good governance, the working group also studied this aspect.

On this occasion, organisations from the (semi-) public sector were also included. Where relevant, principles and best practices from the proposed revised code were included in a separate framework. This report is not intended as a response to the proposal to revise the Code.

We would like to thank the CAEs who collaborated in contributing insights and for the time they took to complete the questionnaire and conduct interviews.

1 At the time the Royal NIVRA

2 http://www.iaa.nl/SiteFiles/Downloads/Rapport_Bondgenoten_in_Governance.pdf

2 Structure and survey

The project was structured along the following phases:

1. Preparation of the project plan

After exploring the issue, the working group agreed the project approach with the chairs of the NBA LIO and the IIA. The formulated project aim was:

To obtain insight into the current relationship and collaboration between IAF and the AC, based in part on best practices as described in the report 'Allies in Governance' (NIVRA/IIA 2008). The project also considered the degree to which the activities of the IAF and the EA are complementary.

2. Formulation and distribution of the questionnaire

The survey³ was distributed among the 138 members of the IIA and/or the NBA who are registered as CAE.

3. Analysis of the outcomes

The response was good (57%). Also the spread across the different business sectors and the size of the different IAFs were satisfactory. The working group analysed the outcomes of the survey, discussed the most striking findings at length and has drawn preliminary conclusions.

4. Interviewing the respondents

Virtually all the respondents were prepared to explain their answers in more detail. The working group was grateful for this opportunity and interviewed fifteen CAEs. First, to get a better understanding of the responses given and test the preliminary conclusions and, second, to obtain more background information.

5. Validation of the survey results

The main outlines of the survey outcomes and the interviews were shared with the CAEs during the 'IIA-CAE Forum' held in June 2016. Collaboration with the external accountants, culture and conduct audits, as well as fulfilling the role of 'trusted advisor', both for the board and the AC, were specifically discussed with the attending CAEs.

6. Publication of the report

³ The full questionnaire with all the answers received can be found on http://www.iaa.nl/SiteFiles/Publicaties/Bijlage_Enguete_Bondgenoten_in_governance_2_0.pdf

3 Demographics of the survey population

The survey was distributed among all the members of the NBA and the IIA who are registered as CAE in the respective registers (138). Of those, 78 (57%) participated in the survey.

This year, the (semi-)public sector was also included, as a result of which the responses is spread across a greater diversity of typologies than in 2008. The financial sector is always strongly represented among the respondents. The 78 respondents can be broken down as follows:

Sector	Number	Percentage
Financial services	35	45%
(Semi-)public sector	13	17%
Trade	3	4%
Production	13	17%
Other	14	17%
Total	78	100%

The category 'Other' includes a wide variety, from business services via logistics to oil and gas extraction.

Of the 78 organisations, 26 are listed companies (33%). What strikes one is that almost all the companies have an AC, or at least another (external) body that fulfils the same function. Eight respondents indicated that they had no audit committee in the organisation. They were not involved in the survey.

The size of the IAFs varies considerably, from one-person functions to major services.

The survey has provided good insight into the existing relationships between the CAE and the AC of the organisation where they work. The text contains recommendations for further improvements.

4 Duties and responsibilities within the governance structure

Countless publications about the tasks and responsibilities in an organisation's governance have seen the light. In December 2015, the IIA and the NBA published The Principles for Corporate Governance, Organisation Structure and Risk Management ('Beginselen voor ondernemingsbesturing, organisatie-inrichting en risicobeheersing')⁴. This structure is also applied in the text below. Although set up from the perspective of financial organisations, these principles are also true for many organisations. The used terms board, supervisory board, audit committee and suchlike can be replaced by the equivalents in the relevant organisation.

Board

The Board (of management) is responsible for determining the mission, the core values, the strategy, the policy, and the management, structure and risk management of the organisation.

The internationally accepted three-lines-of-defence model is often opted for when setting up an organisation. This model is compulsory within the financial sector. The aim of this model is to set up risk management and monitoring and allocate tasks and responsibilities for risk management. The organisation thus systematically tests and assesses the internal control. This is done by:

- The line management (first line of defence);
- The specialised functions with specific tasks such as risk management, compliance and control, all focused on the adequate control of risks (second line of defence);
- The independent internal audit function (third line of defence).

Internal Audit function

The IAF systematically reviews the effectiveness of the governance processes, risk management and compliance in the first and second line of defence. The effective functioning of the IAF is increased when it has a reporting line to the board and the AC. The IAF reports its findings to the board, to the relevant management in the first and second line of defence and to the AC. The Dutch Corporate Governance Code considers the establishment of an IAF as a best practice for listed companies. The reasons for its absence should be explained in the management report ("Comply or explain").

Supervisory Board

The SB is tasked with supervising the organisation as a whole, the board and the appointment and dismissal of directors.

⁴ [http://www.iaa.nl/SiteFiles/Publicaties/BOOR%20\(def\).pdf](http://www.iaa.nl/SiteFiles/Publicaties/BOOR%20(def).pdf)

Audit Committee

The SB can decide to establish an AC. The AC focuses on the administrative organisation and internal control, ICT, internal audit and the (audit of the) financial reporting. In the absence of an AC, these tasks are vested in the SB.

External accountant

The supervisory board nominates the EA to the General Members' Meeting (ALV) and monitors the functioning of the EA. The audit committee takes a leading role in preparing the decision-making of the supervisory board. The EA has the task of issuing an opinion on the fair presentation of the organisation's financial statements.

When setting up the AC, the SB must draw up rules and regulations. These rules and regulations set out the aim, composition, the tasks and authorisations of the AC. These also include the responsibility towards the IAF and the EA, including the coordination of their activities. Appendix 1 of 'Allies in Governance' contains an English-language model of such a document.

Clause 1.5.1

Duties and responsibilities of the audit committee

The audit committee's duties and responsibilities include monitoring the company's financial reporting and the risk management conducted by the management board. In addition to what is laid down in legislation, the audit committee should in any event focus on monitoring the management board with regard to:

- i. relations with, and compliance with recommendations and following up of comments by, the internal audit function and the external auditor;
- ii. the funding of the company;
- iii. the application of information and communication technology of the company; and
- iv. the company's tax policy.

Source: Proposal for revision Dutch Corporate Governance Code

5 Charter of the Internal Audit function

As monitoring body, the AC is jointly responsible for the effectiveness of the IAF. To fulfil this responsibility, it is paramount that the AC is involved in drafting and approving the charter (mandate) of the IAF.

The IIA standards stipulate that the internal audit charter should contain, among other things, the authorisations and responsibilities of the IAF.

Elements to be included in a charter are:

- The scope of the IAF. This should cover the entire organisation;
- The authorisations of the IAF. The right to full unimpeded information gathering is essential here;
- The responsibilities of the IAF. There should be an undivided responsibility for the executive tasks of the IAF. The IAF should be segregated from other line or staff functions;
- The safeguarding of the independent position of the IAF within the organisation and the corresponding required reporting line to the senior directors and the AC;
- The personal independence and objectivity of the IAF staff;
- The competence, knowledge and professional expertise of the IAF as a whole;
- The applicability of domestic and international professional rules.

The IIA standards require that the CAE regularly evaluate and, where necessary, adjust the charter and submit it to the board and the AC for approval.

Ninety-four per cent of the respondents indicated that they had an internal audit charter. The (semi-)public sector in particular lags behind here with 72%. Virtually all (97%) the charters have been approved by the board and the AC.

At 73% of the organisations, the audit charter is evaluated annually by the CAE and discussed with the board and the AC. In 11% of the cases, the charter has not been amended in the past four years.

Recommendation

- Each year, the AC should discuss the IAF charter, which sets out the aim, the tasks and responsibilities of the IAF, with the CEA and, where necessary, adjust and then approve it.

6 Positioning of the Internal Audit function

The primary reporting line of most of the CAEs (60%) is to the chair of the board. Ten CAEs (14%) report primarily to the CFO; eleven CAEs (16%) to the AC. Compared to earlier surveys, CAEs increasingly report to the organisation's CEO.

The IIA and NBA LIO believe that the primary reporting line should be to the CEO, not to another member of the board. Moreover, there should ideally be a secondary/derived reporting line to the chair of the AC. This ensures complete independence of the CAE. If the CAE reports to another member of the board, it could potentially undermine the independence and objectivity of the CAE because he performs audits of processes and programmes that come under the responsibility of the board member involved.

If the latter is the case, measures should be implemented that remove this threat or at least reduce it to an acceptable level. In fact, the reporting line to the chair of the board is already included in the Banking and Insurers' Codes.

In the opinion of the IIA and NBA LIO, it is not ideal that the CAE primarily reports to the chair of the AC, because this poses the risk that the IAF is actually placed outside the organisation. Nevertheless, that model is justified in specific situations, e.g. in a one-tier structure.

The AC should always fulfil a safety-net function for the CAE for cases in which the CAE comes or can come into conflict with the board in the interest of independence and objectivity.

Recommendation

- The AC periodically reviews the positioning and independence of the IAF.

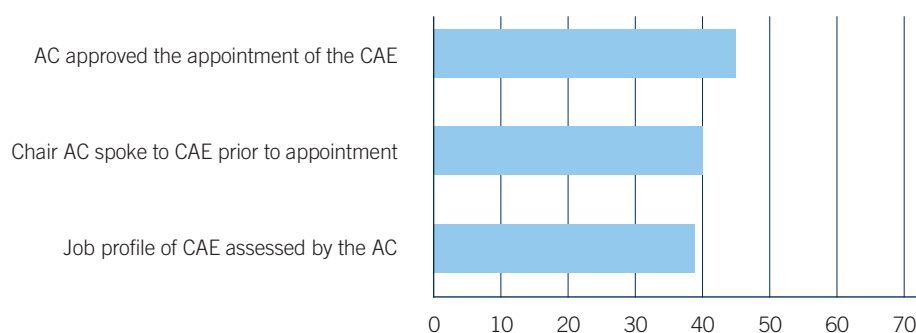
7 Appointment and dismissal of the Chief Audit Executive

The AC is expected to monitor the functioning of the IAF. Crucial here is to select a qualified CAE. It is therefore vital that the AC be involved in the CAE's job profile and recruitment.

The results from the survey show that, at 63% of the respondents, the board submitted the proposed candidate for CAE to the AC. This number was considerably less in the (semi-)public sector (27%). The number of CAEs that spoke to the chair of the AC prior to appointment is 40 (57%). In a single case the CAE had already been appointed before the AC was established.

Slightly more than half the ACs (55%) assesses the job profile for the CAE. Certain employment conditions and personal or departmental targets could act as incentives with an adverse impact on objectivity. Thirty-four per cent of ACs monitors this.

Involvement of the AC in the appointment of the CAE (n = 70)



In 61% of the cases, the dismissal of the CAE was submitted for approval to the chair of the AC. In only a small number of cases (21%) did the chair of the AC conduct an exit interview with the departing CAE. Exit interviews can provide valuable information to the AC about the reasons for the CAE's departure.

Section 6 discusses the assessment of the effectiveness of the IAF as a whole. To safeguard the independence of the CAE, the AC should also have a prominent part in the CAE's appraisal. Among other things, the effectiveness of the measures for safeguarding the independence of the CAE can be discussed here.

Recommendations

- Prior to the recruitment, the AC reviews the job profile for the CAE.
- The chair of the AC holds an interview with the candidate proposed by the board prior to the AC's approval of the appointment of the CAE.
- The chair of the AC has a prominent part in the periodic appraisal of the CAE's performance.
- The chair of the AC conducts an exit interview with the departing CAE.

Clause 1.3.1

Appointment

The management board should both appoint and dismiss the senior internal auditor. Both the appointment and the dismissal of the senior internal auditor should be submitted to the chairman of the audit committee for approval.

Source: Proposal for revision Dutch Corporate Governance Code

8 Assessment of the Internal Audit function

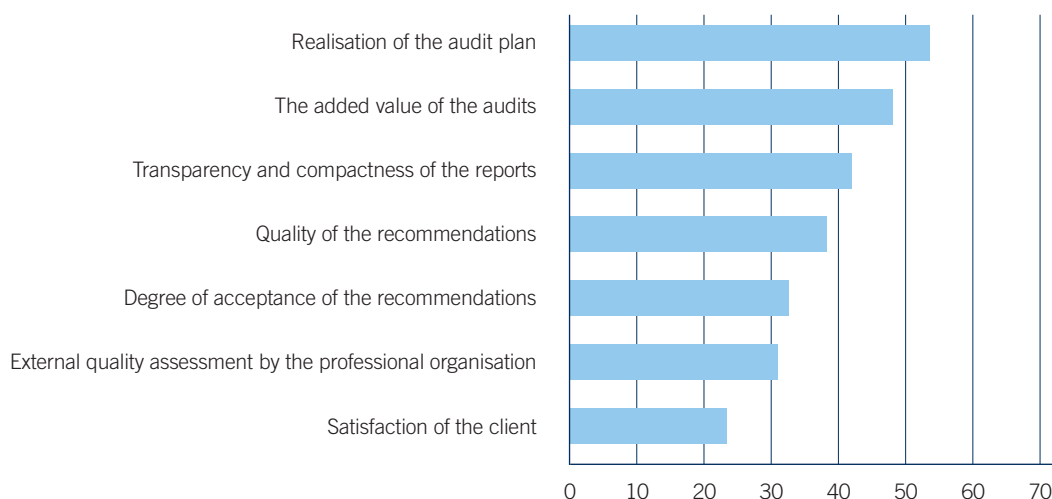
The IIA Standards require that every IAF maintain a quality control and improvement programme. This programme first has to allow for an evaluation of compliance with the IIA Standard and, second, a measuring of the efficiency and effectiveness of the IAF.

The AC should issue an opinion on the functioning of the IAF. This opinion is shared with the board and the entire SB. We learn from the response that 83% of the ACs is involved in evaluating the functioning of the IAF. The key elements for the audit committee's evaluation of the internal audit function are the realisation of the audit plan, the added value of the audits and the quality of the report. The survey results show that the AC takes into account the quality and the acceptance degree of the recommendations in 58% and 46% respectively of the organisations. Client satisfaction is only an issue for ACs in 33% of the cases. Private organisations allow more aspects in the equation than the (semi-)public sector.

The regular implementation of external quality assessments is compulsory for all the members of the NBA (once every six years) and the IIA (once every five years). In the (semi-)public sector, however, the implementation of external quality assessments is not yet at the required level. Only 44% of the ACs includes the results of the external assessment in the evaluation. In some interviews, the CAEs said that the AC had indicated that external quality assessments of the IAF should be performed more frequently than was suggested in the rules of the professional organisations. Sixty-six per cent of the ACs asks the EA about the effectiveness of the IAF.

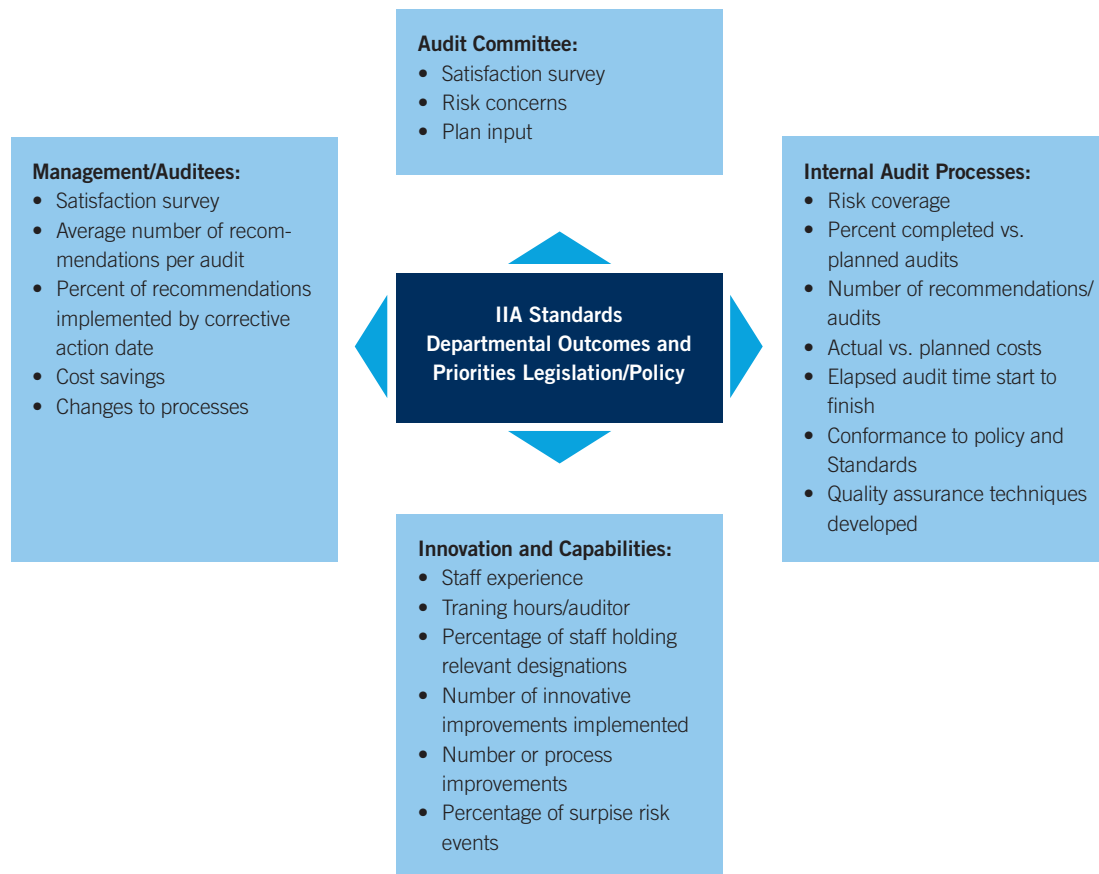
When measuring the effectiveness, the AC can also review the employment conditions and personal targets for the CAE and review the departmental targets to ascertain whether they (could) impede the functioning. Among 34% of the respondents the AC reviewed the employment conditions and targets and established that they did/could not impede the functioning.

Aspects in the evaluation of the IAF (n=70)



The recent IIA publication ‘*Effectiviteitsmeting Internal Auditfunctie*’ (Measuring the effectiveness of the Internal Audit function)⁵ is a good guide for the board and the AC to reach concrete agreements with the CAE about the basis for measuring the effectiveness of the IAF. This publication contains a detailed elaboration of the Balanced Scorecard below from the IIA Practice Guide ‘*Measuring Effectiveness and Efficiency*’⁶.

Model 1: Balanced scorecard type approach



Recommendations

- The AC obtains information from the CAE about the customised system of performance indicators agreed by the board and the CAE and which the CAE uses to monitor the effectiveness of the IAF. The CAE reports to the board and the AC.
- The AC obtains information from the CAE about the term within which the external assessment of the quality of the IAF is carried out, the results of this external review and the ensuing improvement plan.

5 http://www.iaa.nl/SiteFiles/Publicaties/IIA_Bro%20A4%20Effectiviteitsmeting%20IAF%20NL%2002.pdf

6 http://iaa.nl/SiteFiles/IIA_leden/Praktijkguidsen/Practice%20guide%20Measuring%20Internal%20Audit%20Effectiveness.pdf

Clause 1.3.2

Assessment of the internal audit function

The management board should annually assess the functioning of the internal audit function, taking into account the audit committee's opinion.

Source: Proposal for revision Dutch Corporate Governance Code

Clause 1.5.3

Audit committee report

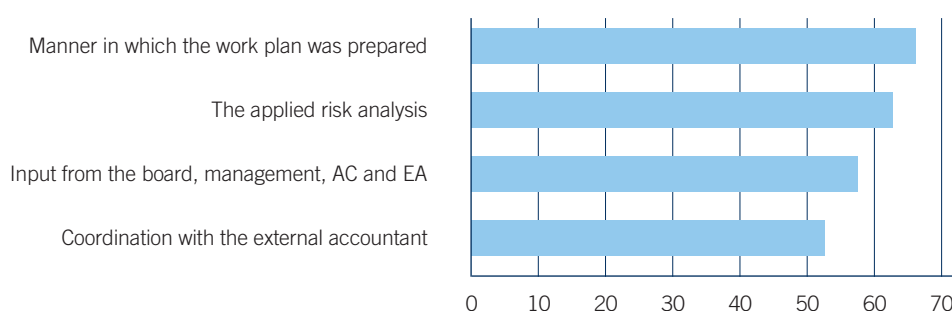
The audit committee should report to the supervisory board on (...) the methods used to assess the effectiveness of the internal and external audit processes.

Source: Proposal for revision Dutch Corporate Governance Code

9 Audit plan of the Internal Audit function

The IIA Standards stipulate that the CAE prepare an audit plan at least once a year. This plan is based on an audit risk analysis whose method and the outcomes have been agreed with the board, management, the AC and the EA. It is important that the CAE agrees the plan with the EA in order to avoid overlap and gaps. The CAE then submits the audit plan and the accompanying financial year budget for approval to the board and the AC. It is possible in exceptional cases that an IAF is not in a position to perform certain audits independently, e.g. because the CAE is also responsible for risk management. Similar restraints should be discussed with the board and the AC.

Aspects about the preparation of the work plan with notes to the Audit Committee (n=70)



In many organisations, the team composition is also on the agenda when discussing the audit plan. The training required is discussed to a lesser extent. In a highly dynamic world, however, ongoing further training of the auditors and the attraction of new disciplines, if necessary, are crucial. For instance, think of cybercrime and the audit of conduct and culture (soft controls). In the private sector, the AC approves 93% of the audit plans and any significant interim changes to them. This is only 55% in the (semi-)public sector.

In almost all the cases the CAE provides an explanation to the AC of how the audit plan was prepared and which risk analysis was applied. This also reveals how the input from the board, senior management, the AC and the EA has been incorporated in the plan. The frequency of the progress reports varies from once per quarter to once per year. The report is also discussed during the AC meeting, at which the EA is also present. Generally, CAEs in the financial sector provide feedback more often than CAEs in the (semi-)public sector. In this sector, the progress of the audit plan is on the agenda of the tripartite meeting with the Dutch central bank (DNB).

Based on the organisation's risk policy and the estimated time required, the CAE decides how much and what resources are required for performing the desired audits. This results in an audit plan with an accompanying budget, which are discussed with the board. It may lead to the conclusion that the allocated resources are not sufficient for implementing the envisaged plan. The CAE will discuss this with the board and the AC, with the CAE having to be clear about what his boundaries are from his professional independence perspective. This discussion may result in the allocation of extra resources or the acceptance that certain desired audits will not be performed. Finally, the audit plan and the accompanying budget are approved by the AC. Almost all the respondents (90%) say that the adequacy of the available resources is discussed with the AC at least annually.

Recommendations

- The AC should discuss the IAF's audit plan, the allocated budget and significant changes in the audit planning with the CAE and give formal approval.
- When discussing the audit plan, the AC refers to the IAF's interaction agreement with the EA.

Clause 1.3.3

Internal audit plan

The internal audit function should draw up an internal audit plan and, after coordinating with the external auditor, should submit it for approval to the management board and then to the audit committee. In this internal audit plan, attention should also be paid to the interaction with the external auditor.

Source: Proposal for revision Dutch Corporate Governance Code

Clause 1.3.4

Performance of work

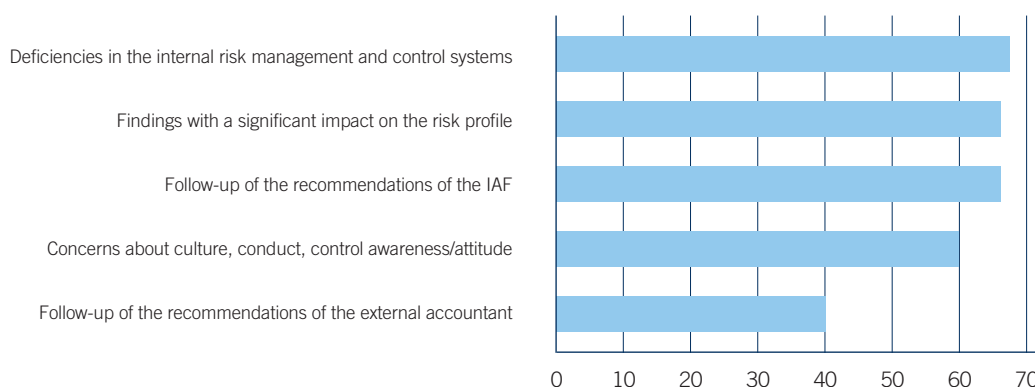
The internal audit function should have sufficient resources to execute the internal audit plan and have direct access to information that is important for the performance of its work. The internal audit function should have direct access to the audit committee and the external auditor. Records should be kept of how the audit committee is informed by the internal audit function.

Source: Proposal for revision Dutch Corporate Governance Code

10 Report of findings and follow-up

Practically all the CAEs inform the AC about deficiencies in the internal risk management and control systems and about findings that impact the organisation's risk profile. The follow-up of the findings is also reported frequently. In 59% of the cases, the IAF reports on the follow-up of the EA's findings. During interviews, respondents said that the recommendations of the EA were frequently not in the CAE's hands, but in those of another position, e.g. the CFO. Consequently, the practice usually deviates from the proposed revision of the Code.

Report to AC



In a few cases the IAF manages a database with all the pending audit findings. It also includes the findings and improvement actions from the EA's management letter.

Recommendation

- The AC regularly obtains information from the CAE on the progress of the follow-up of the IAF's and EA's recommendations.

Clause 1.3.5

Reports of findings

The internal audit function should report its audit results to the management board and the essence of its audit results to the audit committee and should inform the external auditor. The internal audit function should inform the management board, the audit committee and the external auditor of:

- any flaws in the effectiveness of the internal risk management and control systems;
- any findings and observations with a material impact on the risk profile of the company and its affiliated enterprise; and

iii. any failings in the follow-up of recommendations made by the internal audit function and external auditor

In the consultation by the management board and the audit committee with the internal audit function, issues pertaining to the culture and conduct within the enterprise affiliated with the company should also be addressed.

Source: Proposal for revision Dutch Corporate Governance Code

Clause 1.5.1

Duties and responsibilities of the audit committee

The audit committee's duties and responsibilities include monitoring the company's financial reporting and the risk management conducted by the management board. In addition to what is laid down in legislation, the audit committee should in any event focus on monitoring the management board with regard to:

- i. relations with, and compliance with recommendations and following up of comments by, the internal audit function and the external auditor;

Source: Proposal for revision Dutch Corporate Governance Code

1 1 Presence of the Chief Audit Executive at meetings of the Audit Committee

A key requisite for proper functioning is an open and transparent relationship with the AC, the board and management. This can best be achieved by inviting the CAE to attend the entire AC meeting. This is also the case at the majority of the organisations (80%). At the remaining organisations, the CAE is only present for part of the agenda, or only if there is need for it. It is evident for this 20% that the CAE and the chair of the AC need to make the usefulness and relevance of CAE's contribution at the AC an agenda item.

In two thirds of the organisations, the AC consults structurally and/or bilaterally with the CAE. This is important and strengthens trust and the mutual bond. Moreover, this consultation also underlines the independent position (also in the spirit) of the CAE and is a sign of the transparency embraced by the board.

In the interviews and during the roundtable discussion it became clear that the bilateral consultation worked well. It is essential here that the chair of the board be kept informed about the content of the meeting.

At the remaining organisations, the chair of the AC and the CAE would do well to make the importance of and the need for a periodic bilateral meeting a discussion point. The importance of this meeting may not be underestimated, also with a view to what it reflects to the rest of the organisation. In this, the chair of the AC will underline the importance of the internal audit to the organisation and to the AC as monitoring body.

Recommendation

- The chair of the AC invites the CAE to periodic bilateral consultation. The agenda for this meeting is decided in mutual consultation.

Clause 1.5.2

Attendance of the management board, internal auditor and external auditor at audit committee consultations

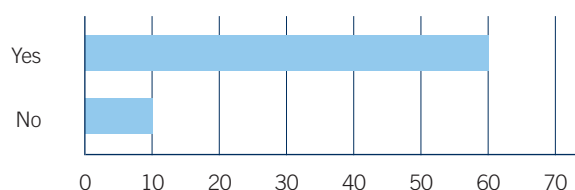
In principle, the internal auditor and the external auditor should attend the audit committee meetings. The audit committee should decide whether and, if so, when the chairman of the management board and the chief financial officer should attend its meetings.

Source: Proposal for revision Dutch Corporate Governance Code

12 Conduct and culture (soft controls)

Partly prompted by scandals and bankruptcies, the interest in audits in the field of conduct and culture (soft controls) is on the increase. The financial sector reviews conduct and culture as a fixed element of its audit plan. There are also some organisations and IAFs that are still in an orienting or preparatory phase. There are increasing calls from the board, the SB or the AC for auditing conduct. These policy-making, supervisory bodies understand only too well that no matter how well an internal control measure may be described, the organisation's culture makes or breaks the success of its implementation.

Concerns about culture and conduct discussed with the AC? (n = 70)



It has become absolutely clear that the audit profession can no longer skirt around conduct and culture audits now that the Corporate Governance Monitoring Committee expects the AC to pay attention to soft controls in its proposed revision of the Code. In its response to this proposal, the IIA board made clear that the IAF can have a prominent role here in monitoring it.

It is interesting that the issue is also increasingly being raised explicitly by managers and supervisors in the (semi-)public sector. As a result, and sometimes in anticipation of that, the issue of controls is also raised at IAFs.

The choice of a framework of norms to apply to conduct and culture audits is important. Some concepts have now been developed for it. The best known systems have been developed by KPMG and the AFM. But the COSO 2013 offers a good guidance in its Internal Control-Integrated Framework.

In 2015, the IIA issued the *'Discussion paper Soft Controls'*⁷. This publication outlines the status of soft-control audits, resulting in an overview of different approaches and possibilities.

The report was discussed at length during the roundtable sessions with the CAEs about the results of the survey. These revealed that the manner of reporting was not yet crystal clear. Some organisations report in writing, other IAFs orally.

How do you include the outcomes of audit of culture and conduct in the weighting of a rating? In the practice, the lack of 'hard' norms makes it difficult for the auditor to reach an objective opinion.

Knowledge about, insight into and experience with a conduct and culture audit approach are in the making. Some large audit services (especially those of financial institutions) have appointed behavioural specialists

⁷ http://www.iaa.nl/SiteFiles/Publicaties/IIA_Bro_A4_Soft_Controls_03.pdf

http://www.iaa.nl/SiteFiles/Publicaties/IIA_Bro%20A4%20Soft%20Controls%20Engels%2002.pdf

A printed copy can be ordered from vaktechniek@iaa.nl

(psychologists and/or sociologists), after which all the auditors are then given training in these procedures. Other services hire expertise temporarily or attend separate courses in this field. This field of knowledge should also be included in the professional training courses for auditors and accountants.

It would be advisable for the IAF to agree an approach that will enable auditors to develop a framework of norms and audit tools, as well as the best communication means for discussing and reporting the necessary improvement actions.

Recommendation

- The AC obtains information from the CAE about the approach for conduct and culture audits and their results.

Clause 1.3.5

Reports of findings

... In the consultation by the management board and the audit committee with the internal audit function, issues pertaining to the culture and conduct within the enterprise affiliated with the company should also be addressed.

Source: Proposal for revision Dutch Corporate Governance Code

Clause 2.5.5

Accountability regarding culture

In the management report, the management board should explain the manner in which a culture is shaped within the company that is aimed at long-term value creation.

Source: Proposal for revision Dutch Corporate Governance Code

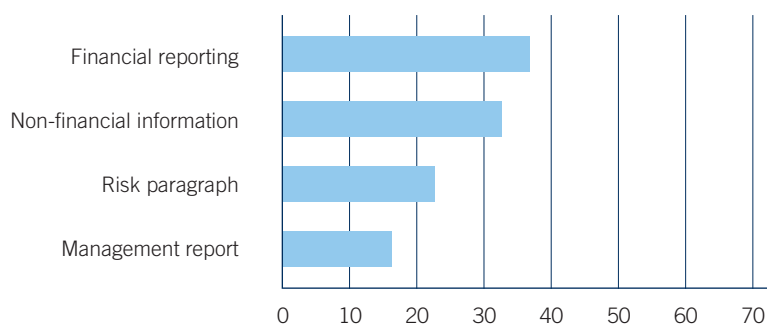
13 Collaboration with the external accountant

In 2009, the IIA and the NBA published the report *Impact on Governance - Internal and external auditor; together, an even stronger contribution towards governance*⁸. They concluded that this collaboration had a varied intensity and was good in the practice, but could still be further improved on effectiveness and efficiency. This large diversity was also revealed during the roundtable session that formed part of this survey. Collaboration was especially forthcoming where the one party could draw on the specific expertise of the other. The AC formulates the engagement for the audit of the financial statements to the EA and submits it to the SB, which reviews it and then tables it at the ALV. The ALV appoints the EA.

To reach an opinion on the fair presentation of the financial statements, the EA assess the risks of a material misstatement in the financial statements. The EA thus gains more insight into the organisation, among other things, including the internal control. The existence of an IAF is a key internal control measure. The EA should establish that the organisational position, policy lines and procedures of the IAF adequately support the objectivity of the internal auditors. In addition, the EA also reviews the competency level of the IAF as a whole and whether the IAF applies a systematic and disciplined approach. If all of this sufficient in the opinion of the EA, the EA can rely on the work of the internal audit function in a constructive and complementary manner. The IAF can serve as a key, effective and efficient source of information for the EA.

The survey shows that some 80% of the IAFs pays attention to the agreement with the EA in the notes to their audit plan to the AC. Still, it often does not specifically discuss the complementarity of the work of the IAF and the EA. At 54% of the IAFs this happens before the agreement of the work regarding the financial reporting. This figure is 49% for non-financial information. The complementary procedures in the field of the management report and the risk paragraph from it are less frequently disclosed in the audit plan.

Complementarity of the work of the EA and IAF



Management report

In addition to the financial statements, the management report forms part of the annual report. In its position paper *'Een relevant en betrouwbaar bestuursverslag'* (A relevant and reliable management report)⁹, the NBA points out, among other things, that

⁸ http://www.iaa.nl/SiteFiles/PDF/14januari_Impact%20op%20governance_DEF_15okt09_web.pdf

⁹ https://www.nba.nl/Documents/Nieuws/Persberichten/NBA_Position_paper-Een_relevant_%20en_betrouwbaar_bestuursverslag.pdf

“the accountant must at least be able to give an opinion on the correctness and completeness of the risk paragraph, continuity analysis and corporate governance information contained in the management report. To the extent that the accountant, based on his knowledge of the organisation, cannot assess the quality of some parts, he must collaborate with other material experts to do so”.

This logically implies more intensive collaboration with the IAF because the latter continuously review the adequate setup and functioning of the organisation’s governance. Good governance should offer sufficient guarantees for a reliable management report. The roles of the EA and the IAF should therefore go hand- in-hand. Clear positioning, optimum collaboration and knowledge sharing are key in this respect.

The regular IAF reports to the BoM and SB, and copied to the EA, are key sources of information for the management report and fulfil a highly important signalling role in respect of its transparency, completeness and correctness.

The survey shows that 87% of the EAs receives the audit reports and/or quarterly reports from the IAF.

The working group advocates the inclusion of non-financial information concerning the environment, social and personnel issues, respect for human rights and combating corruption and bribery in the management report. This increases the accessibility of this information because it becomes part of a single report. Besides, this information is then part of the EA’s brief.

The CAEs specifically mention the financial and non-financial information as areas where the work of the EA and the IAF is complementary. This is significantly less so in the case of the risk paragraph in the management report. The interviews show that the IAF is often to a more or lesser extent involved in its preparation. As a result, the EA can rely less on the work of the IAF. In more than 70% of the surveyed population, the internal auditor has a regular progress meeting with the EA. This should increase to 100%.

Recommendation

- The AC should obtain information on the way in which the complementarity of the work of the EA and the IAF is put into practice by the EA and the IAF.

Internal audit function’s work plan

The Committee proposes to clarify in a best practice provision who should be involved in drawing up the internal audit function’s work plan, and how. After coordination with the external auditor, the work plan should be submitted for approval to the management board and then the audit committee. The Committee proposes to add that the internal audit function’s work plan should address the interaction with the external auditor. The Committee wishes to emphasize in that respect that the performance of the duties of the internal audit function and those of the external auditor are complementary.

Source: Proposal for revision Dutch Corporate Governance Code

14 All the recommendations at a glance

- Each year, the AC should discuss the IAF charter, which sets out the aim, the tasks and responsibilities of the IAF, with the CEA and, where necessary, adjust and then approve it.
- The AC periodically reviews the positioning and independence of the IAF.
- Prior to the recruitment, the AC reviews the job profile for the CAE.
- The chair of the AC holds an interview with the candidate proposed by the board prior to the AC's approval of the appointment of the CAE.
- The chair of the AC has a prominent part in the periodic appraisal of the CAE's performance.
- The chair of the AC conducts an exit interview with the departing CAE.
- The AC obtains information from the CAE about the customised system of performance indicators agreed by the board and the CAE and which the CAE uses to monitor the effectiveness of the IAF. The CAE reports to the board and the AC.
- The AC obtains information from the CAE about the term within which the external assessment of the quality of the IAF is carried out, the results of this external review and the ensuing improvement plan.
- The AC should discuss the IAF's audit plan, the allocated budget and significant changes in the audit planning with the CAE and give formal approval.
- When discussing the audit plan, the AC refers to the IAF's interaction agreement with the EA.
- The AC regularly obtains information from the CAE on the progress of the follow-up of the IAF's and EA's recommendations.
- The chair of the AC invites the CAE to periodic bilateral consultation. The agenda for this meeting is decided in mutual consultation.
- The AC obtains information from the CAE about the approach for conduct and culture audits and their results.
- The AC should obtain information on the way in which the complementarity of the work of the EA and the IAF is put into practice by the EA and the IAF.