

EUROPEAN Company Law



Wolters Kluwer
Law & Business

European Company Law

European Company Law (ECL) is published under the aegis of the Centre for European Company Law (CECL), an academic partnership of the Universities of Leiden, Utrecht, Maastricht, the Netherlands Uppsala (Sweden) and Rome, LUISS Guido Carli (Italy) (www.cecl.nl). The purpose of CECL is to further the study of company law by focusing on supranational issues. These include both developments in the EU and on other international levels, as well as comparative law. Leiden University acts as the leading partner in CECL, with Professor Steef M. Bartman, as coordinating director. ECL aims to be interesting for both practising and academic lawyers in the field of European company law. There are six issues of ECL per year. Two of these (April and October) concentrate on specific topics. The other issues contain articles on various subjects and may also include country reports of a general nature, highlighting important developments in a number of EU jurisdictions, as well as columns that offer summaries of recent EU legislation, ECJ case law and of selected articles from various national legal periodicals.

EDITORIAL BOARD

STEEF BARTMAN (Main Editor), Professor of Company Law at Leiden University, the Netherlands
e-mail: s.m.bartman@law.leidenuniv.nl

ANDREAS CAHN Director of the Institute for Law and Finance, Johann Wolfgang Goethe-University, Frankfurt, Germany
e-mail: cahn@ilf.uni-frankfurt.de

BARBARA DE DONNO Professor of Comparative Private Law, LUISS Guido Carli, Rome, Italy
e-mail: bdedonno@luiss.it

ADRIAAN DORRESTEIJN Professor of International Company Law at Utrecht University, the Netherlands
e-mail: decaan@law.uu.nl

CHRISTOPH VAN DER ELST Professor of Law and Management, Tilburg University, The Netherlands
e-mail: C.vdrElst@uvt.nl

HOLGER FLEISCHER Professor of Law, Director of the Max Planck Institute for Comparative and International Private Law, Hamburg, Germany
e-mail: fleischer@mpipriv.de

MARCO LAMANDINI Full Professor of Company Law at the University of Bologna, Italy
e-mail: marcolamandini@forschung.it

FRANCISCO MARCOS IE Law School, Madrid, Spain
e-mail: Francisco.Marcos@ie.edu

KID SCHWARZ Professor of Company Law at Maastricht University, the Netherlands
e-mail: c.schwarz@pr.unimaas.nl

DANIEL STATTIN Professor of Corporate Law, Uppsala University, Sweden
e-mail: Daniel.Stattin@jur.uu.se

ERIK WERLAUFF Professor of Company and Business Law at Aalborg University, Denmark
e-mail: erik@werlauff.com

JAAP WINTER Professor of International Company Law at the Universiteit van Amsterdam, the Netherlands
e-mail: jaap.winter@debrauw.com

CONTRIBUTING INTERNATIONAL LAW FIRMS

ALLEN & OVERY Jan Louis Burggraaf
e-mail: JanLouis.Burggraaf@AllenOvery.com

BAKER & MCKENZIE Jeroen Hoekstra
e-mail: Jeroen.Hoekstra@BAKERNET.com

DE BRAUW Geert Potjewijd
e-mail: geert.potjewijd@debrauw.com

DLA PIPER Marnix Holtzer
e-mail: marnix.holtzer@dlapiper.com

HOUTHOFF BURUMA André G. de Neve
e-mail: a.de.neve@houthoff.com

LOYENS & LOEFF / UTRECHT UNIVERSITY Tineke Lambooy
e-mail: t.lambooy@law.uu.nl

STIBBE Christian van Megchelen
e-mail: christian.vanmegchelen@stibbe.com

COUNTRY REPORTERS

KARIN EKLUND University Lecturer in Corporate Law, Uppsala University, Uppsala, Sweden
e-mail: Karin.Eklund@jur.uu.se

THOMAS PAPADOPOULOS Lecturer at the Department of Law of the European University, Nicosia, Cyprus
e-mail: T.Papadopoulos@euc.ac.cy

FEDERICO RAFFAELE Assistant Professor of Comparative Law and Research Fellow in Corporate Law, LUISS Guido Carli, Rome, Italy
e-mail: fraffaele@luiss.it

FRANÇOIS CARLE & ISABELLE DESJARDINS
e-mail: francois.carle@ey-avocats.com, idesjardins@carlara.com

CHRISTOPH VAN DER ELST Professor of Law and Management, Tilburg University, The Netherlands
e-mail: C.vdrElst@uvt.nl

BOHUMIL HAVEL Institute of Law, Czech Academy of Science, Prague, Czech Republic
e-mail: bhavel@kop.zcu.cz

FRANCISCO MARCOS Instituto de Empresa Business School, Madrid, Spain
e-mail: Francisco.Marcos@ie.edu

PAVLOS MASOUIROS Assistant Professor of Corporate Law, Leiden University, the Netherlands, Attorney-at-Law, Athens, Greece
e-mail: p.masouros@law.leidenuniv.nl

BEATE SJÄFJELL Centre for European Law, Faculty of Law, University of Oslo
e-mail: b.k.sjafjell@jus.uio.no

RAFAL STROINSKI Warsaw University, Poland
e-mail: Rafal.Stroinski@uw.edu.pl

CHRISTOPH TEICHMANN University of Heidelberg, Germany
e-mail: christoph.teichmann@urz.uni-heidelberg.de

ERIK WERLAUFF Aalborg University, Denmark
e-mail: erik@werlauff.com

EDITORIAL SECRETARY

CORNELIS DE GROOT Leiden University, the Netherlands
e-mail: c.degroot@law.leidenuniv.nl

PAVLOS MASOUIROS Leiden University, the Netherlands
e-mail: p.masouros@law.leidenuniv.nl

THOMAS PAPADOPOULOS European University, Nicosia, Cyprus
e-mail: T.Papadopoulos@euc.ac.cy

Published by:
Kluwer Law International
PO Box 316
2400 AH Alphen aan den Rijn
The Netherlands
Website: www.kluwerlaw.com

DISTRIBUTION

Sold and distributed in North, Central and South America by:
Aspen Publishers, Inc.
7101 McKinney Circle
Frederick MD 21704
United States of America
E-mail: customer.service@aspenpublishers.com

Sold and distributed in all other countries by:
Turpin Distribution Services Ltd.
Stratton Business Park
Pegasus Drive, Biggleswade
Bedfordshire SG18 8TQ
United Kingdom
E-mail: kluwerlaw@turpin-distribution.com

European Company Law Journal is published six times per year. Subscription prices for 2015 including postage and handling:
Print subscription prices: EUR 710/USD 947/GBP 522
Online subscription prices: EUR 657/USD 878/GBP 484

Printed on acid free paper.

SHORT TITLE AND QUOTATION

ISSN: 1572-4999
© 2015 Kluwer Law International BV, The Netherlands

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, mechanical, photocopying, recording or otherwise, without written permission from the publisher.

Permission to use this content must be obtained from the copyright owner. Please apply to: Permissions Department, Wolters Kluwer Legal, 76 Ninth Avenue, 7th floor, New York, NY 10011, USA.
E-mail: permissions@kluwerlaw.com

Table of Contents

5	Editorial EU Legal Entities: New Options? <i>Harold Koster</i>
7	Non-intermediated Securities: A European View on the Draft UNCITRAL Model Law on Secured Transactions A major challenge for the drafters of the UNCITRAL Model Law on Secured Transactions would seem to be the coordination with EU legislation that is relevant to securities. In particular, the current text of the draft Model law does not reflect the fundamental distinction made in the EU Financial Collateral Directive between transactions involving securities that enhance liquidity in the financial markets and other types of securities, resulting in distinct legal regimes in the European Union. <i>Thomas Keijser</i>
13	AASA: Locating the Central Administration of a Subsidiary Company Which Is Part of a Group of Companies under Article 60 of Brussels I Regulation There is no definition of the term ‘central administration’ under Article 60(1)(b) of the Brussels I Regulation; and Article 60 of Brussels I does not make specific provisions for locating the central administration of a subsidiary company within a corporate group. English Courts in <i>Anglo American South Africa Limited</i> after a re-evaluation of the correctness of previous decisions by English judges, sought to apply the concept of central administration in a ‘European way’ to a subsidiary company within a corporate group. <i>Chukwuma Samuel Adesina Okoli</i>
19	The Use of Mailbox Companies in International Investment Protection To obtain a favourable protection for their investments, investors have resorted to treaty shopping in which an investor locates a newly set up legal entity (usually a mailbox company) in another jurisdiction. First, an overview is provided of the system of international investment protection, mainly elaborating on the definitions and criteria as for instance, the investment and investor definition. Then, on the use of mailbox companies in international investment protection is discussed. <i>Fai de Swart</i>

26

The European Legislative Framework for Audit Committees

This first analysis of the new European legal framework of audit committees of public-interest entities shows that the role and importance of this committee is considered to be pivotal. The requirements to monitor the work and independence of the auditor should not be underestimated. There are some doubts, however, whether all the new measures are all equally advantageous for reaching the goal of an effective statutory audit.

Christoph Van der Elst

34

The Societas Unius Personae (SUP)

The Societas Unius Personae is proposed for the benefit of a quicker and cheaper way of establishing a single-member private limited liability company across the border. In order to achieve this objective, a mandatory full electronic registration procedure is included in the proposed Directive. Although Member States are bound by certain conditions, they have some freedom in designing the (online) registration process and the requested information. As a result, twenty-eight different registration procedures may come into force.

Iris Wuisman

45

Report

Report from Europe: The Proposal for a Directive Amending the Shareholders Rights Directive

Tom Dijkhuizen

51

Columns

Survey of Legislation and Case Law, August, September and October 2014

Paul Jager

52

Book Review

Paul Omar (ed.), *International Insolvency Law. Reforms and Challenges*, Ashgate 2013, 478 pp. Price: £90.00 (exclusive of VAT). Also available as ebook

Bob Wessels

The European Legislative Framework for Audit Committees

CHRISTOPH VAN DER ELST, PROFESSOR OF BUSINESS LAW AND ECONOMICS, TILBURG UNIVERSITY AND GENT UNIVERSITY*

In 2014, the European Union reformed the regulatory framework of statutory audits in Directive 2014/56/EC and Regulation (EU) No. 537/2014. Part of the new legislation addresses the composition and responsibilities of the audit committee of public-interest entities. This contribution studies the innovations for audit committees. It is shown that many new requirements are very detailed and will force audit committees to develop new procedures. We fear that some of these new requirements are too prescriptive and will not necessarily reach the goal of better audits.

1. INTRODUCTION

Audit committees are a key instrument for developing a sound corporate governance system in a company. In its communication of May 2003, the European Commission stated that the audit committee has an important role in the monitoring of the internal and external audit function.¹ The European Commission embodied this role in a Recommendation in 2005. As a non-executive subcommittee of the board, the audit committee had to monitor the integrity of the financial information, review the internal control and risk management process, ensure the effectiveness of the internal audit function as well as the external audit process, make recommendations to the (supervisory) board for the election of the external auditor and monitor the latter's independence and objectivity, in particular by reviewing the extent and nature of non-audit services.² The European Commission could rely on the American Sarbanes-Oxley Act of 2002 (SOX) for developing the role and composition of the audit committee.³ This important piece of federal US legislation was issued to restore the

confidence in the American capital market after the collapse of Enron, Worldcom and others. According to this Act, the audit committee must appoint the auditor and monitor his work, must establish procedures for addressing complaints related to internal audit and control⁴ and must approve certain non- audit services.⁵ The external auditor reports the audit committee about different issues related to his work and the accounting policies of the company.⁶ The audit committee must be composed of independent directors and comprise at least one financial expert.⁷

The major difference between the American and European approach at that time was the kind of regulation: mandatory in the US, best practice guidance in Europe. In this journal, Erik Mouthaan addressed the state of the art of audit committees in nine European Member States as well as of the European recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.⁸ His research focused on the position of audit committees in the national corporate governance codes which were of a 'comply' or 'explain' nature. He found that the corporate governance audit committee requirements show a high degree of communality but emphasize 'disclosure', 'explanations' and 'guidance' instead of detailed mandatory regulations.

For the control of the financial statements, the European Commission wanted to provide in harmonized statutory audit requirements and it worked towards a directive that would address this issue. It resulted in Directive 2006/43/EC⁹ in which the most important parts address the position and activities of the statutory auditor. Auditors must be approved and registered in a public

* E-mail: c.vderelst@tilburguniversity.edu.

1 European Commission, *Communication from the Commission to the Council and the European Parliament - Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move*, COM (2003) 284, Brussels, 21 May 2003, p. 15.

2 Annex 1 – Committees of the (supervisory) board, s. 4.2. Role of the audit committee in Commission Recommendation of 15 Feb. 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, *OJ L* nr. 52 of 25 Feb. 2005, p. 51.

3 Officially 'Public Company Accounting Reform and Investor Protection Act of 2002'. See for an analysis, J. Martella, M. Paul, T. Philipp & R. James, *Audit Committee Requirements for Foreign Companies Listed in the United States*, 62 *European Co. L.* (2004).

4 Section 301 SOX.

5 Section 201 and 202 SOX.

6 Section 204 SOX.

7 Section 301 and 407 SOX. If no financial expert is part of the committee, the reasons therefor must be disclosed.

8 E. Mouthaan, *The Audit Committee from a European Perspective*, *European Co. L.* 10–18 (2007).

9 Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/ 660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, *OJ L* nr. 157 9 Jun. 2006, p. 87.

register. The auditors will be submitted to public oversight which must be independent of the industry. The national public oversight system is mutually recognized to be able to meet and cope with international business requirements.

Additionally, the Directive 2006/43/EC contains one part which is directed towards the public-interest entities. These entities include the large listed entities, credit institutions and insurance undertakings.¹⁰ Those entities are required to establish an audit committee at the level of the administrative organ or supervisory board, composed with at least one member being independent and familiar with auditing and/or accounting. The committee has specific duties vis-à-vis internal control, risk management and the selection procedure of the auditor.¹¹

Shortly after the publication of the aforementioned Directive 2006/43/EC, the debate was started whether the regulatory framework need further improvements, in particular after the start of the financial crisis. European Commissioner Barnier opined that the regulatory framework was inadequate for appropriately addressing the financial crisis.¹² The European Commission studied the different issues at stake and reported in its Green Paper of 2010 that the audit committee should be regularly in dialogue with the external auditor as well as with the internal auditor.¹³ The Commission was of the opinion that this regular dialogue ‘*would ensure that there are no loopholes in the total coverage of compliance, risk monitoring as well as the substantive verification of assets, liabilities, revenues and expenses*’. Later, the Federation of European Accountants (FEE) identified a number of shortcomings in the functioning of audit committees and recommended a further harmonization of the composition, competences and responsibilities of audit committees and optimization of the relationship between the auditor and the audit committee.¹⁴

The role and duties of the audit committee can be found in the new Directive 2014/56/EC¹⁵ which modifies the existing Directive 2006/43/EC significantly. Furthermore, the audit committee has been granted additional powers in the new Regulation (EU) No. 537/2014.¹⁶ Before the enactment of the Directive 2014/56/EC and the Regulation (EU) No. 537/2014, the European regulatory

framework for audit committees, outside the financial industry, consisted only of Article 41 of Directive 2006/43/EC and the aforementioned European Recommendation of 15 February 2005. Especially Regulation (EU) No. 537/2014 broadens the work and responsibilities of the audit committee of public-interest entities, introduces new procedural requirements for audit committees and provides in a new external supervision of the performance of an audit committee.

The remainder of this contribution is divided in five sections. First, the scope of the new directive is briefly assessed. Section three outlines the requirements related to the composition of the audit committee. In Section four, the responsibilities of the audit committee are studied. Section five addresses the monitoring of the audit committee. Section six contains some concluding remarks.

2. SCOPE

Directive 2006/43/EC launched a new scope in European law. Before the enactment of this Directive, the scope of a directive was on companies whose securities are admitted to trading on a regulated market or on specific industries, like insurance or banking. Directive 2006/43/EC required the establishment of an audit committee in all public-interest entities. These entities comprise all listed entities,¹⁷ credit institutions and insurance undertakings as well as other entities that the Member States designated as public-interest entities. Directive 2014/56/EC did not modify the scope but updated it. As a consequence, the option that Directive 2006/43/EC offered to Member States resulted in a wide diversity of entities being considered as public-interest entities. In some Member States pension funds, UCITS, state-owned entities, government agencies, asset management companies and electronic money institutions as well as some other entities like social security institutions or venture capital funds are envisaged as public interest entities.¹⁸ It is estimated that close to 30,000 entities are considered of public-interest. A small country like Ireland has around 2,000 public-interest entities, a large country like Germany around 1,600. In Spain, the number of public-interest entities is

10 Member States may also designate other entities as public interest entities.
11 See for a short analysis of Art. 41 with references to the functioning of audit committees in other countries C. De Groot, *Corporate Governance as a Limited Legal Concept*, 70–72 (Alphen aan den Rijn, Kluwer L. Intl. 2009).
12 G. Griksas & M. Butler, *The European Commission consults on how the European audit market can be improved*, EU Audit Policy, August 2010, p. 2, http://ec.europa.eu/internal_market/auditing/docs/info-letter/2010_10_en.pdf (accessed 8 Nov. 2014).
13 European Commission, *Green Paper – Audit Policy: Lessons from the crisis*, 13 Oct. 2010, COM(2010) 561 final, p. 8.
14 FEE, *The Functioning of Audit Committees*, Discussion paper, Brussel, June 2012, p. 52, http://www.fee.be/images/Discussion_Paper_on_Audit_Committees_120615.pdf (accessed 7 Nov. 2014).
15 Article 1, 32) Directive 2014/56/EC of the European Parliament and of the Council of 16 Apr. 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, *OJ L* nr. 158, 27 May 2014, pp. 196–226. The Directive modifies Directive 2006/43/EC and exists of only two articles. However for the sake of clarity, we refer hereafter to the articles in the modified Directive 2006/43/EC.
16 Regulation (EU) No. 537/2014 of the European Parliament and of the Council of 16 Apr. 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC *OJ L* nr. 158, 27 May 2014, pp. 77–112.
17 Or, more precise, entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Art. 4(1) of Directive 2004/39/EC.
18 For an overview of the scope in each country see FEE, *Definition of Public-Interest Entities (PIE) in Europe*, October 2014, pp. 11–16, http://www.fee.be/images/publications/auditing/PIE_definition_survey_outcome_141015.pdf.

even around 8,000 and Slovenia counts only seventy public-interest entities.¹⁹

Directive 2014/56/EC authorizes the Member States to exempt certain types of public-interest entities to establish an audit committee. The Directive 2014/56/EC differentiates between the exemption to establish an audit committee if the functions of the committee are performed by the (supervisory) board and an overall exemption of both the establishment and the responsibilities of the committee. The exemption of the establishment of the committee can also be provided to companies with an organ that performs equivalent functions to an audit committee.²⁰

The first exemption can conditionally be granted to small and medium-sized companies and companies with a market capitalization of less than EUR 100 million.²¹ The Directive 2014/56/EC emphasizes the importance of the audit committee being composed of non-executive and independent directors.²² Therefore the Directive conditions of companies that provide the (supervisory) board with the functions of the audit committee not to have an executive chairman, whilst the board is performing the functions of the audit committee.

Second, Member States can provide in a full exemption for both establishing an audit committee and for providing its tasks, to subsidiaries, if at group level the audit committee requirements are fulfilled, to UCITS, to issuers of asset-backed securities and to unlisted credit institutions that only issued debt securities with a total amount of less than EUR 100 million.²³ For issuers of asset-backed securities, it is required to publicly disclose the reasons why they consider an audit committee is not 'appropriate'.

3. COMPOSITION OF THE AUDIT COMMITTEE

Directive 2006/43/EC required an audit committee to be composed of at least two members.²⁴ The members must be non-executive directors of which one member must be independent, and one of the independent board members must be competent in accounting and/or auditing.²⁵ The Directive 2006/43/EC left it to the Member States to determine how an independent director can prove his required competence.

Furthermore, the Directive 2006/43/EC stated that the audit committee had to be established either as a subcommittee of the

(supervisory) board or its functions must be performed by an organ of the public-interest entity. This requirement is for certain types of public-interest entities difficult to comply with. As an example, we refer to the (listed) partnership limited by shares²⁶ in Belgium which are governed by a business manager. The latter manager is most of the time a public limited liability company, but it does not comply with the conditions of independence and plurality. Practically, these companies established an audit committee at the level of the corporate organ of the business manager, but legally it is not an organ of the public-interest entity. Directive 2014/56/EC rephrased this requirement but did not modify it.

Directive 2014/56/EC strengthened the composition requirements but built in more flexibility regarding the competence of one of the members. The audit committee as a subcommittee of the (supervisory) board must be composed solely of non-executive directors and the majority of the members must be independent. The former directive required only one member to be independent. Neither Directive 2006/43/EC nor Directive 2014/56/EC specify any kind of independence prerequisites. Recital 24 of Directive 2014/56/EC refers to the European Commission Recommendation of 15 February 2005 regarding the establishment of and the functioning of the audit committee, but it does not explicitly cite the Recommendation vis-à-vis the composition or independence requirements. Hence, it can be argued that the Member States' national rules regarding independence prerequisites can be applied. The Directive 2014/56/EC even allows Member States to exempt audit committees from all independence requirements when all members are directors of the company.²⁷

Directive 2006/43/EC ordered that at least one independent board member is competent in accounting and/or auditing. Directive 2014/56/EC disentangled independence from competence in accounting/auditing. It is sufficient if one member has the required expertise in accounting and/or auditing, whether this member is independent or not.

The aforementioned easing of one requirement comes with a new obligation. The audit committee must make sure that it has 'competence relevant to the sector in which the audited entity is operating'.²⁸ This collective competence requires companies to identify the sectors in which operational activities are developed. A useful tool is the industry classification benchmark that is applied

19 Ibid., pp. 7–8.
20 Article 39, §4 Directive 2014/56/EC.
21 Article 39, §2 Directive 2014/56/EC.
22 See for an analysis of the composition of the audit committee, s. 3.
23 Article 39, §3 Directive 2014/56/EC.
24 The Directive uses the term 'members'.
25 Article 41, §1 Directive 2006/43/EC.
26 'commanditaire vennootschap'.
27 Article 39, §5 Directive 2014/56/EC.
28 Article 39, §1, al. 3 Directive 2014/56/EC.

by many stock exchanges which differentiates between forty-one sectors.²⁹ The Directive 2014/56/EC does not identify the kind of competence – operational, strategic, financial or other – that the audit committee must establish. Therefore we argue that the competence must relate to all the tasks that the audit committee must perform.³⁰ However, we are of the opinion that the Directive should not only have related the competence to the industry of the audited entity but also to its subsidiaries and related entities, especially when the latter are making use of the exemption provided in Article 39, §3 of the Directive 2014/56/EC and the audit committee operates for the group.

A last innovation of Directive 2014/56/EC regarding the composition of the audit committee relates to the chairman of the committee. The chairman must be independent of the audited entity.³¹ We already addressed the absence of any kind of definition of *independence*. However, the Directive only requires the chairman to be independent of the audited entity. Furthermore, the Member States can opt to exempt the members from the independence requirement when all the members of the audit committee are selected from the (supervisory) board of the entity.³²

Next, the chairman must be appointed among the members of the committee or by the supervisory board of the entity. The Directive does not seem to allow that the board appoints the chairman in a one-tier board structure. The Directive explicitly provides this power to the committee itself or to the supervisory board. It is unclear why in a one-tier board, the chairman will have to be appointed by the members of the audit committee themselves, and in a two-tier board, the members of the supervisory board can appoint the chairman of the audit committee.

Member States can also opt to have the chairman of the audit committee elected annually by the general meeting of shareholders. Only in the latter case, the procedure for election must be applied annually, which might be burdensome when the board and the audit committee members are elected multi-annually.

4. THE RESPONSIBILITIES OF THE AUDIT COMMITTEE

4.1. Modernization of the Existing Responsibilities

Directive 2006/43/EC provided the audit committee with five specific responsibilities, of which four are monitoring duties: the monitoring of the financial reporting process, the monitoring of the effectiveness of the internal control and risk management system including, if applicable, the internal audit, the monitoring

of the statutory audit of both the annual and the consolidated accounts, and the monitoring of the independence of the statutory auditor or audit firm, especially when the auditor provides non audit services to the audited entity.³³ The fifth responsibility is related to the recommendation upon which the proposal for the appointment of the statutory auditor is based.³⁴ The auditor must inform the audit committee when key matters arise from the audit, especially when the auditor discovers material weaknesses in the internal control in relation to the financial reporting process of the audited entity.³⁵

Directive 2014/56/EC and Regulation (EU) No. 537/2014 expand the responsibilities of the audit committee. The four monitoring duties of the committee are retained, but the Directive 2014/56/EC fine-tunes and/or rephrases each of these tasks:

- The monitoring of the financial reporting process is retained, but it is broadened to include recommendations ensuring the integrity of that process.
- The second task related to the monitoring of the effectiveness of the internal quality control and risk management systems including the internal audit if applicable, regarding the financial reporting, has been modified.

As of now, the audit committee must monitor the effectiveness of the internal *quality* control system. It raises the question whether the addition of ‘quality’ limits the scope, as in Directive 2006/43/EC the overall ‘*internal control*’ was envisaged, or further broadens the committee’s monitoring duties as the monitoring of *the risk management systems* is not modified in Directive 2014/56/EC. Internal control can be embedded in an entity, based on frameworks like COSO or Turnbull, but these frameworks do not address quality controls. The International Organization for Standardization (ISO) distinguishes between risk management (ISO 31000) and internal quality control (ISO 9000). However, in the Directive 2014/56/EC, any further reference to internal quality controls of the audited entity is lacking. This type of controls is only developed for the audit firm.³⁶ We are of the opinion that the Directive 2014/56/EC does not want to modify the existing monitoring of the effectiveness of the internal control process, but it is advisable that the Directive either clarifies or modifies the wording. The monitoring of the effectiveness is in Directive 2014/56/EC limited to the financial reporting. We support this limitation. In 2006, the monitoring of the effectiveness of internal control was an unlimited responsibility and hence had to include all different objectives: strategic, operational, compliance and

29 For more information see <http://www.icbenchmark.com/> (accessed 8 Nov. 2014).
30 For an analysis of the duties and responsibilities of the audit committee, see s. 4.
31 Article 39, §1, al. 4 Directive 2014/56/EC.
32 Article 39, §5 Directive 2014/56/EC.
33 Article 41, §2 Directive 2006/43/EC.
34 Article 41, §3 Directive 2006/43/EC.
35 Article 41, §4 Directive 2006/43/EC.
36 See for example Art. 24, §1, (b) of Directive 2014/56/EC.

reporting. This was virtually impossible. The limitation in the Directive 2014/56/EC brings the effectiveness control more in line with that of the American Sarbanes-Oxley Act.

Directive 2014/56/EC explicitly states that the monitoring of the effectiveness of the aforementioned systems shall not breach the independence requirement of the audit committee. We are of the opinion that the audit committee always must preserve its independence. The additional wording '*without breaching its independence*' for this specific monitoring duty creates confusion vis-à-vis its independence to monitor the other identified duties. Besides, while this paragraph stresses the independence of its activities, the paragraphs on the composition of the audit committee differently approaches the independence requirements.

- Third, the audit committee must monitor the (performance of the) statutory audit of the annual and consolidated financial statements. Contrary to the previous Directive 2006/43/EC, the Directive 2014/56/EC stresses the monitoring of the performance of the audit. While performing this duty, the audit committee must take into account the findings and conclusions of the national supervisory authority.

We believe that his monitoring duty leads to a kind of circular monitoring. The auditor is responsible for the auditing of the financial statements. According to Directive 2013/34/EC, the members of the administrative, management and supervisory bodies have collectively the duty for drawing up and publishing the financial statements and annual report.³⁷ The financial statements must '*give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss*'³⁸ which is controlled by the auditor, opining that these financial statements indeed give a true and fair view in accordance with the relevant financial reporting framework.³⁹ Next, the audit committee, which is either a subcommittee of the (supervisory) board or a stand-alone committee of the entity, monitors the work of the external auditor. Performing its monitoring duty, the audit committee will take into account the findings and conclusions of the supervisory agencies of the auditors. Furthermore, the latter agencies will assess the performance of the audit committee.⁴⁰ The auditor is auditing the entity, which is, through its audit committee monitoring the controlling auditor, which is controlled by competent agencies that is assessing the performance of the audit committee of the controlled entity!

- The last retained monitoring duty of the audit committee is the review and the oversight of the independence of the auditor or audit firm. This duty has been refined in Directive 2014/56/EC by explicitly emphasizing that the audit committee must take into account several provisions in the Directive 2014/56/EC and the Regulation (EU) Nr. 537/2014 performing its monitoring duty. Furthermore the committee must monitor whether the provision of non-audit services by the auditor is appropriate.⁴¹ The 'appropriateness' of these services needed not be reviewed in the Directive 2006/43/EC.

The task of the audit committee in the selection process of the auditor is resumed. According to Directive 2006/43/EC the (supervisory) board had to base its proposal for the election of the auditor on a recommendation of the audit committee. The general meeting must elect the auditor.⁴²

According to the new Directive 2014/56/EC, the audit committee has its proper responsibility, viz. '*for the procedure for the selection of statutory auditor(s) or audit firm(s) and recommend the statutory auditor(s) or the audit firm(s) to be appointed in accordance with Article 16 of Regulation (EU) No 537/2014*'.⁴³ Before, the responsibility for the selection was vested in the (supervisory) board, this responsibility shifted to the audit committee. Not only Article 39, §6 of the Directive 2014/56/EC but also Article 16, §3, al. 2 of Regulation (EU) No. 537/2014 empowered the audit committee: '*The audit committee shall be responsible for the selection procedure*'.

A further analysis of the responsibility of the audit committee for the selection process of the auditor shows some ambiguity. Whereas Article 16, §3, al. 2 of Regulation (EU) No. 537/2014 makes the audit committee responsible for the selection procedure, Article 16, §3 of Regulation (EU) No. 537/2014 starts with the requirement that the *audited entity* shall *organize the selection procedure* of which the recommendation of the audit committee forms an important part. We opine that the responsibility of the audit committee is more related to the 'monitoring' of the selection procedure, organized by the audited entity. Besides, the Regulation (EU) No. 537/2014 requires in Article 16, §3, al. 1, c) that the audited entity '*shall be free to determine the selection procedure*'. The responsibility of the audit committee should be found in the monitoring that the audited entity organizes a selection process and reviewing how the entity is shaping the process in accordance with both the Directive 2014/56/EC and Regulation

37 Article 33 of Directive 2013/34/EC of the European Parliament and of the Council of 26 Jun. 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance, *OJ L* nr. 182, 29 Jun. 2013, p. 48.

38 *Ibid.*, Art. 4 of Directive 2013/34/EC.

39 Article 28, §2 (c), (i) Directive 2014/56/EC.

40 Article 27 Regulation (EU) No. 537/2014.

41 See s. 4.3.

42 Article 37 Directive 2006/43/EC, retained by Directive 2014/56/EC.

43 '*except when Article 16(8) of Regulation (EU) No 537/2014 is applied*'. This exception relates to the nomination committee that can, if it is compliant with the requirements of Art. 16(8) of Regulation (EU) No. 537/2014, take over this responsibility of the audit committee.

(EU) No. 537/2014. This view can be aligned with the start of Article 39, §6 of the Directive 2014/56/EC stating that the duties of the audit committee are *without prejudice to the responsibility of the members of the (supervisory) board*.

The selection process criteria are provided in Article 16, §3 of Regulation (EU) No. 537/2014. A detailed assessment of these criteria goes beyond the analysis of the new rules for audit committees. However, the criteria demonstrate the policy of the European Commission supporting smaller audit firms. Audit firms ‘*which received less than 15 % of the total audit fees from public-interest entities in the Member State concerned in the previous calendar year*’⁴⁴ shall not be precluded in a selection procedure. The criteria need not to be applied in case of a renewal of the election of the auditor within the maximum term before an external rotation of the auditor is required in accordance with Article 17 of Regulation (EU) No. 537/2014. Smaller public-interest entities⁴⁵ are also exempted of the specificities of the selection procedure of Article 16, §3 of Regulation (EU) No. 537/2014. However the audit committee of these smaller entities must adhere to the other provisions of Article 16 of the Regulation (offer two choices, be free of any influence, etc.).

Since Directive 2006/43/EC, the audit committee must provide in a recommendation for the appointment of the auditor. The new European legislation further specifies how this recommendation should be developed. The recommendation must provide in at least two choices, and the audit committee must express its motivation for one the retained auditors.⁴⁶ The recommendation shall also state that the audit committee was under no circumstances influenced by a *third party*.⁴⁷ Next, it is forbidden for the audited entity to provide any kind of clause in a contract that restricts ‘*the choice by the general meeting of shareholders or members [...] to certain categories or lists of statutory auditors or audit firms, as regards the appointment of a particular statutory auditor or audit firm to carry out the statutory audit of that entity*’.⁴⁸ In case any such clause is provided in a contract, it shall be null and void.

The Regulation (EU) No. 537/2014 forbids the influence of any third party. This Regulation does not define who third parties are.⁴⁹ We are of the opinion that third parties are those parties that have no relationship with the audited entity and are *located* outside

the audited entity. Indeed, in some countries other parties are involved in the selection process of the auditor. Under Belgian law, the employees council has the right to recommend the auditor to the general meeting, based upon a proposal of the board which is, if an audit committee is established, proposed by that committee.⁵⁰ In the Belgian law, the auditor has been provided with specific duties vis-à-vis the employees council, and hence it is considered of relevance that the council is involved in the selection process of the auditor. Whereas the employees council will recommend the selection of the auditor after the audit committee has performed its duties in that perspective, it cannot be excluded that the employees council is signalling its preferences. Although this signalling should not necessarily be identified as undue influence,⁵¹ we are of the opinion that the employees council should not be considered as a third party.

The problem of undue influence might arise when an audit committee is operating in a subsidiary that has not (yet) been derogated from this requirement according to Article 39, §3, (a) of Directive 2014/56/EC. For instance, after an acquisition, the parent company of that subsidiary could, for reasons of efficiency, support the selection of the group auditor.

Next, the audit committee must state that there is no clause in any kind of contract between the audited entity and a third party restricting the choice by the general meeting to certain categories or lists of statutory auditors or audit firms. As an example, we can refer to a loan agreement in which the credit institution requires the audited entity to elect an auditor of the list that the credit institution provides. This clause in the loan agreement will be null and void. The Regulation (EU) No. 537/2014 forbids two types of clauses: clauses that limit the choice to a certain category or clauses that limit the choice to a predefined list of auditors. We are of the opinion that both kinds of clauses de facto excludes any kind of restriction. However, the restriction is only forbidden if it is provided in a contract. Hence when restrictions follow from other requirements, like the specific lists that exists for certain types of industries, like the banks, to elect an auditor, it is not forbidden.

Any improper influence of the decision of the general meeting of shareholders or any attempt to impose a forbidden contract clause must be reported to the supervision authorities.⁵²

44 Article 16, §3 (a) of Regulation (EU) No. 537/2014.
45 Public-interest entities that meet the criteria set out in points (f) and (t) of Art. 2(1) of Directive 2003/71/EC.
46 Article 16, §2 , al. 2 of Regulation (EU) No. 537/2014.
47 Article 16, §2 , al. 3 of Regulation (EU) No. 537/2014.
48 Article 16, §6 of Regulation (EU) No. 537/2014.
49 Also in other European legislations ‘third parties’ are not identified. This is for instance also the case in the Environmental Liability Directive 2004/35/EC (see for an analysis, *The study evaluating the status quo and the legal implications of third party liability for the European security industry* 23 (L. Bergkamp, M. Faure, M. Hinteregger & N. Philipsen eds., Maastricht October 2013), http://ec.europa.eu/enterprise/policies/security/files/final-report-tpl-11-10-2013_en.pdf.
50 Article 156 Belgian Companies Code.
51 An assessment of the meaning of influence is outside the scope of this contribution.
52 Article 16, §6, al. 2 of Regulation (EU) No. 537/2014.

Surprisingly, (any attempt of) influencing the recommendation of the audit committee must not be reported.

4.2. The New Responsibility

Next to the aforementioned resumed monitoring duties, Directive 2014/56/EC starts in Article 39, §6, (a) with a new responsibility for audit committees. The audit committee must inform the (supervisory) board of the results of the audit and ‘explain how the statutory audit contributed to the integrity of financial reporting and what the role of the audit committee was in that process’. While we presume that it follows from good practices that the external auditor regularly discusses the financial reporting policies and processes (including the integrity issues) with at least the chief financial officer (and or other members of the board), the relationship with the audit committee is formalized through the reporting requirement of the latter to the (supervisory) board. When the different actors perform their duties responsibly, we are of the opinion that most information should already be available to the (supervisory) board. However we deem that Article 39, §6, (a) in fine is not fully clear with respect to the process that is indicated. The Directive refers to ‘that’ process. Does the Directive 2014/56/EC refer to the role of the audit committee in the statutory audit process as performed by the auditor or to the role in the internal reporting process with, in particular, the integrity of this reporting? Demonstrating in *concrete* and *verifiable* grounds that the statutory audit contributed to the integrity as well as how the audit committee performed its role therein, is not always obvious.

4.3. Particularities

Some of the responsibilities of the audit committee in Article 39, §6 of Directive 2014/56/EC are further elaborated in the Regulation (EU) No. 537/2014. In particular, the monitoring of the independence of the auditor is specifically addressed in the latter regulation.

Article 4 of the Regulation (EU) No. 537/2014 compels the audit committee to discuss with the statutory auditor the threats to the latter’s independence and the safeguards applied to mitigate these threats when, during three consecutive financial years, the total fees that the statutory auditor received from the public-interest entity exceeded 15% of the total fees of that statutory auditor. The latter must inform the audit committee that this

threshold has been exceeded. The limitation is also applicable on the group level of the audited entity. The Regulation materializes the principles which were already developed by the European Commission in its Recommendation of 16 May 2002 which stated that the statutory auditors’ independence is impeded when ‘*the total (audit and non-audit) fees that an Audit Firm, or a Network receives or will receive from one Audit Client and its Affiliates make up an unduly high percentage of the total revenues in each year over a five-year period.*’⁵³ That Recommendation did not identify what was considered an unduly percentage.

The audit committee must consider whether an engagement quality control review is necessary before the issuance of the audit report when the aforementioned threshold has been crossed. We presume that in light of the tight timelines during which the statutory audit control of the financial statements must take place, this quality control review is practically impossible. Most likely the statutory auditor and, if need be together with the audit committee of the audited entity, will search for alternative solutions avoiding the crossing of the 15% threshold in the third consecutive year.

In the unlikely situation that the crossing of the threshold continues, the audit committee must decide ‘*on the basis of objective grounds whether the statutory auditor [...] may continue to carry out the statutory audit for an additional period which shall not, in any case, exceed two years.*’

Second, the audit committee has a specific role when the statutory auditor provides the audited entity non-audit services. Since many years, it is debated if and to what extent rendering non-audit services to an audited entity impedes the independence of the auditor.⁵⁴ In its Recommendation of 16 May 2002, the European Commission was of the opinion that drawing up a comprehensive list of non-audit services that compromises the independence of the auditor is impossible but that six services, if unaccompanied by certain protective instruments, would impede the independence of the auditor.⁵⁵ Directive 2006/43/EC did not provide in any list of non-audit services that had to be considered as impeding the independence of the auditor. In the recitals of that directive, some examples could be found but for the remainder the directive referred to the Member States to ensure that the provision of non-audit services does not compromise the auditor’s independence.⁵⁶ From now on, the Regulation (EU) No 537/2014 forbids ‘*any member of the network to which the statutory auditor or the audit firm belongs*’ to provide non-audit services of a list of

53 Commission Recommendation of 16 May 2002 Statutory Auditors’ Independence in the EU: A Set of Fundamental Principles, *OJ L* nr. 191 of 19 Jul. 2002, Art. 8.2. (2) Relationship between total fees and total revenue.

54 Already in 2000, the Securities and Exchange Commission issued a rule that prohibited the rendering of certain non-audit services like bookkeeping, financial information systems design and implementation, appraisal or valuation services and fairness opinions, actuarial services, internal audit services, etc., to the audited entity (SEC, *Final Rule: Revision of the Commission’s Auditor Independence Requirements*, Revision of the Commission’s Auditor Independence Requirements, Effective Date 5 Feb. 2001, http://www.sec.gov/rules/final/33-7919.htm#P139_57710 (accessed 8 Nov. 2014)). This Rule required audit committees to monitor the work of the auditor. In its comment on the Rule the SEC stated that the debate on the endangering of the independence of the auditor when he is delivering non-audit services already started in 1957 (see note 69 of the rule). In 2002, many requirements of this Rule were overruled by the Sarbanes-Oxley Act.

55 Preparing accounting records and financial statements, design and implementation of financial information technology systems, valuation services, participation in the audit client’s internal audit, acting for the audit client in the resolution of litigation, recruiting senior management.

56 See Art. 22 Directive 2006/43/EC.

eleven services, including not only the six non-audit services of the Recommendation of 16 May 2002, but also tax services. Member States can derogate from a number of these services if their legislation provides in appropriate safeguarding measures.⁵⁷ We can remark that the European Parliament and the Council could provide in a comprehensive list, which the European Commission could not draw.

For the other non-audit services, the network of the auditor is allowed to provide to the group of the audited entity, the audit committee must approve these services. It is only allowed to do so if it has properly assessed the threats to the auditor's independence and the safeguards the auditor applied. In the Member States, where non-audit services that are on the European forbidden list are allowed if appropriate measures are provided, the audit committee shall '*issue guidelines with regard to the services*'.

Third, the auditor must report extensively to the audit committee. Every year, the auditor must confirm his independence⁵⁸ and discuss the threats to the independence and the safeguarding measures in place.⁵⁹ Next, the auditor must every year provide the audit committee with an additional report consisting of sixteen items related to the work of the auditor, including the independence declaration, the scope of the audit, the timing, the communication with audit committee, etc.⁶⁰

5. MONITORING OF THE AUDIT COMMITTEE

An innovation of the European legal framework of the statutory auditor is the external monitoring of the audit committee. According to Article 27 of the Regulation (EU) No. 537/2014, the national supervisory agency or the European Competition Network (ECN) shall assess the performance of the audit committee. These monitoring activities raise specific questions with respect to the position of the committee as a subcommittee of a corporate organ of a company: can or must the supervisory agency point the audit committee at deficiencies, does the agency

need to inform the (supervisory) board, must the agency take further action when mistakes were made, etc. These questions are not addressed but should be taken into account with due care.

6. CONCLUDING REMARKS

This first analysis of the new European legal framework of audit committees of public-interest entities shows that the role and importance of this committee is considered to be pivotal. The requirements to monitor the work and independence of the auditor should not be underestimated. The audit committee, the (supervisory) board, the audited entity as well as the auditor have to develop procedures to act in accordance with the new Directive 2014/56/EC and the Regulation (EU) No. 537/2014. 'Compliance' will be key.

We have some doubts whether all the new measures are equally advantageous for reaching the goal of an effective statutory audit. We are of the opinion that the mutual monitoring duties of the audit committee and the statutory auditor over the statutory audit overlap in its current configuration. Further, the responsibilities of the audit committee as an 'advisory' subcommittee of the (supervisory) board which remains the ultimate responsible corporate organ is stretched to the extreme. Third, the selection procedure for the statutory auditor is excessively restrictive: the audit committee, the board, the general meeting, in some countries the employees council, all must have their say in a very prescriptive manner, which will raise the costs significantly. Fourth, we fear that some of the policy elements of the new audit framework, like better audits in a more competitive market, will not reach their goal. The heavily regulated audit market with low margins, significant liability risks and high insurance premiums could become unattractive and peripheral to some audit firms which might refocus their strategic investments in more lucrative other (non-audit) services. We hope that future developments prove us wrong.

57 See thereto Art. 5, §3 of Regulation (EU) No. 537/2014.
58 As well as the independence of the audit firm and partners, senior managers and managers, conducting the statutory audit.
59 Article 6, §2 of Regulation (EU) No. 537/2014.
60 Article 11 of Regulation (EU) No. 537/2014.

Author Guide

[A] Aim of the Journal

European Company Law has been designed to be the ideal working tool for all corporate lawyers with a European practice. The journal deals with European company law in a broad sense, including such topics as codetermination law, insolvency law and securities law. All contributions should follow ECL's SCIP-principle, which welcomes articles that are scientific, concise, informative and practical.

[B] Contact Details

Manuscripts should be submitted to ECL's main editor, e-mail: s.m.bartman@law.leidenuniv.nl and to its editorial secretary, e-mail: c.degroot@law.leidenuniv.nl

[C] Submission Guidelines

- [1] Manuscripts should be submitted electronically, in Word format, via e-mail.
- [2] Submitted manuscripts are understood to be final versions. They must not have been published or submitted for publication elsewhere.
- [3] Contributions should have a range of approximately 4,000 to 5,000 words (footnotes excluded).
- [4] Only articles in English will be considered for publication. Manuscripts should be written in standard English, while using 'ize' and 'ization' instead of 'ise' and 'isation'. Preferred reference source is the Oxford English Dictionary. However, in case of quotations the original spelling should be maintained. In case the complete article is written by an American author, US spelling may also be used.
- [5] The article should contain an abstract, a short summary of about 100 words. This abstract will also be added to the free search zone of the Kluwer Online database.
- [6] A brief biographical note, including both the current affiliation as well as the e-mail address of the author(s), should be provided in the first footnote of the manuscript.
- [7] An article title should be concise, with a maximum of 70 characters.
- [8] Special attention should be paid to quotations, footnotes, and references. All citations and quotations must be verified before submission of the manuscript. The accuracy of the contribution is the responsibility of the author. The journal has adopted the Association of Legal Writing Directors (ALWD) legal citation style to ensure uniformity. Citations should not appear in the text but in the footnotes. Footnotes should be numbered consecutively, using the footnote function in Word so that if any footnotes are added or deleted the others are automatically renumbered.
- [9] Authors should make sure that abbreviations are explained when used for the first time.
- [10] Tables should be self-explanatory and their content should not be repeated in the text. Do not tabulate unnecessarily. Tables should be numbered and should include concise titles.
- [11] Heading levels should be clearly indicated.

For further information on style, see the House Style Guide on the website: www.kluwerlaw.com/ContactUs/

[D] Review Process

- [1] Before submission to the publisher, manuscripts will be reviewed by the Board of Editors and may be returned to the author for revision.
- [2] The journal's policy is to provide an initial assessment of the submission within thirty days of receiving the posted submission. In cases where the article is externally referred for review, this period may be extended.
- [3] The editors reserve the right to make alterations as to style, punctuation, grammar etc.
- [4] In general the author will not receive proofs of the article. Proofreading will be taken care of by the Board of Editors.

[E] Copyright

- [1] Publication in the journal is subject to authors signing a 'Consent to Publish and Transfer of Copyright' form.
- [2] The following rights remain reserved to the author: the right to make copies and distribute copies (including via e-mail) of the contribution for own personal use, including for own classroom teaching use and to research colleagues, for personal use by such colleagues, and the right to present the contribution at meetings or conferences and to distribute copies of the contribution to the delegates attending the meeting; the right to post the contribution on the author's personal or institutional web site or server, provided acknowledgement is given to the original source of publication; for the author's employer, if the contribution is a 'work for hire', made within the scope of the author's employment, the right to use all or part of the contribution for other intra-company use (e.g. training), including by posting the contribution on secure, internal corporate intranets; and the right to use the contribution for his/her further career by including the contribution in other publications such as a dissertation and/or a collection of articles provided acknowledgement is given to the original source of publication.
- [3] The author shall receive for the rights granted (subject to signing the 'Consent to Publish and Transfer of Copyright' form) two free copies of the issue of the journal in which the article is published, plus a PDF file of his/her article.